



Information on economic trends

September 2016

Summary

Real GDP grew by 0.5% from the first to the second quarter 2016, while available monthly statistical indicators for the beginning of the second quarter suggest that economic growth continued at a similar pace. Positive trends in the labour market, which marked the first five months of 2016, lost momentum in June and July. The annual decrease in consumer prices slowed down slightly, from –1.6% in June to –1.5% in July, under the influence of movements in the prices of processed food products. Economic and monetary developments over the summer months were dominantly influenced by favourable trends during the tourist season, so that net foreign assets of the monetary system increased noticeably while money (M1) recorded robust growth. The CNB continued pursuing an expansionary monetary policy and conducted the third structural repo operation at a lower fixed interest rate of 1.4%, thereby placing a total of HRK 0.9bn to the banks in 2016. Against a background of high kuna and foreign currency liquidity, the government secured the planned funds in the domestic market at more favourable terms, after having decided not to issue bonds abroad in June. In the first seven months, total placements to domestic sectors (excluding the government) expanded by 1.5%, boosted by more vigorous lending to both corporates and households. Cash fiscal data show that favourable fiscal developments continued in April and May.

According to the first CBS estimate, real GDP continued to grow at a similar pace in the second as in the first quarter of 2016, recording an increase of 2.8% on an annual basis (Figure 1). All components of aggregate demand contributed to GDP growth, with fixed capital formation increasing the most. Household consumption growth continued under the influence of positive labour market trends, while government consumption also expanded strongly. Though exports of goods and services rose slightly in the second quarter, on average, they levelled off at the end-of-2015 level throughout the first half of 2016. By contrast, imports of goods and services rose sharply.

The GDP nowcasting model shows that the pace of the current growth in real economic activity remained the same at the beginning of the third quarter as in the first half of the year (Figure 1).¹ Retail trade turnover expanded perceptibly (1.6%), while the volume of industrial production was slightly smaller in July than the average for the previous three months (–0.8%), largely due to the drop in the production of capital goods (Figures 3 and 7). Production of intermediate and durable consumer goods was also reduced, while production of non-durable goods and energy increased (Figure 4). Consumer optimism, which began to decrease late in the first quarter of 2016, continued to fall in July and August, but remained at a relatively high level. Developments in the consumer confidence index were the consequence of less favourable expectations regarding the financial situation of households and of poorer expectations regarding unemployment trends for the following period of one year. By contrast, business optimism exhibited relatively favourable trends in the same period. Confidence in the service sector gathered strength in July and August, and the drop in confidence in industry came to an end. Confidence in trade and construction remained almost unchanged from the previous quarter (Figure 8).

According to CPIA data, employment continued upward in the second quarter of 2016. Employment in private sector services (excluding trade) grew strongly, while employment in industry dropped mildly on a quarterly basis (Figure 14). Unemployment continued to fall in the same period, with net outflows due to clearings from the records for other reasons (registration cancellation and failure to report regularly) being more pronounced than outflows from the register in consequence of employment and other business activities. As a result, the registered unemployment rate dropped from 16% in the first quarter

2016 to 15.1% (Figure 15). Nominal and real wages grew at a slower pace in the second quarter than in the first quarter 2016, and they decreased in July (Figure 16). Furthermore, July 2016 also saw a marginal decrease in employment and a slower fall in unemployment.

Consumer prices dipped by 0.7% from June to July (Table 1), largely on account of the seasonal decrease in clothing and footwear prices, and prices of vegetables. In addition, after five months of steady growth, retail prices for refined petroleum products decreased as a result of the strong decline in global crude oil prices (Figure 19). By contrast, the strongest positive contribution to monthly inflation came from prices of processed food products (milk in particular), pharmaceutical products, and accommodation services and package holidays. The slowdown in the annual decline in overall consumer price inflation and in core inflation, from –1.6% and –0.9%, respectively, in June to –1.5% and –0.8% in July was mostly due to the slower annual drop in the prices of processed food products, because of their increase on a monthly level and the base effect (Figure 18).

In the first quarter of 2016, foreign trade was marked by falling exports and stagnant imports, while the second quarter saw an increase in exports and a slightly weaker growth in imports. Total goods exports grew by 4.9% from the previous quarter average (Figure 10), to a large extent due to higher exports of ships and oil and refined petroleum products. The growth in exports of the narrow aggregate slowed down noticeably (to only 0.3%), primarily due to unfavourable trends in exports of capital equipment (in particular metal working machinery), electricity, and cork and wood, while exports of medical and pharmaceutical products, road vehicles and clothes strengthened. Total exports of goods grew by 1.4% in the second quarter (Figure 11), mostly as a result of increased imports of oil and refined petroleum products, while imports of ships decreased. In the same period, imports of the narrow aggregate contracted (by 0.9%), with the drop in imports of chemical products and manufactured goods classified according to material being particularly pronounced. On the other hand, an increase was recorded in imports of road vehicles and capital equipment, in particular general industrial machinery (Figure 12).

The nominal exchange rate of the kuna against the euro was mostly stable in July and August. Having strengthened mildly against the euro early in July, largely due to mounting seasonal foreign currency inflows, the kuna moved within the very narrow

1 The estimate is based on the available monthly data for July. The model is described in a paper by Kunovac, D., and B. Špalat: *Nowcasting GDP Using Available Monthly Indicators* (WP-39, October 2014).

range of $\pm 0.2\%$ around the average exchange rate of EUR/HRK 7.48. The exchange rate was the same at end-August, appreciating by 0.4% from the end of June (Figure 21). The kuna strengthened modestly against most other currencies of the main trading partners, so that the nominal effective kuna exchange rate index weakened by 0.8% between the end of June and the end of August (Figure 22). The exchange rate of the kuna appreciated mostly against the yuan renminbi and the pound sterling, which was due to the strengthening of the euro against these currencies in the global foreign exchange market.

The continued expansionary monetary policy of the ECB and abundant banking sector liquidity in the euro area during July and August 2016 triggered a further fall in euro benchmark interest rates. The six-month EURIBOR stood at -0.19% at the end of August, while the overnight interest rate EONIA was -0.33% (Figure 24). The assessed general degree of risk in European emerging market economies also decreased (Figure 24) as did the financing costs for parent banks of the largest domestic banks (Figure 26) and the risk premium for Croatia. Standing at 219 basis points at the end of August, this premium still remained much higher than in Central and Eastern European peer countries (Figure 25), though this difference continued to shrink in the period under review.

As ample liquidity in the domestic financial system in August 2016 continued to be supported by the CNB's monetary measures, money market activities of credit institutions decreased steadily. The weighted interest rate on overnight loans in direct interbank trading stood at 0.29% in August 2016 (Figure 27). In that month, two auctions of T-bills were held, at which one-year kuna T-bills were placed at historically low interest rates of 0.91% and 0.87%. Also placed in August were 455-day euro T-bills with an interest rate of 0.70% and one-year T-bills with a euro currency clause and an interest rate of 0.24% (Figure 28).

Lending and deposit interest rates of banks continued their fall in August 2016 (Figure 29). The overall interest rate spread on loan balances continued to rise slowly and stood at 4.91 percentage points at the end of August (Figure 32).

Monetary developments in June and July 2016 were marked by a strong seasonal upsurge in the net foreign assets (NFA) of the monetary system, with a concomitant noticeable jump in total liquid assets (M4) (Figure 33). M4 recorded a perceptible annual increase of 7.5% at end-July (excluding the exchange rate effects) (Figure 41), largely thanks to the steady, strong growth in money (M1), of 16.0% (Figure 40). The June and July increase in money was stimulated by good results during the tourist season and the continued economic recovery in general, which was particularly evident in the rise in currency and demand deposits of non-financial corporations and households. Kuna deposits went up marginally, while the growth in foreign currency deposits was mostly due to non-financial corporations (Figure 44). Placements of credit institutions to domestic sectors (not including the government) dropped in June (-0.4%) and edged up by 0.2% in July, while the annual rate of change in total placements remained negative and stood at 0.1% (transaction-based) (Figure 35).

Taking into account cumulative trends in placements in the first seven months of 2016, lending recovered mildly and placements to domestic sectors (not including the government) went up 1.5%, with corporate loans growing more than household loans (3.5% vs 0.6%) (Figures 36 and 37). By contrast, the 3.4% decrease in the nominal value of placements in that period was mostly the result of the process of the conversion and partial write-off of household loans indexed to the Swiss franc, in which banks wrote off a total of HRK 5.9bn in the period from end-November 2015 to end-July 2016, as well as the sale

of placements, which amounted to HRK 3.9bn in the first half of the year. The increase in placements to the central government accelerated to 2.0% and the growth in net claims on the government reached 6.8% in the first seven months of 2016. At end-July, bank claims on the central government became equal to bank claims on enterprises, while five years before their ratio had been 55%.

The CNB continued to pursue an expansionary monetary policy. In addition to regular reverse repo operations, the CNB conducted the third structural reverse repo operation in July to ensure banks' continued access to long-term sources of kuna liquidity. The CNB placed HRK 234.4m with a four-year maturity at a lower fixed interest rate of 1.4%, while the interest rate offered at the previous two auctions was 1.8%. The CNB has placed a total of HRK 945.9m through this instrument in 2016 so far.

Having slightly increased in the first quarter, the net external debt of domestic sectors dropped by EUR 1.0bn in the second quarter of 2016 (Figure 51). Along with a marginal decrease in foreign assets, this was the result of the pronounced reduction in liabilities to foreign creditors. Gross liabilities (Figure 52) were equally reduced by the central bank, other domestic sectors (private non-financial corporations in particular) based on direct investments, and credit institutions. Furthermore, the government continued to deleverage at a slightly slower pace, while other domestic sectors recorded an increase in liabilities to non-affiliated creditors. As a result, gross external debt was EUR 43.4bn at the end of June (Figure 53), a decrease of EUR 0.9bn from the end of March.

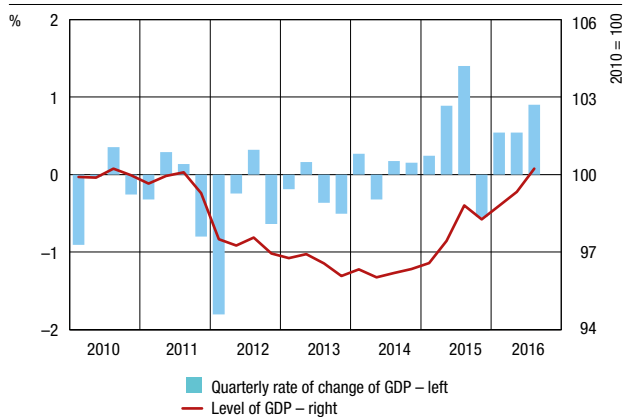
The data on the general government deficit (in accordance with the ESA 2010 methodology) indicate that a strong fiscal adjustment was made in the first quarter of 2016. Due to the parallel increase in revenues and a slight decrease in expenditures the deficit was cut to HRK 2.2bn, HRK 3.4bn less than in the same period in the previous year. Favourable trends were seen in most revenue items, with revenues from direct taxes contributing the most to the growth in total revenues. The decrease in expenditures may be partly attributed to the fact that the budget execution in the first quarter was influenced by the provisional financing of the government budget and extrabudgetary funds. Expenditures contracted mostly due to expenditures for subsidies and intermediary consumption, and expenditures for employees also moved in the same direction. In contrast, expenditures on investments and social benefits rose.

According to the monthly MoF data for April and May, favourable fiscal trends continued into the second quarter of 2016 as revenue growth outpaced expenditure increases. Tax revenues recorded robust growth from the same period last year, reflecting a strong upturn in most of the major items. The May increase in VAT revenues more than offset the poor performance in the first four months of 2016. Substantial growth was also seen on the expenditure side, mostly on account of larger expenditures for subsidies, which, bearing in mind their large decrease in the first quarter, was probably due to the different annual dynamics of their payment. Interest expenditures held steady from last year thanks to favourable conditions in financial markets and the uninterrupted decrease in interest rates on new issues of public debt. Consolidated general government debt continued to shrink, falling to HRK 285.0bn at end-May 2016, HRK 3bn less than at the end of the first quarter. This was due to the use of deposited funds, the exchange rate effect on the debt stock, and more favourable fiscal trends. At the beginning of the second half of the year, the government used the high liquidity in the domestic financial system to refinance maturing liabilities at favourable terms and raise the funds needed to service regular

liabilities. In July, it issued HRK 6bn worth of five-year kuna bonds at the very low interest rate of 2.75% and in early August, it borrowed EUR 1.5bn through the issuance of 455-day T-bills

with an interest rate of 0.7%. As a portion of the funds raised in this way was deposited, liquidity of the government sector remained high through to the end of August.

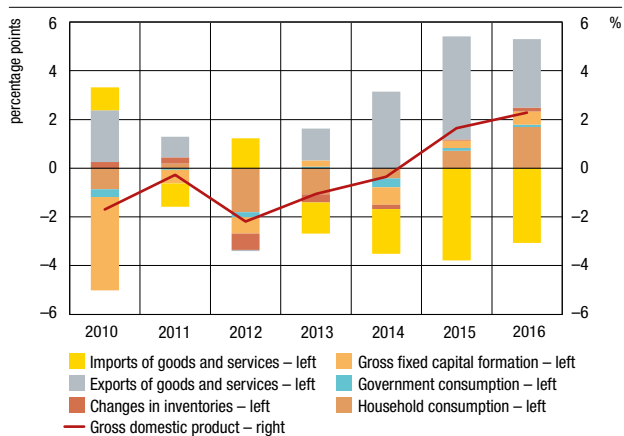
Figure 1 Quarterly gross domestic product
seasonally adjusted real values



Note: Data for the third quarter of 2016 is the estimate derived using the CNB's Monthly indicator of real economic activity, on the basis of data published until 2 September 2016.

Sources: CBS data seasonally adjusted by the CNB and CNB calculations.

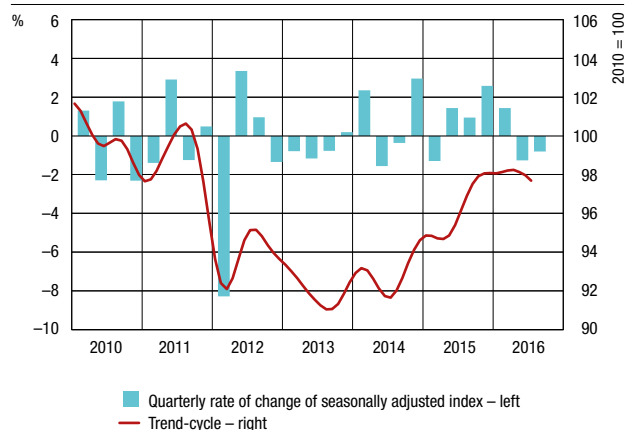
Figure 2 GDP rate of change
contribution by components



Note: The projection for 2016 refers to the official projection of the CNB from July 2016.

Source: CBS.

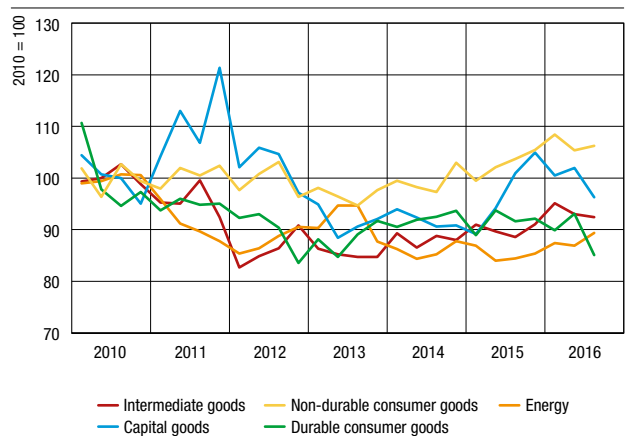
Figure 3 Industrial production



Note: Data for the third quarter of 2016 refers to July.

Source: CBS data seasonally adjusted by the CNB.

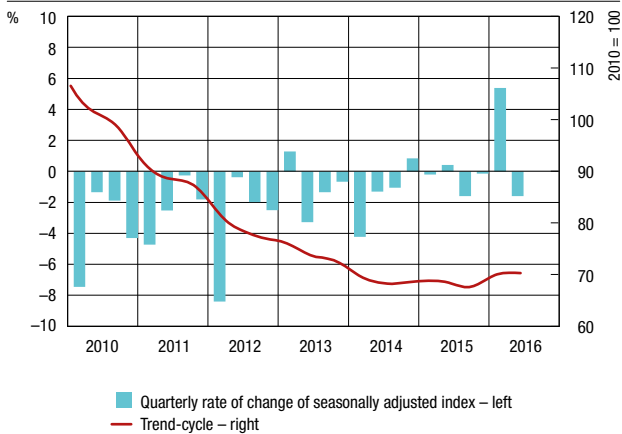
Figure 4 Industrial production by main industrial groupings
seasonally adjusted indices



Note: Quarterly data are calculated as the average of monthly data.

Source: CBS data seasonally adjusted by the CNB.

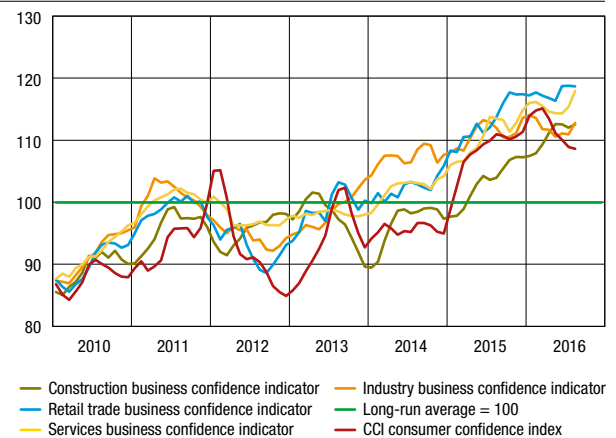
Figure 5 Total volume of construction works



Source: CBS data seasonally adjusted by the CNB.

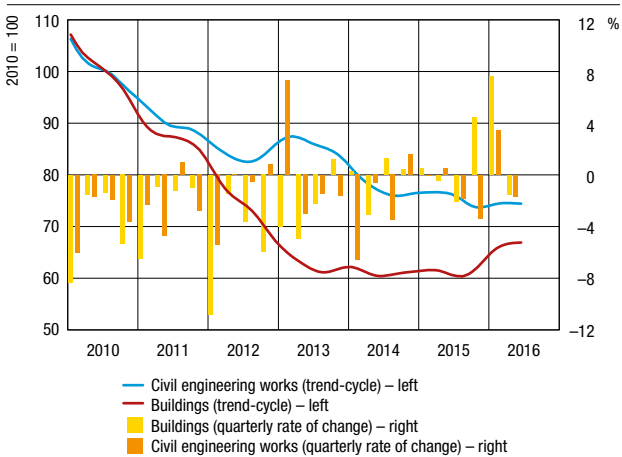
Figure 8 Business confidence indicators

standardised and seasonally adjusted values, three-member moving averages



Sources: Ipsos and CNB data seasonally adjusted by the CNB.

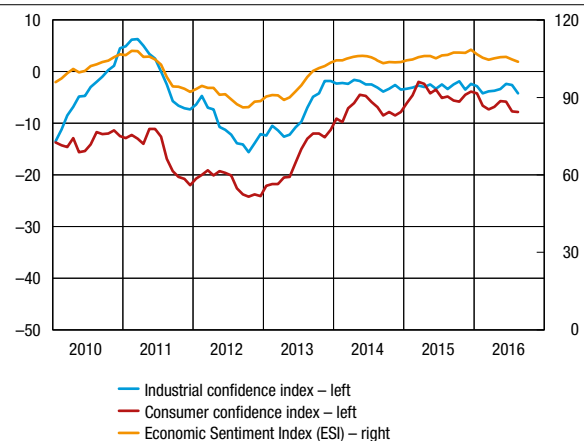
Figure 6 Buildings and civil engineering works



Source: CBS data seasonally adjusted by the CNB.

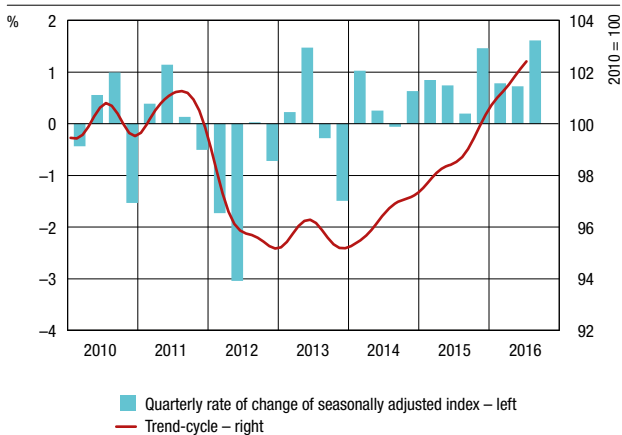
Figure 9 EU confidence indices

seasonally adjusted series



Source: Eurostat.

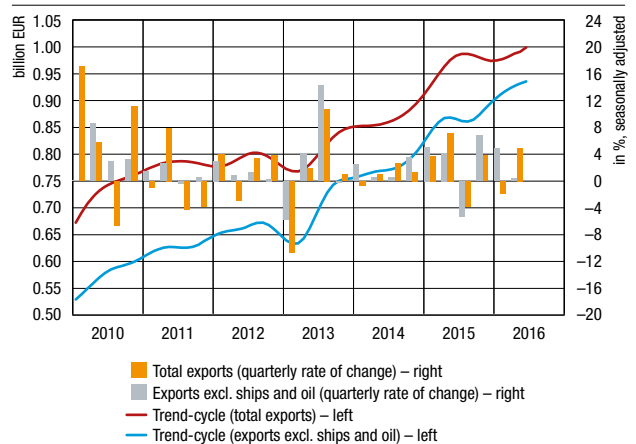
Figure 7 Real retail trade turnover



Note: Data for the third quarter of 2016 refers to July.

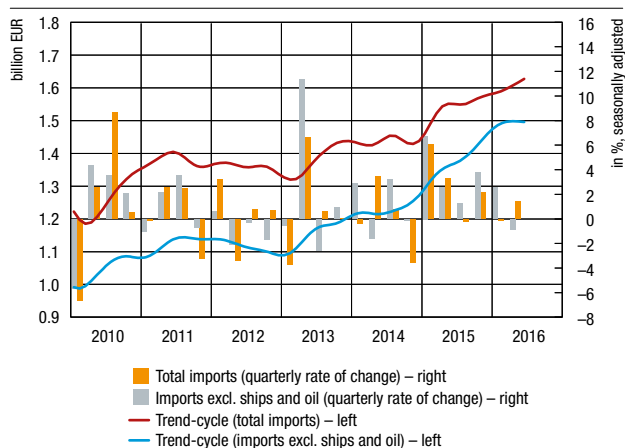
Source: CBS data seasonally adjusted by the CNB.

Figure 10 Goods exports (f.o.b.)



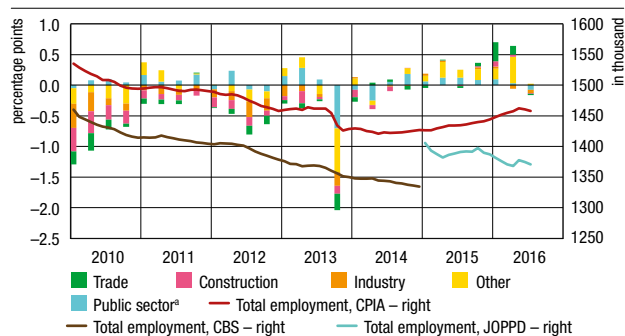
Source: CBS data seasonally adjusted by the CNB.

Figure 11 Goods imports (c.i.f.)



Source: CBS data seasonally adjusted by the CNB.

Figure 14 Total employment and contribution to the quarterly change in employment by sector

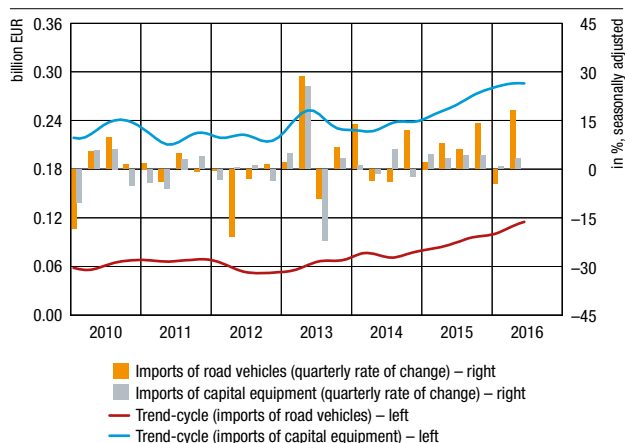


^a Public administration and defence, compulsory social security, education and human health and social work activities.

Note: Around 20,000 insured persons were removed from the CPIA register due to administrative reasons in October 2013. The JOPPD form is now the source of data on employed persons and wages due to changes in the CBS methodology for collection and processing of data on employed persons and wages in effect as of January 2015. Structural columns show contributions by sector in accordance with CPIA data. Data for the third quarter of 2016 refer to July.

Sources: CBS and CPIA data seasonally adjusted by the CNB.

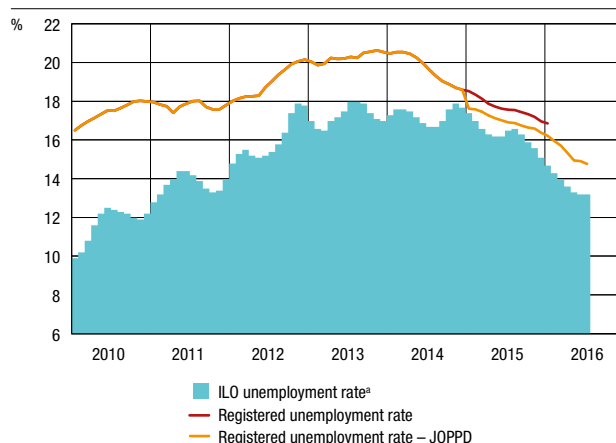
Figure 12 Imports of capital equipment and road vehicles (c.i.f.)



Note: Imports of capital equipment (SITC divisions 71 – 77).

Source: CBS data seasonally adjusted by the CNB.

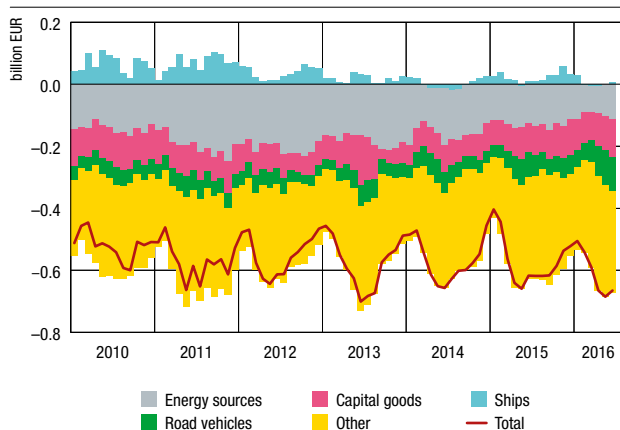
Figure 15 Registered and ILO unemployment rates seasonally adjusted data



^a Monthly ILO unemployment rate is Eurostat's estimate.

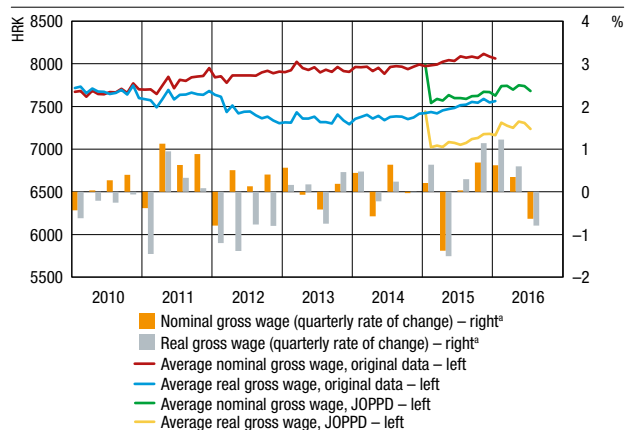
Sources: CBS and Eurostat data seasonally adjusted by the CNB.

Figure 13 Trade in goods balance three-member moving averages of monthly data



Source: CBS.

Figure 16 Average gross wages

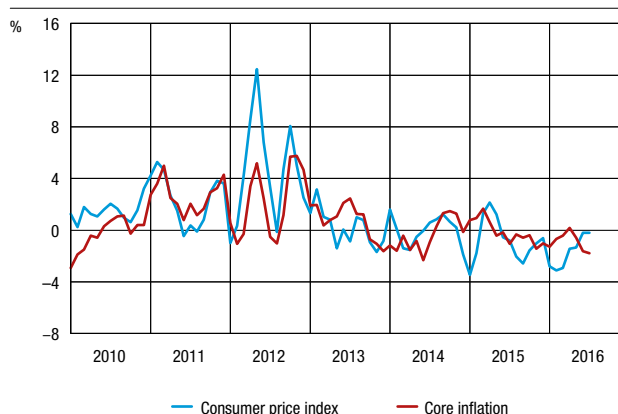


^a From the second quarter of 2015, rates of change are based on the data contained in the JOPPD form.

Note: Data for the third quarter of 2016 refer to July.

Source: CBS data seasonally adjusted by the CNB.

Figure 17 Consumer price index and core inflation
annualised month-on-month rate of change^a



^a The month-on-month rate of change is calculated based on the quarterly moving average of seasonally adjusted consumer price indices.

Sources: CBS and CNB calculations.

Table 1 Price indicators

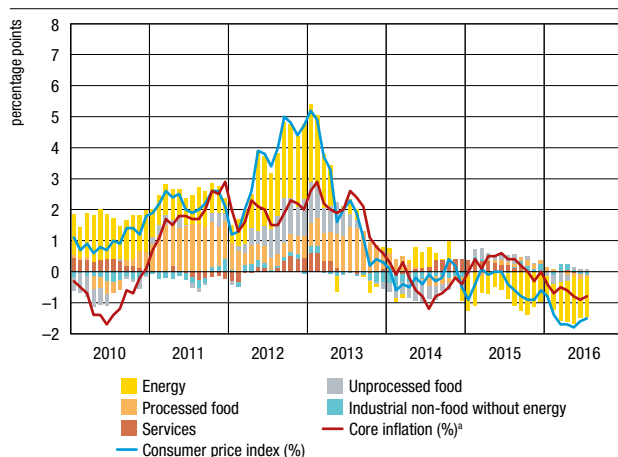
year-on-year and month-on-month rates of change

	Year-on-year rates		Month-on-month rates	
	6/16	7/16	7/15	7/16
Consumer price index and its components				
Total index	-1.6	-1.5	-0.8	-0.7
Energy	-7.3	-7.5	-0.5	-0.7
Unprocessed food	0.8	0.7	-1.2	-1.4
Processed food (incl. alcoholic drinks and tobacco)	-0.7	-0.2	-0.1	0.3
Industrial non-food without energy	-0.3	-0.5	-2.5	-2.7
Services	-0.1	0.0	0.4	0.4
Other price indicators				
Core inflation	-0.9	-0.8	-0.8	-0.7
Index of industrial producer prices on the domestic market	-4.8	-5.0	-0.5	-0.7
Brent crude oil price (USD)	-22.2	-19.3	-10.4	-7.0
HWWI index (excl. energy) ^a	-3.6	0.9	-3.8	0.7

^a The index is calculated on the basis of raw materials prices expressed in US dollars.

Sources: CBS, Bloomberg, HWWI and Eurostat.

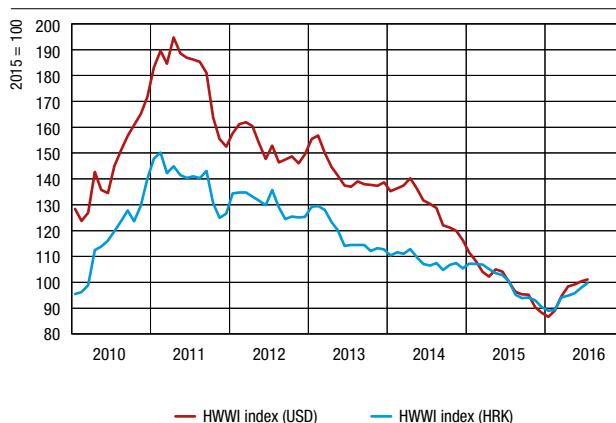
Figure 18 Year-on-year inflation rates and components' contribution to consumer price inflation



^a Core inflation does not include agricultural product prices and administrative prices.

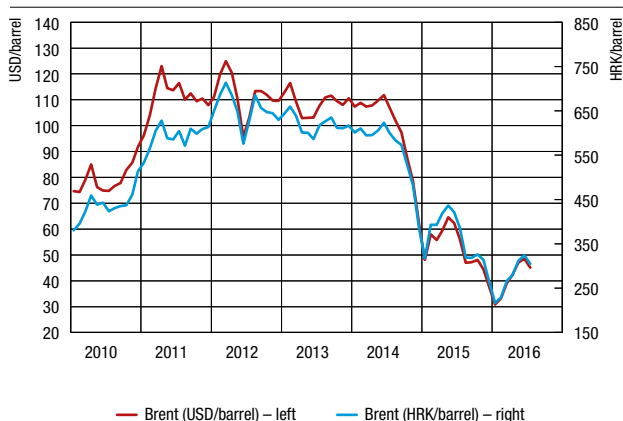
Sources: CBS and CNB calculations.

Figure 20 HWWI index (excl. energy)



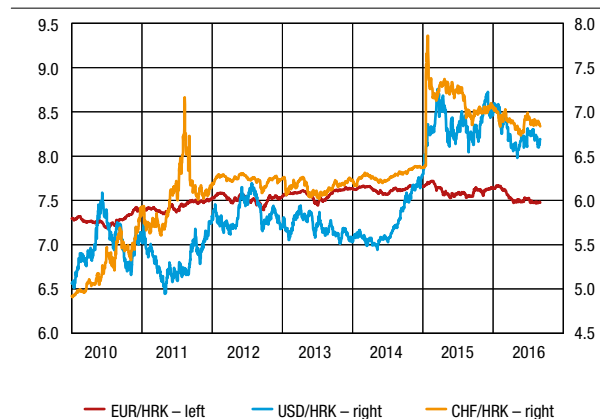
Sources: HWWI and CNB calculations.

Figure 19 Crude oil prices (Brent)



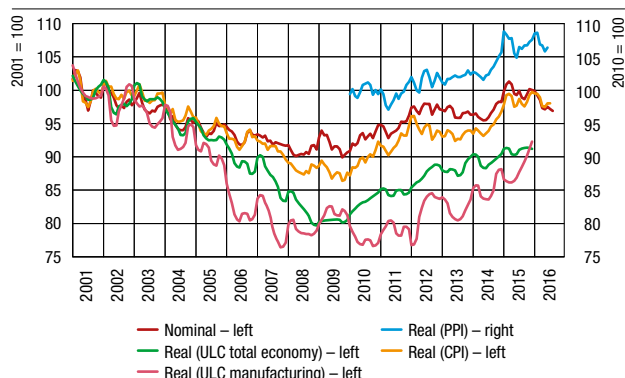
Sources: Bloomberg and CNB calculations.

Figure 21 Daily nominal exchange rate – HRK vs. EUR, USD and CHF
CNB midpoint exchange rate



Source: CNB.

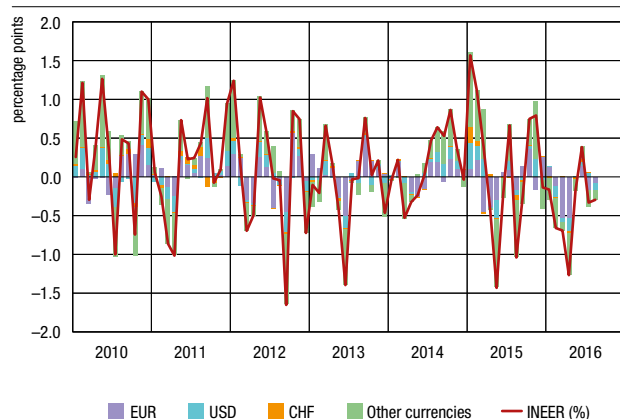
Figure 22 Nominal and real effective exchange rates of the kuna



Note: Real effective exchange rate of the kuna deflated by producer prices includes the Croatian index of industrial producer prices on the non-domestic market, which is available from January 2010. Real effective exchange rate of the kuna deflated by unit labour costs is the result of the interpolation of quarterly values. A fall in the index denotes an effective appreciation of the kuna.

Source: CNB.

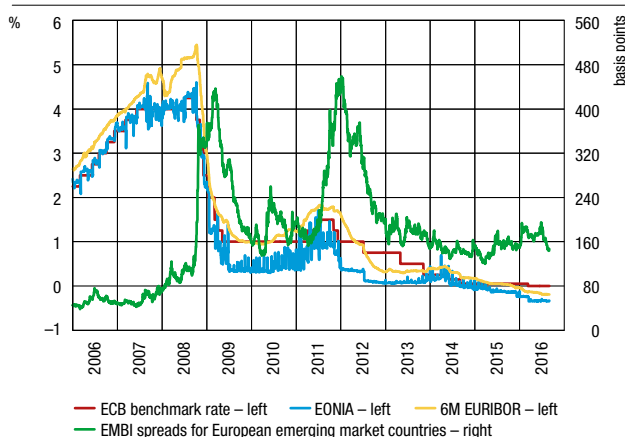
Figure 23 Contributions^a of individual currencies to the monthly rate of change of the average index of the nominal effective kuna exchange rate (INEER)



^a Negative values denote contributions to the appreciation of the INEER.

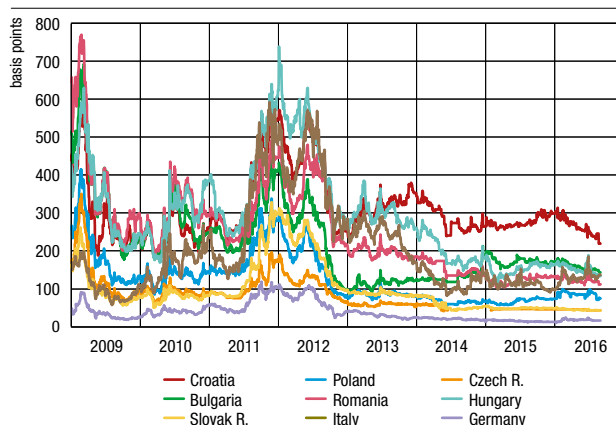
Source: CNB.

Figure 24 Interest rates on the euro and the average yield spread on bonds of European emerging market countries



Sources: ECB, Bloomberg and J. P. Morgan.

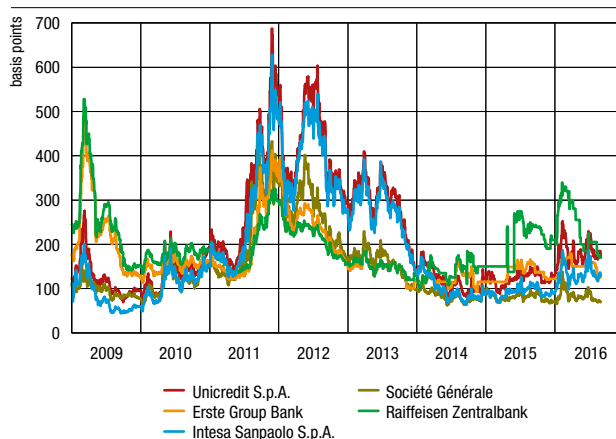
Figure 25 CDS spreads for 5-year government bonds of selected countries



Note: Credit default swaps (CDS) spread is an annual premium that a CDS buyer pays for protection against credit risk associated with an issuer of an instrument.

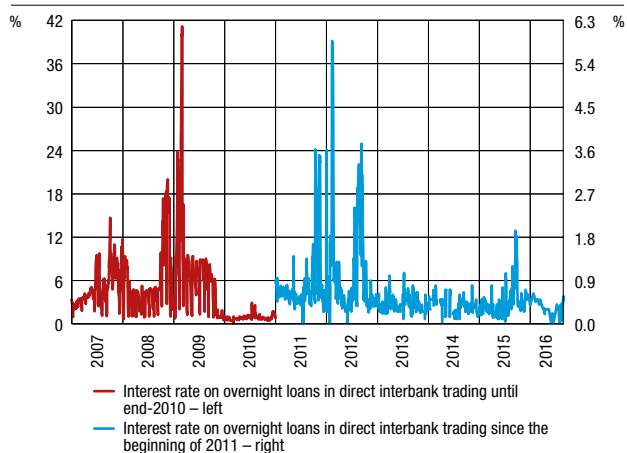
Source: Bloomberg.

Figure 26 CDS spreads for selected parent banks of domestic banks



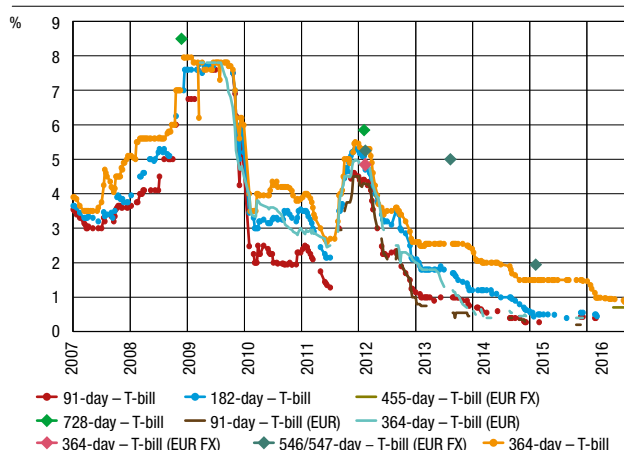
Source: Bloomberg.

Figure 27 Average interest rate on the money market daily data, on annual basis



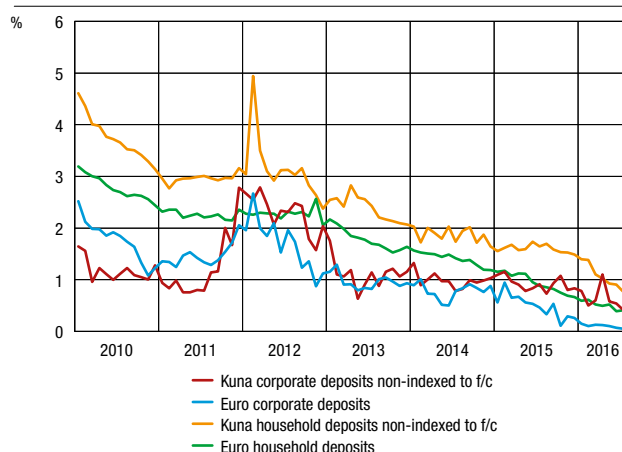
Source: CNB.

Figure 28 Interest rates on kuna and euro T-bills on auction days



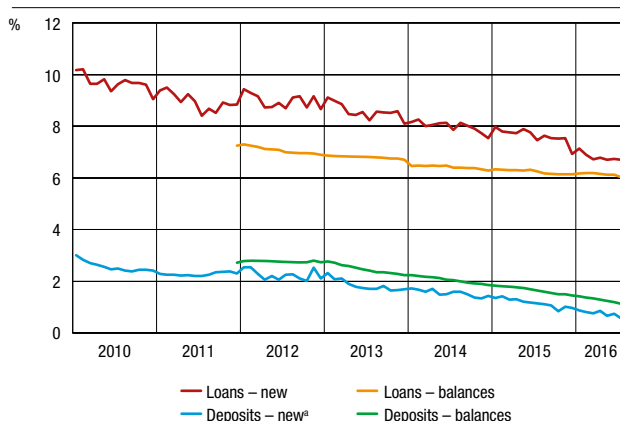
Source: CNB.

Figure 31 Average interest rates on new time deposits maturing in three months on annual basis



Source: CNB.

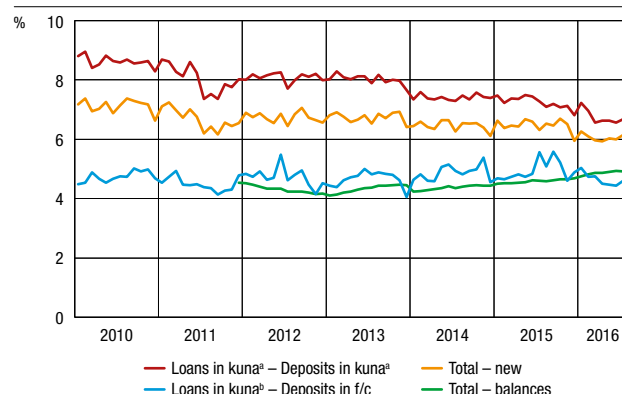
Figure 29 Average interest rates on loans (excl. revolving loans) and deposits on annual basis



^a For time deposits, interest rates on newly received deposits are weighted by their balances.

Source: CNB.

Figure 32 Spread between interest rates on loans (excl. revolving loans) and interest rates on deposits on annual basis

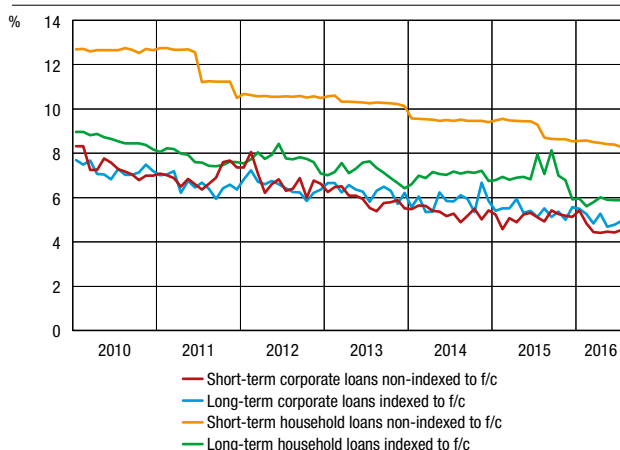


^a Non-indexed to f/c. ^b Indexed to f/c.

Note: Spread between average interest rates on loans and average interest rates on deposits should be differentiated from net interest margin (the ratio of the difference between interest income and interest expenses to total assets of credit institutions).

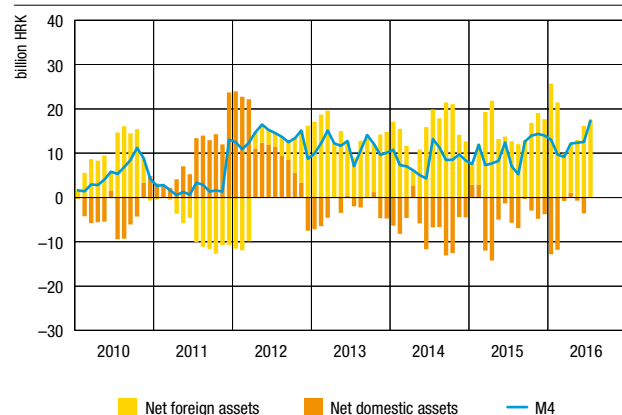
Source: CNB.

Figure 30 Average interest rates on new kuna loans (excl. revolving loans) on annual basis



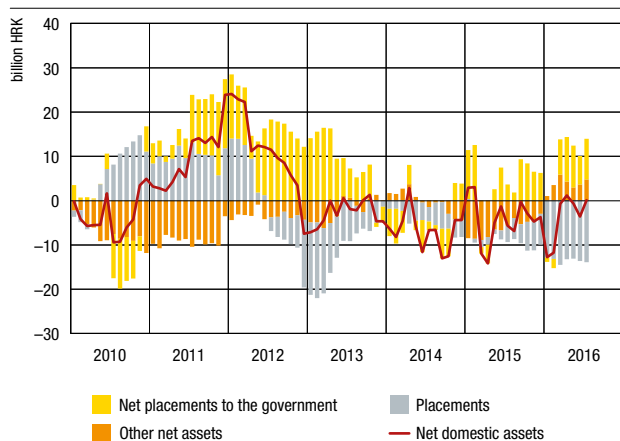
Source: CNB.

Figure 33 Net foreign assets, net domestic assets and total liquid assets (M4) absolute change in the last 12 months



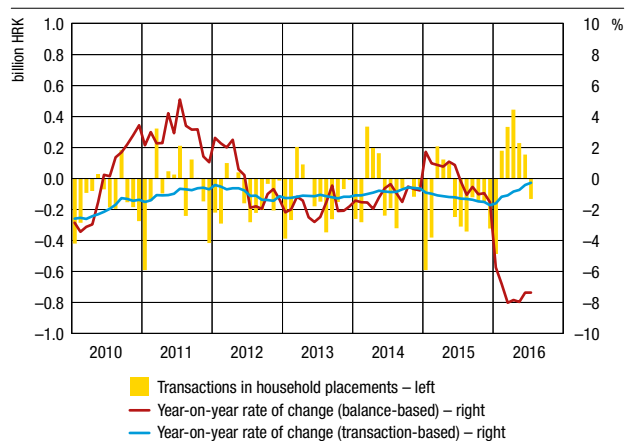
Source: CNB.

Figure 34 Net domestic assets, structure
absolute change in the last 12 months



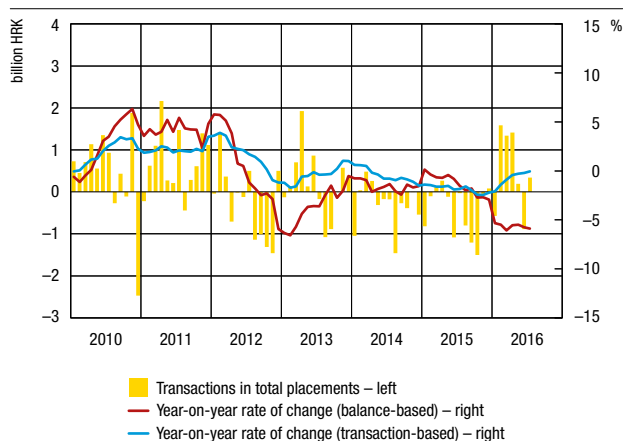
Source: CNB.

Figure 37 Placements to households



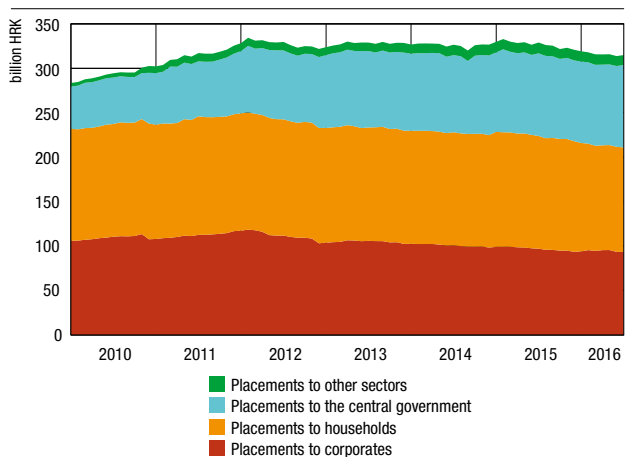
Source: CNB.

Figure 35 Placements



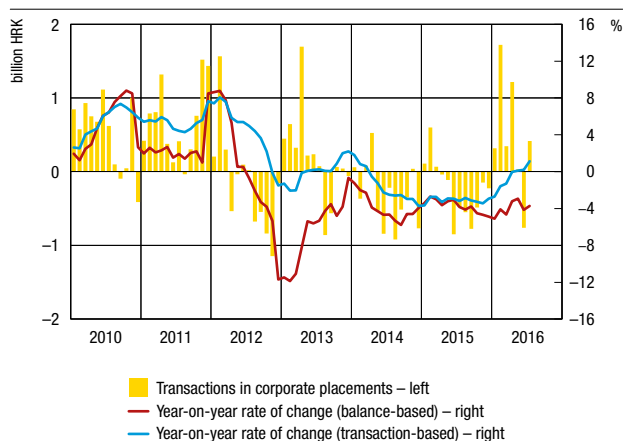
Source: CNB.

Figure 38 Structure of credit institution placements



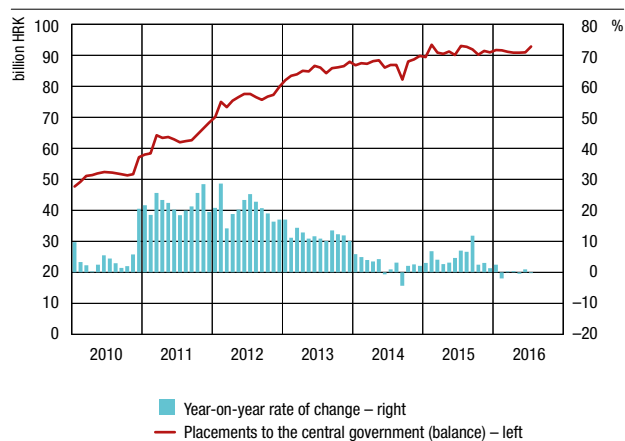
Source: CNB.

Figure 36 Placements to corporates



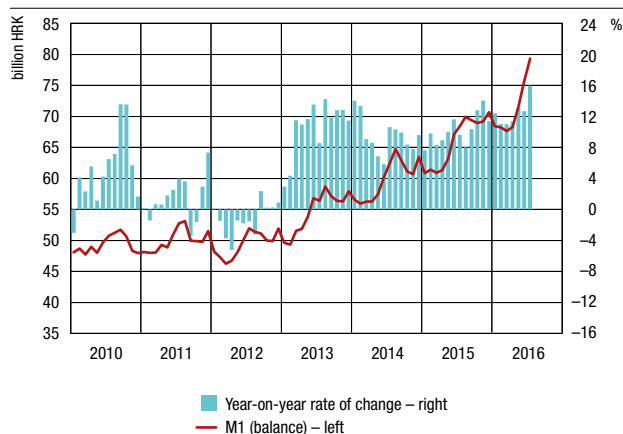
Source: CNB.

Figure 39 Credit institution and MMF placements to the central government



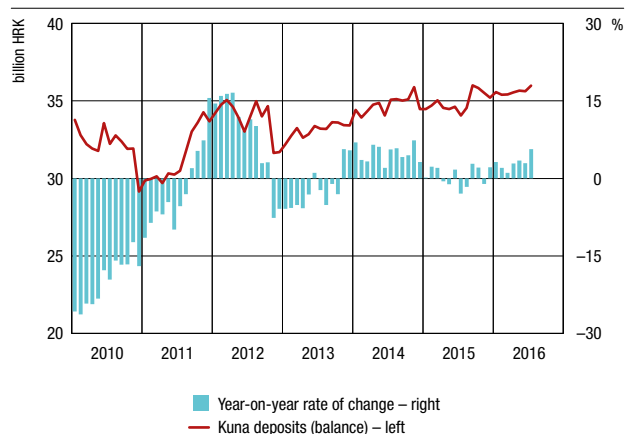
Source: CNB.

Figure 40 Money (M1)



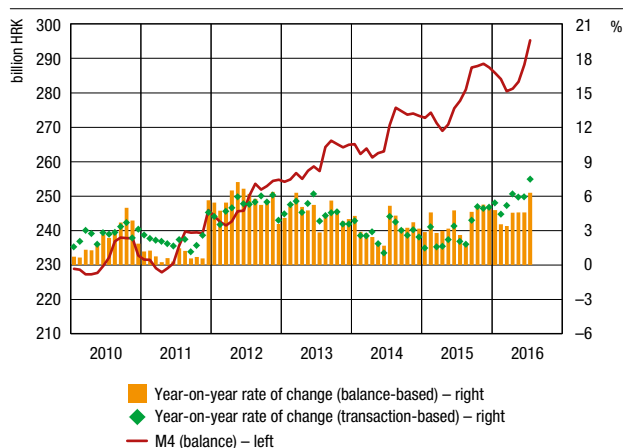
Source: CNB.

Figure 43 Kuna savings and time deposits



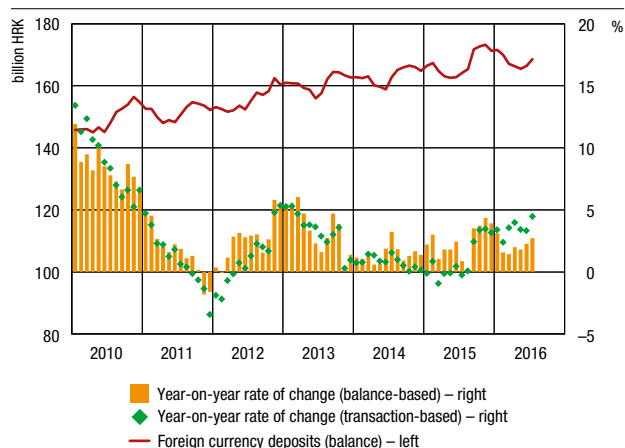
Source: CNB.

Figure 41 Total liquid assets (M4)



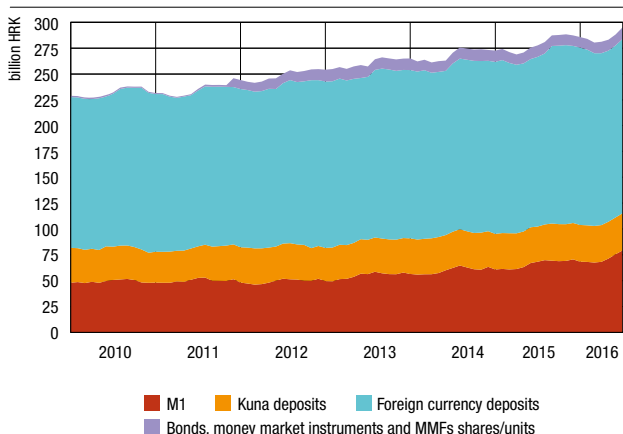
Source: CNB.

Figure 44 Foreign currency deposits



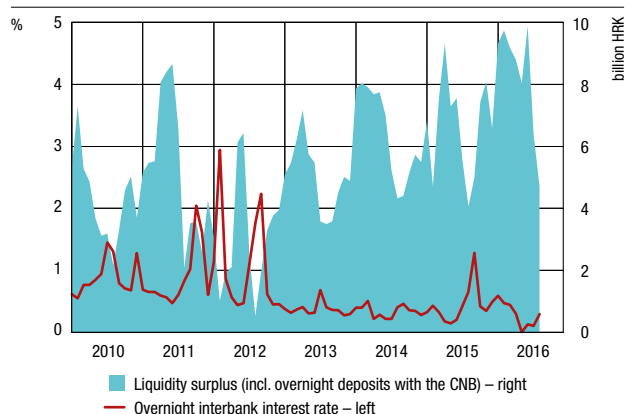
Source: CNB.

Figure 42 Structure of M4 monetary aggregate



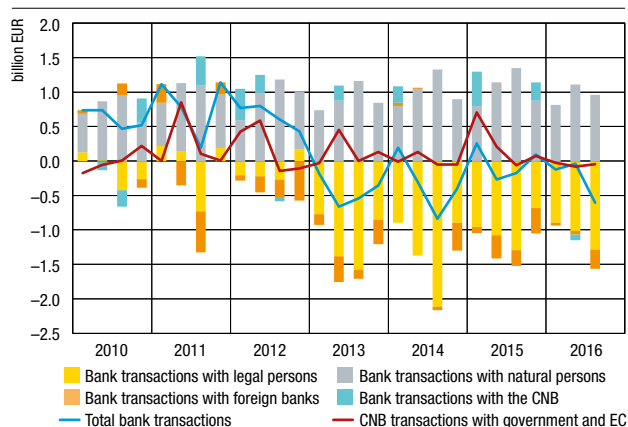
Source: CNB.

Figure 45 Bank liquidity and overnight interbank interest rate



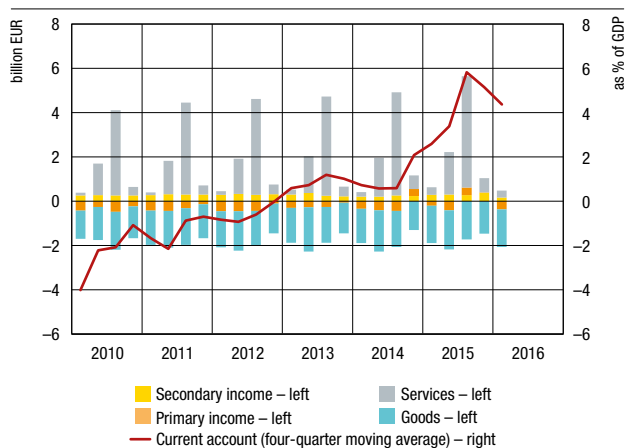
Note: Liquidity surplus is the difference between the balance in bank settlement accounts with the CNB and the amount that banks are required to hold in their accounts after the calculation of reserve requirements.

Source: CNB.

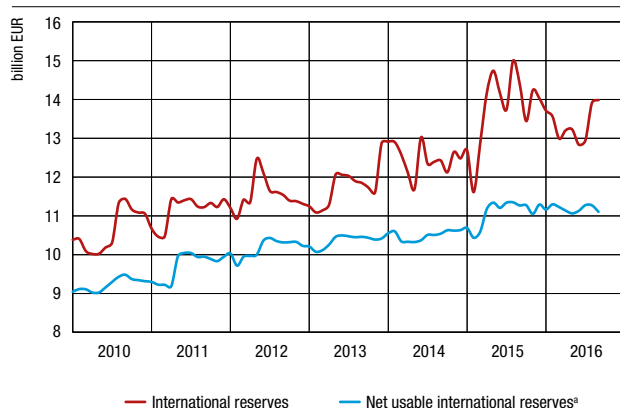
Figure 46 Spot transactions in the foreign exchange market (net turnover)

Note: Positive values denote net purchases and negative values denote net sales. Legal persons include the government. Data for the second quarter of 2016 refer to April and May.

Source: CNB.

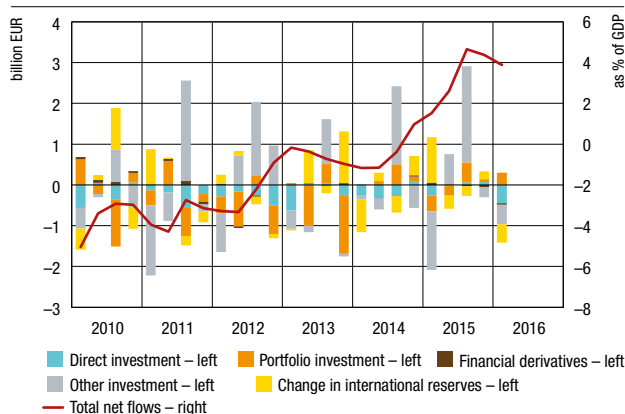
Figure 48 Current account flows

Source: CNB.

Figure 47 International reserves of the CNB at current rate of exchange

^a NUIR = international reserves – foreign liabilities – reserve requirements in f/c – foreign currency government deposits.

Source: CNB.

Figure 49 Financial account flows

Note: A positive value denotes net outflow of equity abroad (including on the basis of the growth in international reserves). Total net capital flow series are shown as a four quarter moving average.

Source: CNB.

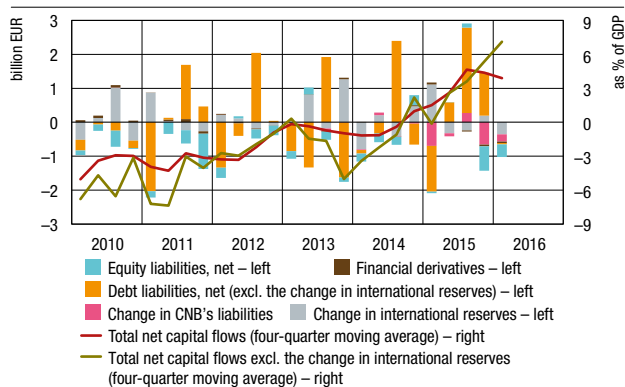
Table 2 Balance of payments^a

preliminary data, in million EUR

	2015	Q1/2015	Q1/2016	Indices	
				2015/ 2014	Q1/2015/ Q1/2016
Current account	2,259.8	-1,263.5	-1,587.5	251.6	125.6
Capital account	312.4	34.6	64.6	365.7	186.6
Financial account (excl. reserves)	1,176.7	-2,032.8	-670.3	124.6	33.0
International reserves	745.3	1,115.4	-447.7		
Net errors and omissions	-650.2	311.5	404.9	114.2	130.0

^a In line with the 6th edition of the Balance of Payments and International Investment Position Manual (BPM6).

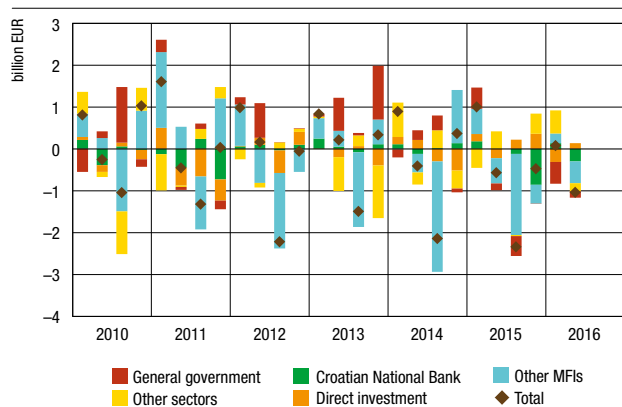
Source: CNB.

Figure 50 Financial account flows by type of investment

Note: A positive value denotes net outflow of equity abroad. The change in CNB's assets includes the change in gross international reserves and funds in the dedicated cash account in TARGET2-HR. Net liabilities represent the difference between the change in assets and the change in liabilities. Total net capital flow series are shown as a four-quarter moving average.

Source: CNB.

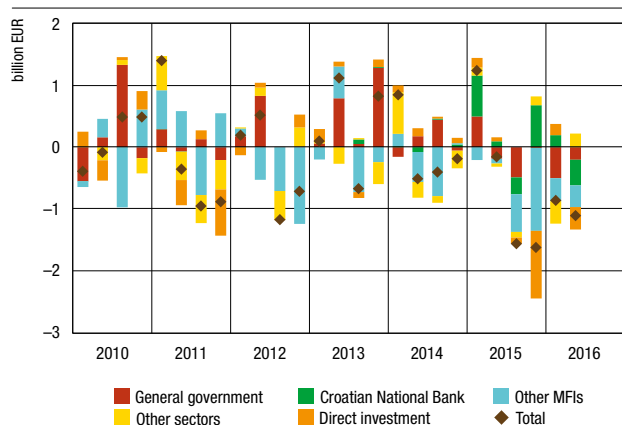
Figure 51 Net external debt (NED) transactions



Note: Transactions refer to the change in debt excl. cross-currency changes and other adjustments. Net external debt is calculated as gross external debt stock net of foreign debt claims.

Source: CNB.

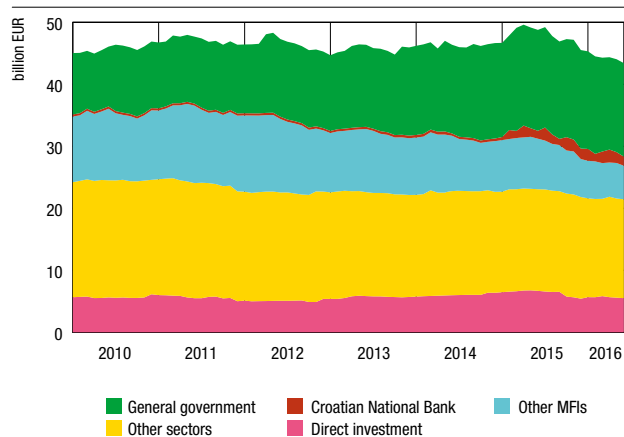
Figure 52 Gross external debt (GED) transactions



Note: Transactions refer to the change in debt excl. cross-currency changes and other adjustments.

Source: CNB.

Figure 53 Gross external debt end of period



Source: CNB.

Table 3 Consolidated general government balance

ESA 2010, in million HRK

	Jan. – Mar. 2015	Jan. – Mar. 2016
Total revenue	32,658	35,606
Direct taxes	4,271	6,410
Indirect taxes	14,203	14,428
Social contributions	9,508	9,808
Other	4,676	4,960
Total expenditure	38,242	37,794
Social benefits	13,273	13,771
Subsidies	1,748	1,169
Interest	2,951	2,988
Compensation of employees	9,132	8,865
Intermediate consumption	6,417	6,003
Investment	2,008	2,345
Other	2,713	2,654
Net lending (+) / borrowing (-)	-5,583	-2,188

Sources: Eurostat and CBS.

Table 4 Consolidated central government net borrowing

GFS 2001, in million HRK

	Jan. – May 2015	Jan. – May 2016
1 Revenue	48,847	52,950
2 Disposal of non-financial assets	142	144
3 Expenditure	53,088	54,127
4 Acquisition of non-financial assets	1,218	1,416
5 Net borrowing (1 + 2 – 3 – 4)	-5,317	-2,448

Sources: MoF and CNB calculations.

Table 5 General government debt

in million HRK

	Jan. – May 2015	Jan. – May 2016
Change in total debt stock	5,679	-4,628
Change in domestic debt stock	3,013	2,671
– Securities other than shares, short-term	-2,214	-210
– Securities other than shares, long-term	4,934	5,844
– Loans	302	-2,967
Change in external debt stock	2,666	-7,300
– Securities other than shares, short-term	-368	-40
– Securities other than shares, long-term	4,419	-4,551
– Loans	-1,384	-2,708
Memo item:		
Change in total guarantees issued	-425	115

Source: CNB.