Information on economic, financial and monetary developments

November 2024

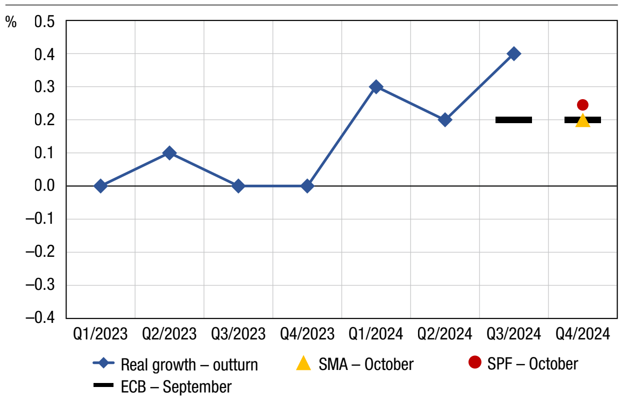
Summary

According to a flash estimate from Eurostat, the euro area economy continued to expand in the third quarter, following relatively favourable results in the first half of the year. Economic activity grew by 0.4% from the previous quarter, which was more than expected and was also the strongest quarterly growth in the past two years. Looking at the largest economies of the monetary union, strong growth continued in Spain and, to a lesser extent, robust growth was also recorded in France, which may be associated with the holding of the Summer Olympic Games. The German economy has returned to growth, avoiding the expected contraction, while the Italian economy stagnated. As regards the rest of the year, most projections assume continued growth, albeit at a slower pace than in the summer (Figure 1). This is confirmed by the monthly survey indicators, such as the purchasing manager index (PMI), which point to a modest growth of the euro area economy in the last three months of 2024.

According to Eurostat's flash estimate, euro area inflation picked up from 1.7% in September to 2.0% in October (Figure 2). This was mostly driven by the rise in energy price inflation (which increased to –6.1% from –4.6% in September), largely reflecting the unfavourable base effect due to a sharp fall in energy prices in October last year, which is no longer included in the calculation of the annual inflation rate. Food prices also went up noticeably in October, which was reflected in the rise of their annual growth rate to 2.9% from 2.4% in September. Core inflation, which excludes energy and food prices, held steady at 2.7% in October, unchanged from the level recorded in September. Services price inflation remained unchanged at a still high level of 3.9%, while industrial goods inflation edged up (to 0.5%, from 0.4% in September). October saw a decrease in the momentums of all main components of euro area inflation (excluding food), and the overall inflation momentum, which is a good indicator of current inflationary pressures, slowed down to 1.9%.

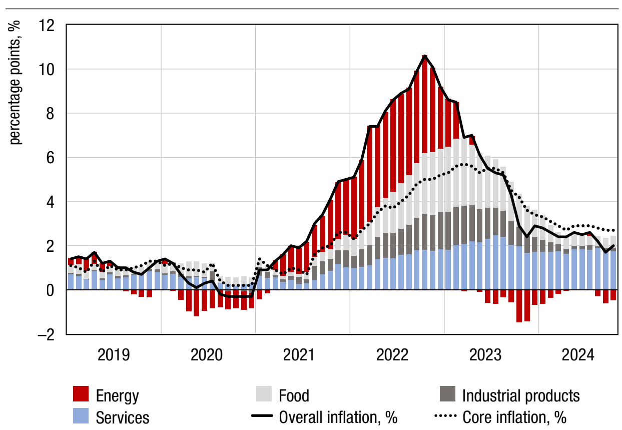
Monthly data for Croatia for the third quarter of 2024 point to continued strong growth in economic activity. According to the CNB's nowcasting model of economic activity, after growing by 1.0% in the second quarter of this year, real GDP might increase by 0.8% on a quarterly level in the third quarter, with its growth on an annual level accelerating to 4.1%, from 3.5% in the second quarter (Figure 3). Such developments are mostly driven by a very strong growth in domestic demand, which supported the rise in real retail trade turnover in the third quarter, while retail sales in the summer months seem to have been negatively affected by developments in tourism. In addition, the construction sector also witnessed very favourable developments, with an additional increase in activity in August following a strong growth in July. Looking at July and August taken together, the volume of construction works rose by more than 5% from the second quarter. This dynamics largely reflects the growing volume of construction works on buildings, with an increase in civil engineering works. After industrial production had fallen sharply in August, its volume rose considerably in September. Observed on a quarterly basis, industrial production went up by 3.7% in the third quarter, after stagnating in the previous three months. This was mostly influenced by the very strong growth in energy production and supply, which are

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



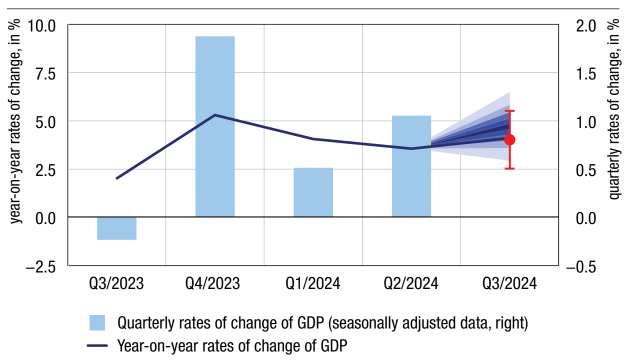
Notes: Abbreviation ECB – September refers to ECB September projections of real growth in the euro area (Macroeconomic Projection Exercise, MPE). Abbreviations SMA, Survey of Monetary Analysts and SPF, Survey of Professional Forecasters refer to the results of the ECB survey of market participants in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

Figure 2 Inflation indicators in the euro area



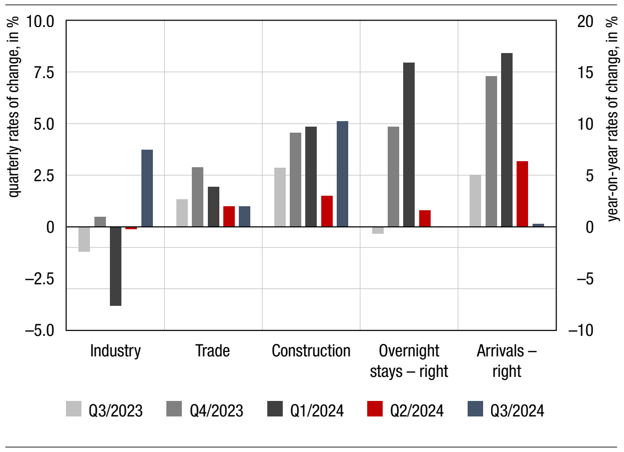
Note: Core inflation is measured by the harmonised index of consumer prices, which excludes energy, food, alcoholic beverages and tobacco prices.
Sources: Eurostat and CNB calculations.

Figure 3 Quarterly gross domestic product



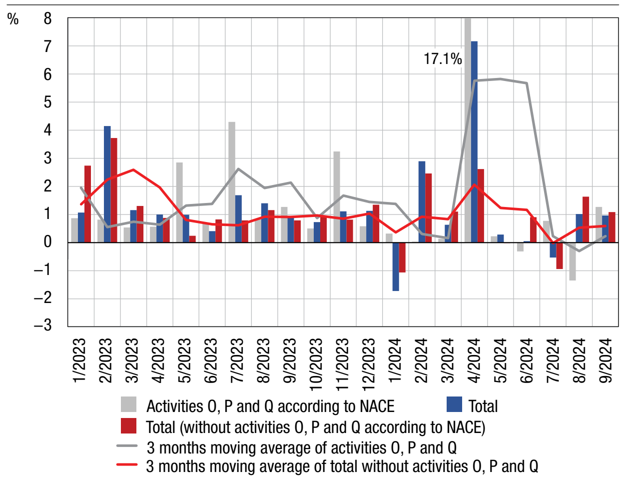
Notes: The estimate for the third quarter of 2024 refers to the Monthly indicator of real economic activity of the CNB (for more details on the calculation of the MRGA indicator, see CNB survey Kunovac, D., and B. Špalat: "Nowcasting GDP Using Available Monthly Indicators"). The models are estimated on the basis of data published up to 31 October 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 indicators of economic activity in Croatia



Note: Data for the third quarter of 2024 for construction refer to July and August 2024.
Sources: CBS and eVisitor.

Figure 5 Nominal gross wages
monthly rate of change



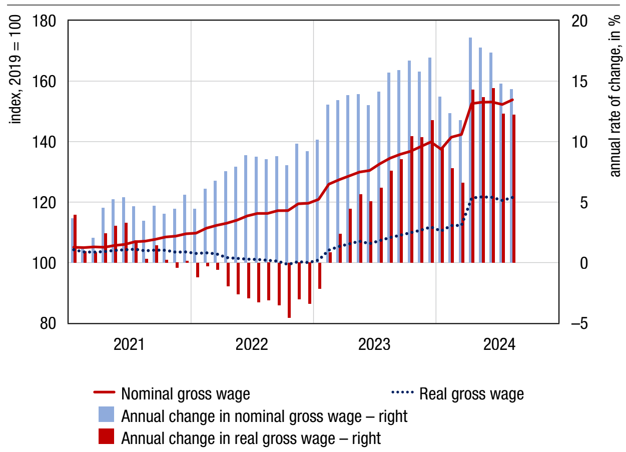
Sources: CBS and CNB calculations (seasonally adjusted by the CNB).

relatively volatile components of total industry. Industrial production recorded only a slight increase from the same period last year and remained below the levels reached in 2022.

Survey indicators of consumer and business optimism remained broadly favourable at the beginning of the fourth quarter of 2024. All indicators have continued to move noticeably above their long-term average. The consumer confidence index returned to around its August level in October, ending its four-month fall. Business confidence indicators continue to point to a divergence between the strong growth in construction and services and the relatively subdued activity in industry. Confidence continued to increase in the services sector and held steady at a relatively high level in construction, while in trade and industry it weakened somewhat.

The labour market saw a slowdown in employment growth in the third quarter, with a further decline in unemployment, while wages rose only slightly from the second quarter. Employment in Croatia continued to grow in September at monthly rates seen in July and August, increasing on average by 0.9% in the third quarter from the previous three months (1.1% in the second quarter). While employment growth in public administration, education, health care and social services (activities O, P and Q) was almost equal (up by 1.6% from 1.5% in the second quarter), the rise in the number of employed persons in the rest of the economy slowed down (to 0.7% from 1.1%), which can largely be attributed to the slowdown in employment growth in tourism-related service activities. Unemployment continued to trend down in September, albeit at a slower pace. The number of unemployed persons in the third quarter decreased by 6.6% from the quarter before. The registered unemployment rate declined to 5.1% of the labour force at the end of the third quarter. In September 2024, the average nominal gross wage continued to grow at the same rate as in the previous month (1.0%), after stagnating at the end of the second quarter and decreasing in June. As a result, the average nominal gross wage in the third quarter rose only slightly from the previous quarter (up by 0.6%, in contrast with the growth of 8.9% in the second quarter (Figure 5)). Wages in activities loosely comprising the public sector (O, P and Q) remained at the level recorded in the previous quarter, while those in the rest of the economy rose slightly (1.1%). Viewed in relation to the third quarter of the previous year, the average nominal gross wage in the third quarter rose by 14.5%, in contrast with 17.8% in the second quarter. The slowdown in

Figure 6 Nominal and real gross wages
index, 2019 = 100, annual rate of change



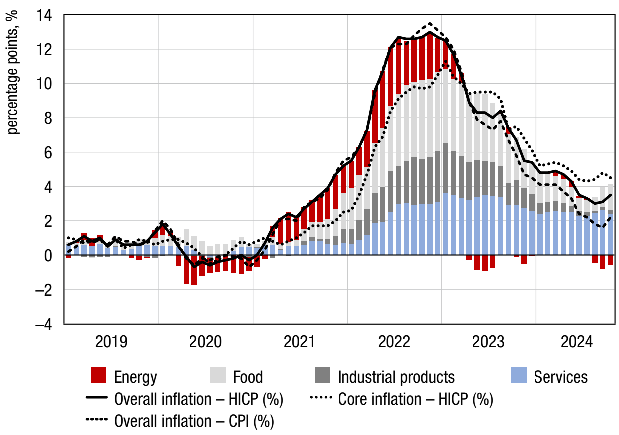
Sources: CBS and CNB calculations (seasonally adjusted by the CNB).

the annual rate of change in the average wage largely reflects the base effects of a sharp rise in public sector wages in mid–2023, which since July has no longer affected the annual rate of wage growth (Figure 6). The average real wage stagnated in the third quarter relative to the previous three months (0.1%) and was 12.4% higher than in the same period of the previous year.

Inflation in Croatia accelerated in October 2024, mainly reflecting current inflationary pressures, particularly in food prices, and to a lesser extent adverse base effects. According to Eurostat's flash estimate, inflation in Croatia measured by the harmonised index of consumer prices (HICP)[1] picked up to 3.5% in October 2024, from 3.1% in September (Figure 7). The acceleration in overall inflation was fuelled by a noticeable rise in food price inflation (which increased to 5.2%, from 3.9% in September) and the rise in the annual rate of change in energy prices. Food price inflation accelerated for the third consecutive month, largely reflecting the strengthening of current

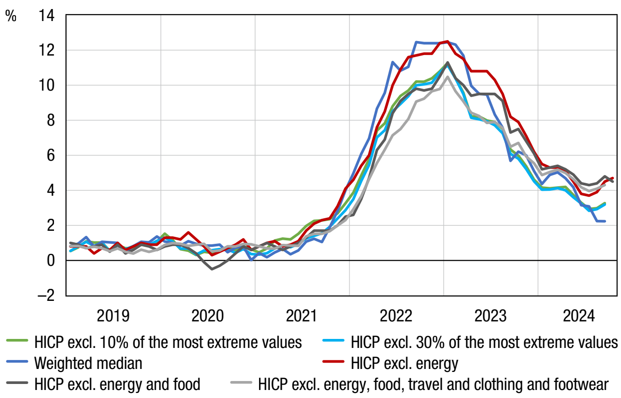
1 Inflation measured by the national consumer price index (CPI), which does not cover consumption of non-residents and institutional households, picked up from 1.6% in September to 2.2% in October.

Figure 7 Inflation indicators in Croatia



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

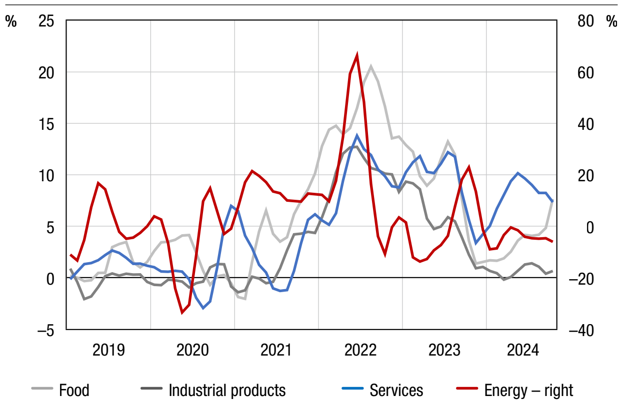
Figure 9 Core inflation indicators



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.

inflationary pressures, influenced, among other things, by adverse weather conditions, the spillover of wage growth and the increase in food product prices in the main trading partners. Accordingly, the momentum[2] of food price inflation has increased markedly and is well above its normal values (Figure 8). In addition to food prices, energy prices also contributed to the acceleration of overall inflation. Despite having remained in negative territory, the annual rate of change in energy prices increased in October (to –4.5%, from –6.8% in September), driven by the negative base effects (caused by the slump in prices in October last year) and, to a lesser extent, by the rise in the administered prices of gas. In contrast to energy and food price inflation, services price inflation slowed down in October (to 7.5%, from 8.2% in September), after having accelerated in the previous three months. Notwithstanding this, services remain the most significant component for overall inflationary developments in Croatia, contributing 2.4 percentage points to overall inflation. Services price inflation remained well above normal values,

Figure 8 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.

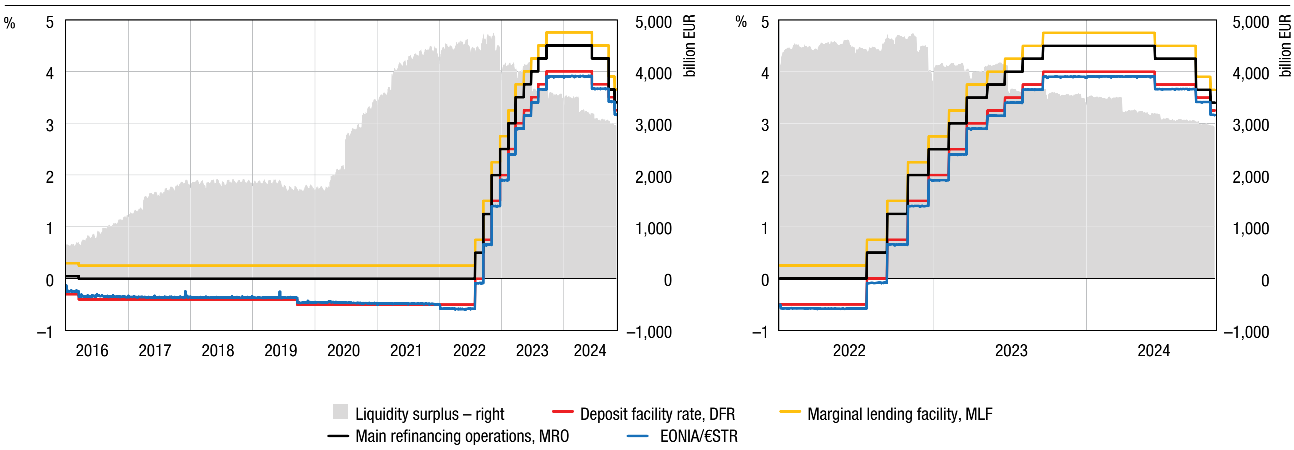
2 Momentum is a short-term inflation indicator which shows annualised three month-on-three month rates of price change, seasonally adjusted.

despite a marked slowdown in momentum. Industrial goods inflation accelerated only slightly (to 0.8%, from 0.7% in September). However, owing to a deceleration in services price inflation, core inflation (excluding energy and food prices) slowed down in October to 4.5%, from 4.8% in September (Figure 9).

At its meeting on 17 October, the Governing Council of the ECB decided to further gradually moderate the degree of monetary policy restriction (Figure 10). The deposit facility rate, a relevant indicator of the ECB's monetary policy, was set at 3.25% starting from 23 October, a reduction of 25 basis points. The Governing Council noted that the incoming information on inflation showed that the disinflationary process was well on track. Meanwhile, financing conditions remained restrictive. Inflation is expected to rise in the coming months, before declining to target in the course of next year. Domestic inflation remains high, due to still strong wage growth, which is expected to fade gradually. At the same time, declining corporate profits should continue to buffer the impact of this increase on inflation. The Governing Council will keep ECB key interest rates sufficiently restrictive for as long as necessary for inflation to return to the target level in a timely manner, and it will base its decisions on a data-dependent approach. The Governing Council is not pre-committing to a particular rate path.

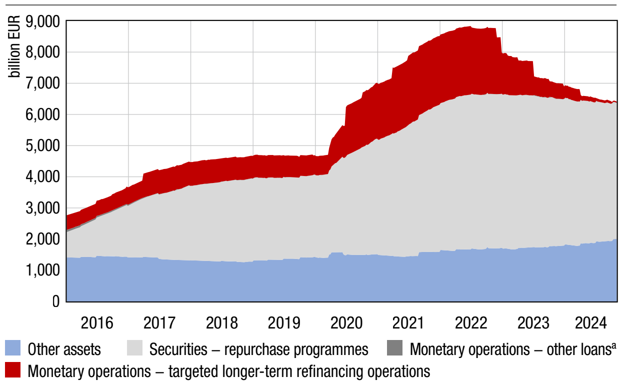
The size of the Eurosystem's balance sheet has continued to decrease gradually (Figure 11). Banks continued to repay the amounts borrowed under the targeted longer-term refinancing operations (TLTRO), and by the end of October they almost fully repaid them. The portfolio of securities purchased within 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 regards the pandemic emergency purchase programme (PEPP), principal payments from maturing securities purchased under the PEPP are no longer reinvested in full as of July 2024, with the PEPP portfolio expected to decline monthly by EUR 7.5bn on average over the second half of 2024. The reinvestment of principal payments coming due under the PEPP is planned to be fully discontinued at the end of 2024. The Governing Council will continue applying flexibility in reinvesting principal payments from maturing securities in the PEPP portfolio until the end of 2024, with a view to countering risks to the monetary policy transmission mechanism related to the pandemic.

Figure 10 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.

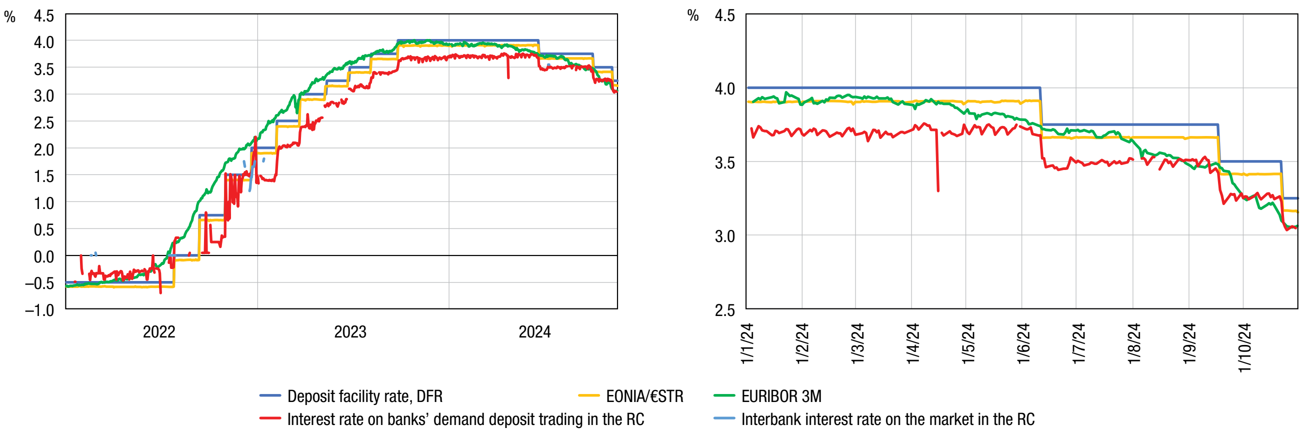
Figure 11 Eurosystem balance sheet



[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.

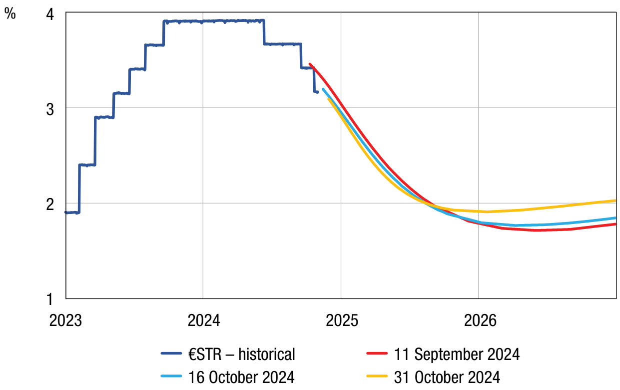
Developments in euro area financial markets at the beginning of October were mostly driven by data releases on an unexpectedly large number of new jobs in the US labour market, while at the end of October the markets were mostly influenced by data on surprisingly strong economic activity in the euro area, with inflation continuing to move around market expectations. The reduction in key ECB interest rates by 25 basis points in October spilled over quickly to money market interest rates. The €STR decreased by the amount of the decrease in key interest rates, to 3.2%, and remained at that level until the end of October (Figure 10). Similar trends were observed in the Croatian money market, where the overnight interest rate on banks' demand deposits trading fell by 24 basis points to 3.0% in October. With regard to market expectations, the €STR forward curve shifted to higher values in the first half of October, especially for longer maturities. This was mostly due to the spillover of the increase in the yield curve from the USA, where, above all, favourable data from the US labour market released in early October led to a shift in market expectations towards smaller cuts in key Fed interest rates and a higher terminal level of interest rates. These changes in market expectations were also

Figure 12 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 13 €STR forward curve



Notes: The forward curve is estimated using the rate from the spot overnight indexed swap (OIS) rate. Forward curves indicate selected forward curves formed on the day before the meeting of the Governing Council of the ECB in September and October 2024 and on the last day of October 2024.
Sources: Bloomberg and CNB calculations.

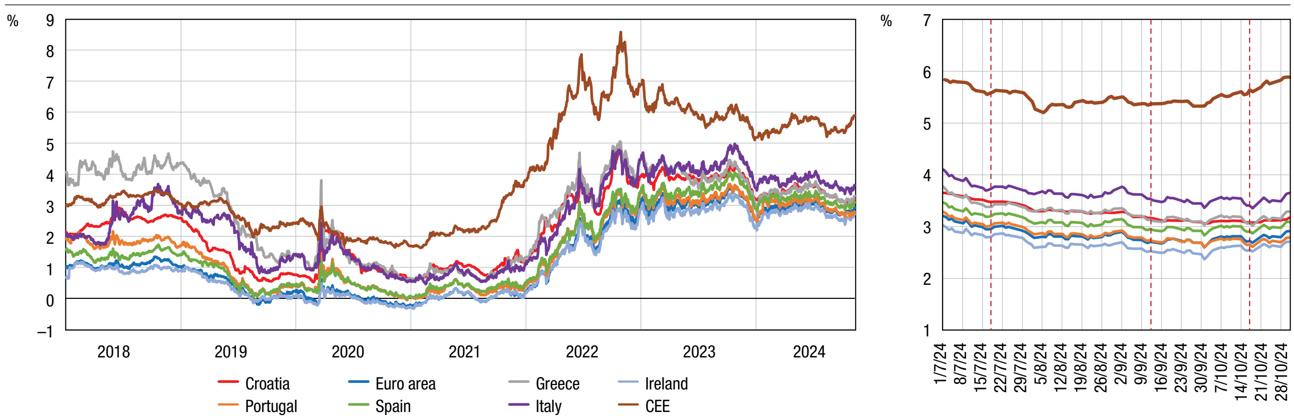
driven by the rise in inflation expectations caused by escalating geopolitical tensions and elevated uncertainty regarding possible shifts in economic policies after the US elections. In the aftermath of the Governing Council meeting, market participants expected a reduction in the key ECB interest rates by around 35 basis points on average by the end of this year. However, the release of higher than forecast data on economic activity growth and inflation in the euro area during the last two days of October pushed the forward curve up, particularly for longer maturities, so that in the last two days of October, financial market participants moderated their expectations regarding the intensity of the decline in key interest rates by the end of the year to around 30 basis points. Overall, the €STR forward curve was slightly lower for shorter maturities at end-October than the levels recorded at end-September, while for longer maturities the levels were higher (Figure 11). This shows that market participants changed their expectations in October towards a somewhat stronger cut in key ECB interest rates in the short run and a slightly higher terminal interest rate.

The yields on long-term government bonds in the euro area rose in October, driven in part by the growth of US long-term interest rates. The euro area GDP-weighted average of long-term government bond yields increased in October by 22 basis points and reached 2.9% at the end of month (Figure 12). The yield on long-term Croatian bonds remained almost unchanged and stood at 3.2% at end-October. The difference between the yields on Croatian and German long-term government bonds declined slightly below 80 basis points, the lowest level since 2008.

In September, the costs of corporate financing by credit institutions dropped to their lowest level this year. Interest rates on general-purpose cash loans also decreased, while interest rates on housing loans remained at the elevated levels reached at the beginning of the year. The average interest rate on new corporate loans stood at 4.6% in September, 26 basis points lower than in August (Figure 15). This decline was mostly fuelled by a fall in the interest rates on working capital loans granted mostly to large corporations. The interest rate on general-purpose cash loans to households averaged 6.1%, down by 14 basis points from August, while the interest rate on housing loans remained almost unchanged (3.8%). The pass-through of the ECB's monetary policy easing has had a larger impact on corporations. The average interest rate on new corporate loans was 82 basis points lower in September than the highest level recorded during the last monetary policy tightening cycle. With regard to households, this pass-through was less sensitive to the changes in short-term interest rates due to a large share of long-term loans with fixed interest rates that are less susceptible to short-term rate oscillations. Interest rates on existing corporate loans held steady in September (4.6%), while interest rates on existing household loans edged up (to 6.0% for general-purpose cash loans and 3.1% for housing loans). Interest rates on existing household loans rose only slightly, driven by the inflow of new loans granted at higher interest rates that are also fixed until loan maturity, while interest rates on existing loans linked to the NRR levelled off at 3.2% for housing loans and 5.4% for non-housing loans.

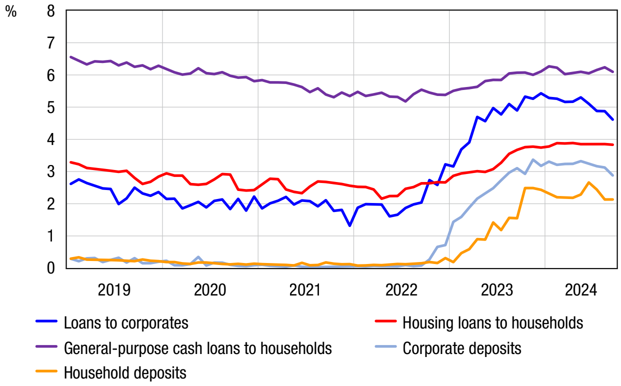
Interest rates on pure new deposits of corporates declined in September, while for households they remained unchanged. The average interest rate on pure new corporate deposits decreased by 24 basis points in September and stood at 2.9% (Figure 15), while it remained at 2.1% for households, with a positive contribution of the increase in the interest rate on 6 to 12 month time deposits being offset by the decrease in the interest

Figure 14 Yields on long-term government bonds with the remaining maturity of approximately 10 years



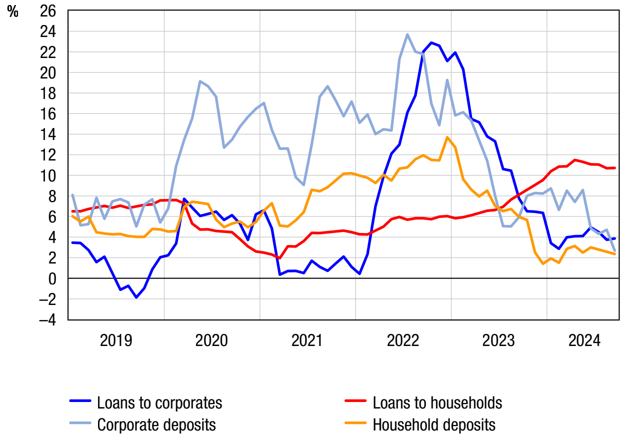
Notes: CEE – countries of Central and Eastern Europe (the Czech Republic, Hungary, Poland and Romania); yields for the euro area and CEE have been weighted by the share of GDP of the countries included. Data from the euro area do not include those from Estonia, Latvia, Luxembourg and Malta. The red dotted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

Figure 15 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 euros, 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.

Figure 16 Corporate and household loans and deposits
year-on-year rates of change, transaction-based



Source: CNB.

rate on 3 to 6 month time deposits. Interest rates on existing total deposits remained almost unchanged (0.9% for corporates and 0.5% for households), with a very slight fall in interest rates on existing time deposits and only a slight increase in interest rates on overnight corporate deposits. Interest rates on household time deposits edged up, while interest rates on overnight deposits remained unchanged.

Household loans continued to grow in September, primarily driven by a strong growth in general-purpose cash loans, the growth of which continued to accelerate on an annual level, while housing loans went on growing steadily. The annual growth of corporate loans also accelerated slightly. Loans to domestic sectors (excluding the general government) rose in September by EUR 0.3bn or 0.8% (transaction-based), reflecting persistently strong household lending (EUR 0.2bn). Corporate loans also increased (by EUR 0.1bn), following a decline in the past two months. The growth in household loans was mostly accounted for by general-purpose cash loans (EUR 118m). Housing loans also continued their upward trend (an increase of EUR 88m). On an annual level, the growth in total household loans held steady in September at the same level as in August (10.7%, transaction-based, Figure 16). The annual growth rate of general-purpose cash loans accelerated from 15.5% in August to 15.8% in September, reflecting the persistently strong new lending activity, while the annual growth of housing loans remained at 8.6%. The annual growth of corporate loans accelerated from 3.7% in August to 3.9% in September, mostly as a result of stronger lending to large enterprises. The momentum[3] of general-purpose cash loans is below the annual growth rate, but has remained strong (15.2%), while the momentum of housing loans stabilised at a level slightly below 10%. The momentum of corporate loans was slightly negative in September.

Domestic deposits declined in September after growing over the previous four months. Total domestic deposits (excluding the general government) fell by EUR 0.2bn (or 0.3%, transaction-based) in September from August, with a decrease in time deposits (of EUR 0.6bn) and an increase in overnight deposits (of EUR 0.4bn). Corporate deposits decreased by EUR 0.3bn. The decline in time deposits (of EUR 0.5bn) was offset by the increase in overnight deposits (of EUR 0.2bn). The spillover of time deposits to overnight deposits is evident in some enterprises whose balances on transaction accounts increased after the expiry of time deposits of up to 1 month. Household deposits rose by EUR 0.1bn in September, which is entirely attributable to the growth in overnight deposits. In early September, citizens subscribed slightly below EUR 400m worth of "national" T-bills of the Ministry of Finance for a three-month term. This was the sixth issue of government securities in which citizens invested. These securities ended September at EUR 4.1bn. The share of time deposits in total deposits edged down from 28.5% in August to 28.4% in September for households, with a more pronounced decrease for corporates, from 28.1% to 25.8%.

3 Momentum is a short-term indicator of lending activity which shows annualised three months-on-three months rates of change in loans.