Information on economic, financial and monetary developments

May 2024

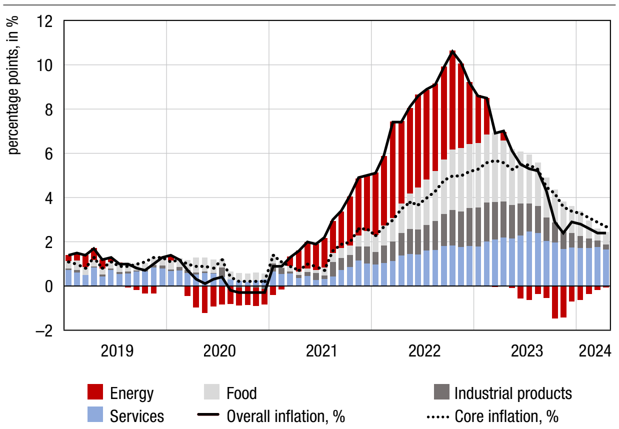
Summary

Eurostat's flash estimates suggest that after a mild recession in the second half of 2023, the euro area economy grew by 0.3% at the beginning of 2024 compared with the previous quarter average (Figure 1)**.** Economic growth in the first three months of the current year was markedly stronger than assumed in most projections, which generally hovered around 0.1%. All the four largest euro area economies exceeded market expectations, including Germany (0.2%), which saw a sharp contraction in the last quarter of the previous year (–0.5%). Rates of change in real GDP should continue to be positive in the second quarter, though growth might be slightly slower. More specifically, available high-frequency data for April, such as the purchasing manager index (PMI) and the economic sentiment index (ESI), point to lingering weaknesses in some economic sectors. For example, despite a marked recovery in the purchasing manager index, manufacturing has remained in contractionary territory. This means that the services sector remains the main generator of growth in the euro area. Regardless of the weaknesses seen in industry and construction, favourable indicators for the first quarter paired with indications of continued expansion in the second quarter suggest that the euro area is likely to have avoided a sharper contraction in economic activity during the cycle of monetary policy tightening.

According to a flash estimate from Eurostat, euro area inflation remained unchanged in April from March, standing at 2.4% (Figure 2). Core inflation (excluding the prices of energy and food) went down to 2.7% in April (from 2.9% in March); industrial product inflation fell to 0.9% (from 1.1% in March), while inflation of service prices, which held steady at 4.0% in the past five months, dropped to 3.7%, remaining elevated amid the continued relatively robust growth in labour costs. Industrial product inflation has been slowing down mostly owing to the previous decreases in the prices of energy and other raw materials on the global market and the easing of inflationary pressures arising from the earlier stages of the price chain, as reflected in the fall in import prices and low annual growth rates of producer prices of durable and non-durable consumer goods in the domestic market. By contrast, food inflation increased to 2.8 % in April (from 2.6 % in March) and energy inflation rose to –0.6 % (from –1.8 % in March), offsetting the fall in the contribution of core inflation; as a result, overall inflation remained unchanged from the previous month. The momentum indicator for overall inflation, that is, the annualised quarterly rate of inflation, which is a good indicator of current inflationary pressures, rose to 3.5% in the euro area in April, and was above its long-term average for the second consecutive month, reflecting a pick-up in the momentum of energy and service price inflation.

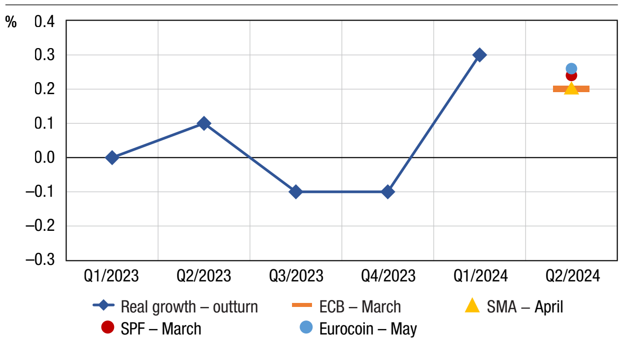
High-frequency data for the first quarter suggest that economic activity in Croatia continued to grow at relatively strong rates, mostly due to the robust increase in trade-related service activities and in construction, with industrial production falling sharply at the same time (Figures 3 and 4)**.**

Figure 2 Inflation indicators in the euro area



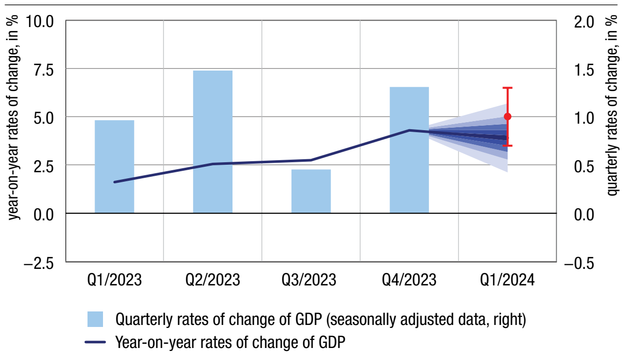
Note: Core inflation is measured by the harmonised index of consumer prices, which excludes energy, food, alcoholic beverages and tobacco prices.
Sources: Eurostat and CNB calculations.

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



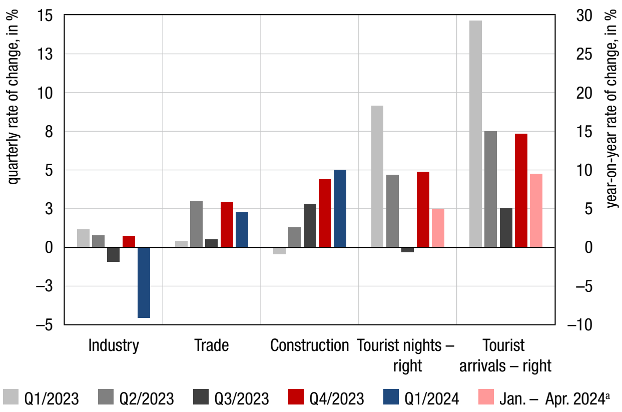
Notes: Abbreviation ECB – March refers to ECB March projections of real growth in the euro area (Macroeconomic Projection Exercise, MPE). Abbreviations SMA (Survey of Monetary Analysts) and SPF (Survey of Professional Forecasters) refer to the results of the ECB survey of market participants in April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



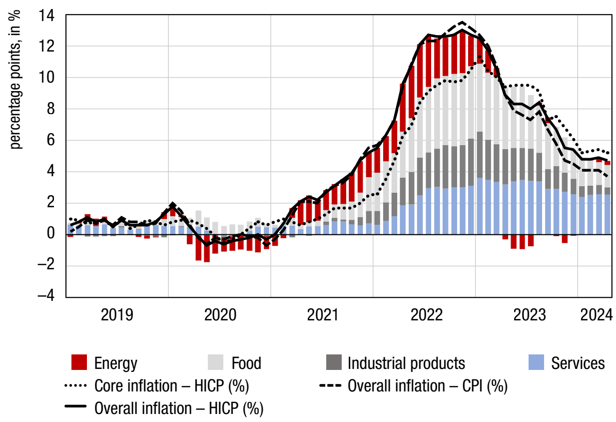
Notes: The estimate for the first quarter of 2024 refers to the Monthly indicator of real economic activity of the CNB (for more details on the calculation of the MRGA indicator, see CNB survey Kunovac, D., and B. Špalat: "Nowcasting GDP Using Available Monthly Indicators"). The models are estimated on the basis of data published up to 2 April 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 Monthly economic indicators for Croatia



ª Including data on tourist arrivals and nights in the first 20 days of April.
Note: Data on industry and trade in the first quarter of 2024 refer to January and February, while data on construction refer to January 2024.
Sources: CBS and eVisitor.

Figure 5 Inflation indicators in Croatia



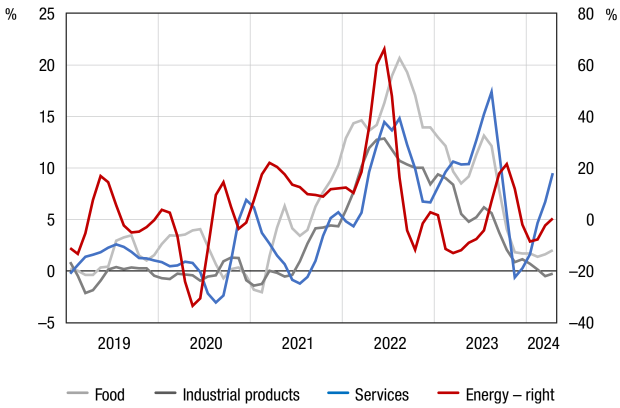
Note: Core inflation is measured by the harmonised index of consumer prices, which excludes energy, food, alcoholic beverages and tobacco prices.
Sources: CBS, Eurostat and CNB calculations.

Real GDP in the first quarter could rise by 1.0% from the end of 2023, while its annual growth might reach 3.9%. The rise in real retail trade turnover and the surge in consumer optimism, which marked April as well, suggest that personal consumption continued to grow strongly early this year in an environment of relatively buoyant growth in employment and real wages. However, it should be noted that real wage growth decelerated at the beginning of the year, primarily reflecting a slowdown in nominal wage growth. The quarterly growth rate of nominal gross wages dropped at the beginning of the year to the levels last seen at the end of 2021, with a noticeably slower growth in wages in construction and accommodation and food service activities, while wages in IT activities decreased from the end of the previous year. Developments in construction were also very favourable, with the volume of construction works on both buildings and civil engineering works rising sharply in the first two months of this year. On the other hand, despite the monthly growth in March, industrial production failed to compensate for the January and February slump, with production in all categories, apart from non-durable consumer goods, down from the end of the previous year. In contrast to the pace of that decline, which can partly be explained by movements in volatile components of industry such as energy production, the decrease in the production of durable consumer goods has been gradually gaining traction. Business confidence data for April suggest that unfavourable trends in industrial production might continue in the second quarter. Thus, confidence in industry fell sharply in April, to the long-term average, with a significant deterioration in expectations for the next three months. In addition, an increasing share of corporations have started to report insufficient demand as a limiting factor in production, although most corporations still single out labour shortages as the main problem. Confidence in trade and services also declined, increasing in construction alone; nevertheless, confidence in all these activities remained considerably above the long-term average.

According to Eurostat's flash estimate, overall annual inflation in Croatia measured by the harmonised index of consumer prices (HICP) slowed to 4.7% in April 2024 (from 4.9% in March),[1] reflecting lower rates for all main components except for energy (Figure 5). Energy price inflation held steady from March to April (2.1%). On the other hand, the downward trend in food and industrial product price inflation continued, reflecting the weakening of the impact of past inflationary shocks (primarily the rise in the prices of energy products and other raw materials and disruptions in supply chains) that are mirrored in low annual rates of change in producer prices of food, intermediate goods and durable consumer goods. Against this background, the annual growth rate of food and industrial product prices fell from 5 % and 2.2%, respectively, in March to 4.9% and 1.8% in April. Services price inflation also decelerated mildly in April (from 8% in March to 7.9% in April), but remained very high, accounting for more than a half of overall inflation. The slight slowdown in the inflation of services prices reflects a favourable base effect, i.e. a monthly increase in services prices higher in April 2023 than in April this year. The persistence of the inflation of services prices is the result of their increased sensitivity to wage growth relative to other inflation components in the context of strong domestic and foreign demand for catering and accommodation services. As a result of these factors, the momentum[2] of service inflation gained more traction, albeit remaining noticeably lower than in mid-2023. In contrast to services, inflation momentums of other components hover around their long-term averages and point to the stabilisation of inflationary pressures at a low level for everything except

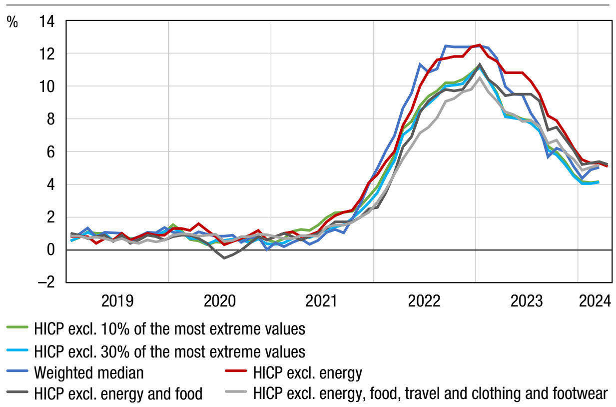
1 Inflation measured by the national consumer price index (CPI), which does not cover consumption of non-residents and institutional households, slowed down from 4.1% in March to 3.7% in April.
2 Momentum is a short-term inflation indicator which shows annualised three months-on-three months rates of price change, seasonally adjusted.

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 7 Core inflation indicators



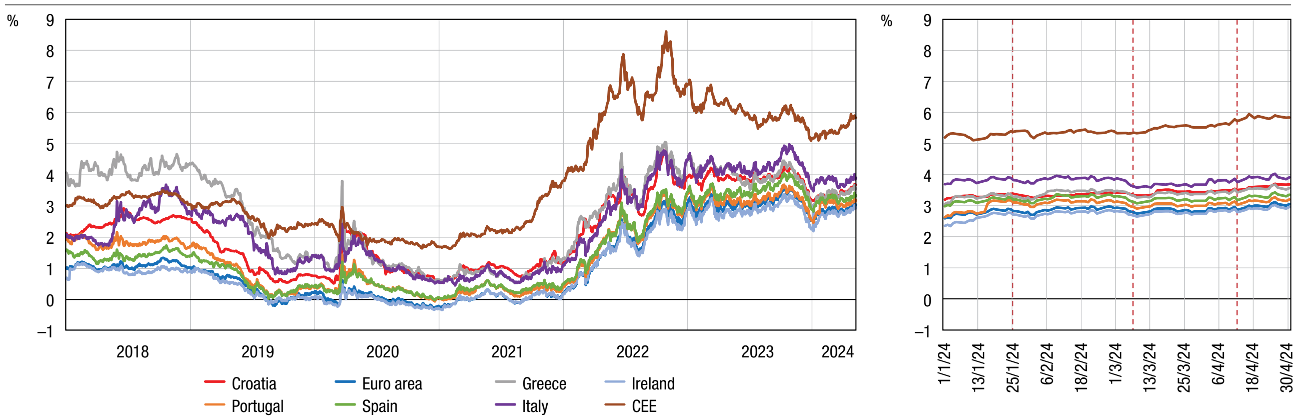
Notes: Trimmed mean eliminates 5% (15%) of components (out of a total of 87 components) with maximum and minimum annual rates of change. The weighted median excludes all values but the weighted median of the distribution of price change.
Sources: Eurostat and CNB calculations.

services (Figure 6). Core inflation (excluding the prices of energy and food) also decelerated, from 5.4% in March to 5.2% in April (Figure 7), reflecting the lower inflation of prices of industrial products and services.

Global financial markets in April were marked by vigilance driven by a renewed build-up of inflationary pressures. This was primarily due to the latest economic data for the US, where inflation and labour market indicators proved to be stronger than expected. Increased fears of inflation were also driven by geopolitical events. Amid elevated tensions in the Middle East, oil prices in April reached their peak from the beginning of the year. Uncertainty about geopolitical developments and the expectation that the Fed would postpone the cut in the benchmark interest rate due to higher inflation led to a drop in most equity indices from record highs. In this context, the euro area GDP-weighted average of long-term government bond yields rose by around 20 basis points in April and slightly exceeded 3.0 % (Figure 8), its highest level since the beginning of the year. The yield on the Croatian ten-year eurobond was also at its highest level since the beginning of the year, i.e. at around 3.7%. The spread between the yield on Croatian ten-year bonds and the yield on the German bond of a similar maturity was stable, averaging 107 basis points. The money market recorded no significant shifts in April. The three-month EURIBOR continued gradually declining to 3.8% in response to the build-up of expectations that the ECB would soon lower its key interest rate (Figure 9). The Croatian money market was also calm. The temporary decline in the interest rate in mid-month reflected only one transaction in overnight deposits at a somewhat lower interest rate of 3.3%, probably due to a reduced trading volume on the day before the non-working day.

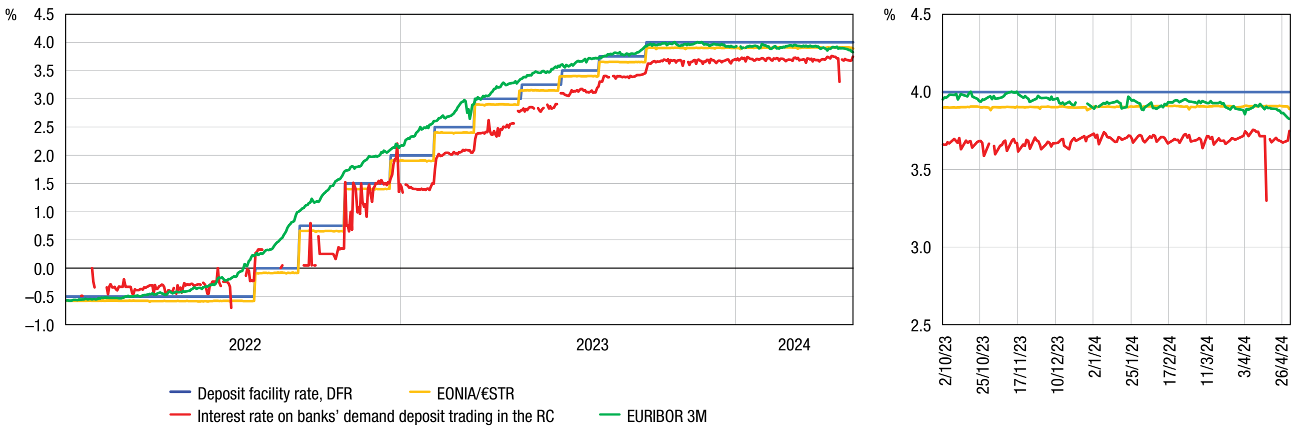
The costs of corporate and household financing by credit institutions continued to decline in March. The costs of household borrowing through general-purpose cash loans decreased markedly, while interest rates on housing loans did not change significantly. Corporations also borrowed at lower interest rates in March. After interest rates on corporate loans and general-purpose cash loans to households peaked at the turn of the year (5.4% in December 2023 for corporate loans and 6.3% in January 2024 for general-purpose cash loans to households), these rates continued to fall in March. The interest rate on pure new general-purpose cash loans to households averaged 6.0% in March, down by as much as 20 basis points

Figure 8 Yields on long-term government bonds with the remaining maturity of approximately 10 years



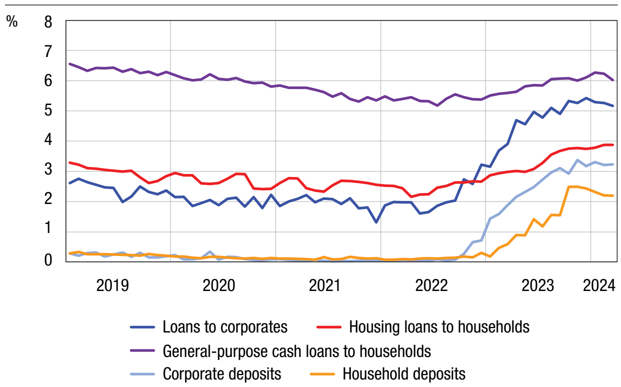
Notes: CEE – countries of Central and Eastern Europe (the Czech Republic, Hungary, Poland and Romania); yields for the euro area and CEE have been weighted by the share of GDP of the countries included. Data from the euro area do not include those from Estonia, Latvia, Luxembourg and Malta. The red dotted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

Figure 9 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 the €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 10 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, in kuna with a currency clause in euro and in euro, and from January 2023 to loans and deposits in euro. Data refer to pure new loans and deposits. Deposits with a maturity of up to 1 month have been excluded.
Source: CNB.

from February, while the rate on housing loans remained almost unchanged from February (3.9%). Corporate borrowing costs at banks dropped by 10 basis points in March, to 5.2% (Figure 10). The interest rate on working capital loans fell the most, followed by the interest rate on loans for investments and other financing, while the interest rate on factoring edged up. In terms of size, interest rates on loans to medium-sized enterprises decreased the most, while interest rates on loans to large enterprises dropped mildly. In March, micro and small enterprises borrowed at higher interest rates than in February. Interest rates on housing loans to households showed signs of stabilisation, but have not yet started to decline. Interest rates on existing loans, i.e. on their stocks, continued to rise at a very slow pace. The average interest rate on the stock of corporate loans was 3 basis points higher in March than in February, reaching 4.5%, while interest rates on the stock of housing and general-purpose cash loans remained virtually unchanged.

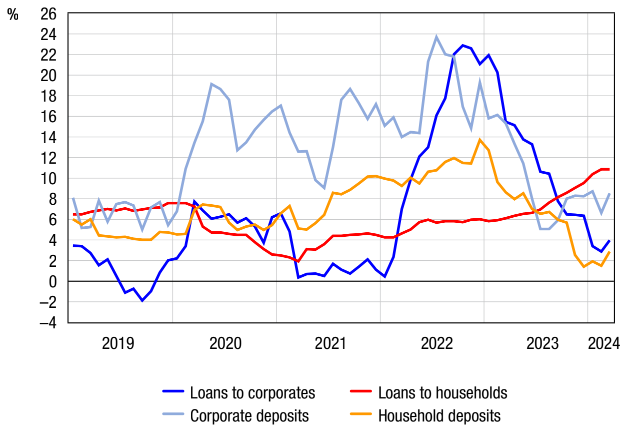
Interest rates on household and corporate time deposits did not change much from February to March. The average interest rate on pure new corporate deposits was only 3 basis points higher in March than in February, standing at 3.2%. The interest rate on household time deposits dropped by 1 basis point from February, to 2.2%. In March, households again opted for deposits with maturities between 6 and 12 months, as in the last quarter of 2023, despite the fact that the interest rate on deposits with shorter maturities (from 3 to 6 months) has been consistently higher since the beginning of the year. Interest rates on total existing deposits continued to rise, with rates on corporate deposits going up by 11 basis points from February to March, reaching 1.0%, while interest rates on household deposits grew mildly, by 3 basis points, to 0.5%. The interest rate on total corporate time deposits continued to grow, reaching 2.9%, having risen by 4 basis points, as did the interest rate on household time deposits, which, having risen by 7 basis points, came to 1.6%. At the same time, the interest rate on overnight corporate deposits fell by 1 basis point, to 0.13%, while the interest rate on household overnight deposits remained unchanged at 0.02%.

The annual growth rate of general-purpose cash loans to households picked up further in March, while the rise in housing loans held steady at the previous month's level; the increase in corporate loans gained momentum, after slowing down over the past year. Loans to domestic sectors (excluding the general government) grew in March 2024, by EUR 0.4bn or 1.2% (transaction-based), due to the further increase in household loans (of EUR 0.2bn or 1.1%), as well as the rise in corporate loans (of EUR 0.2bn or 1.4%). The increase in household loans was largely driven by general-purpose cash loans, which continued to grow sharply (by EUR 133m or 1.6%), while housing loans continued to grow at a pace similar to that of the previous months, increasing by EUR 61m or 0.6% in March. On an annual level, the growth in total household loans remained unchanged from February (10.9%, transaction-based), with the rise in general-purpose cash loans picking up from 12.8% in February to 13.0% in March, the strongest growth rate seen since December 2011, and housing loans increasing at an unchanged annual growth rate of 10.8%. The momentum of housing loans, which remained stable at around 8.0% over the past months, indicates a slight deceleration in current housing loan activity in March. In contrast, after subdued credit activity in recent months, corporate loans increased sharply in March, by EUR 0.2bn (1.4%).

The bulk of this growth was accounted for by loans for working capital, while investment loans accounted for a smaller share. As a result, following a steady slowdown from February last year, the annual growth in corporate loans accelerated to 4.0% in March, from 2.9% in February (Figure 11).

Domestic deposits decreased marginally in March. Total domestic deposits (excluding those of the general government) edged down in March from the previous month (transaction-based), with the fall in overnight deposits (EUR –0.71bn) being almost entirely offset by the rise in time deposits (EUR 0.68bn). The growth in corporate deposits was driven by the rise in time deposits (EUR 0.6bn), while overnight deposits decreased (EUR 0.3bn). Total household deposits remained unchanged because the growth in time deposits in this segment was equal to the fall in overnight deposits (EUR 0.1bn). The share of time deposits in total deposits thus continued to rise, reaching 29.6% for corporate deposits and 28.9% for household deposits in late March, as against around 20% and 23%, respectively, in mid-2023. Other non-bank financial institutions, in particular pension and investment funds, decreased their deposits with banks (EUR 0.2bn), which was almost entirely due to the fall in overnight deposits.

Figure 11 Corporate and household loans and deposits
year-on-year rates of change, transaction-based



Source: CNB.