Information on economic, financial and monetary developments

April 2024

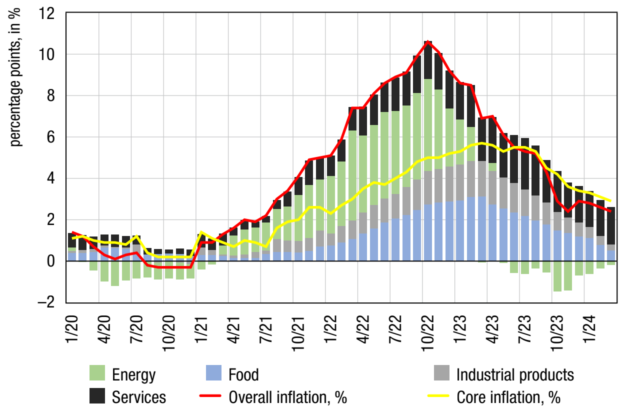
Summary

After stagnating in 2023, the euro area economy is likely to have recovered very modestly in early 2024 (Figure 1). Most of the available projections and model estimates for the first quarter of 2024 point to a marginal growth of 0.1% on a quarterly basis. However, prospects for any significant recovery in the first half of the year are very slim against the backdrop of elevated funding costs, sluggish foreign demand and high uncertainty regarding the war in Ukraine, with the approaching date of the US presidential elections also adding to uncertainty about the direction of future macroeconomic policies. This is confirmed by the latest available monthly indicators of euro area economic activity, such as the purchasing manager index (PMI) and the economic sentiment index (ESI), which have recovered mildly, but remain below or on the dividing line between expansion and contraction. Bearing in mind the widely divergent trends across member states, the modest overall performance mostly reflects a broad-based weakness in industrial production, retail trade and construction.

Euro area inflation measured by the harmonised index of consumer prices continued to decline in March, to 2.4%, after being 2.6% in February, according to Eurostat's flash estimate (Figure 2). The slowdown in inflation was largely due to the easing of inflationary pressures arising from movements in producer and import prices. In terms of components, the slowdown in euro-area inflation was mostly driven by the decline in food inflation (from 3.9% in February to 2.7% in March). By contrast, the inflation of energy prices picked up, from –3.7% in February to –1.8% in March, reflecting an unfavourable base effect, that is, a considerable monthly decrease in energy prices in March last year that is no longer included in the year-on-year inflation calculation. Euro area core inflation (excluding energy and food prices) continued to decelerate, having fallen from 3.1% in February to 2.9% in March. This was entirely due to the slowdown in industrial product inflation to 1.1%, from 1.6% in February, while inflation of service prices levelled off at 4.0% in March, for the fifth consecutive month. The ongoing relatively strong increase in wages is an important factor contributing to persistent inflation of service prices in the euro area. The momentum indicator for service inflation, that is, the annualised quarterly rate of services price inflation, which is a good indicator of current inflationary pressures, rose to 4.3% in March, a level significantly above its long-term average, while momentums of other inflation components were lower.

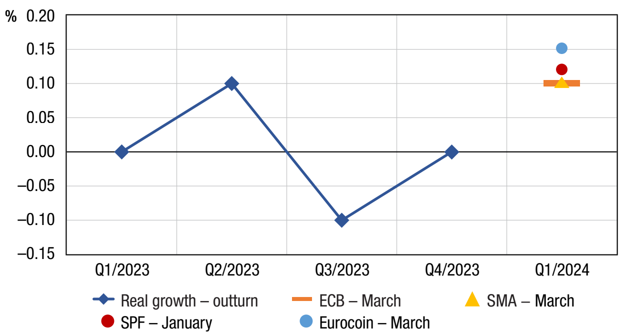
The available monthly data, included in the CNB's nowcasting model of economic activity (MRGA), suggest that strong economic growth in Croatia continued into early 2024 (Figure 3). Croatia's real GDP in the first quarter of the year could rise by 1.3% from the last quarter of 2023, while its annual growth rate might accelerate to 4.6%. Monthly data for January and February point to steady, robust growth in domestic demand. The sharp increase in real retail trade turnover (Figure 4), present since mid-2023, continued, spurred mostly by still resilient personal consumption supported by favourable labour market developments and the growth in the real disposable income of households. The volume of construction works also grew perceptibly (data available only for January), mirroring the rise in investments in the construction of buildings as well as civil engineering works, mostly associated with investment activity of the public sector. Available data also point to favourable developments in the services sector, with tourist arrivals

Figure 2 Inflation indicators in the euro area



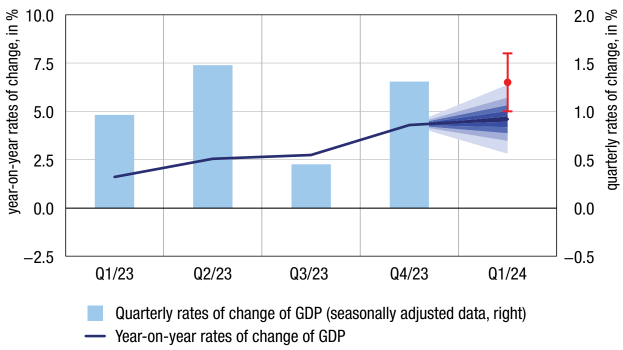
Notes: Core inflation is measured by the harmonised index of consumer prices, which excludes energy, food, alcoholic beverages and tobacco prices. The last available data refer to the first estimate for March 2024.
Sources: Eurostat and CNB calculations.

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



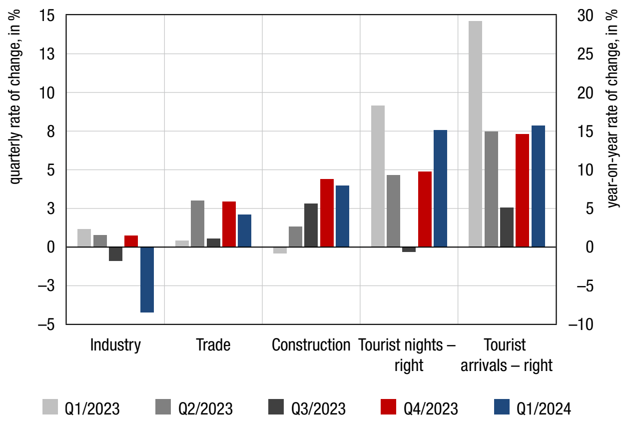
Notes: Abbreviation ECB – March refers to ECB March projections of real growth in the euro area (Macroeconomic Projection Exercise, MPE). Abbreviations SMA (Survey of Monetary Analysts) and SPF (Survey of Professional Forecasters) refer to the results of the ECB survey of market participants in March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

Figure 3 Quarterly gross domestic product



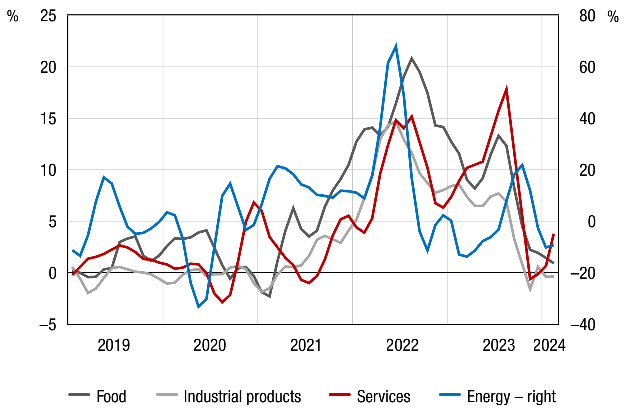
Notes: The estimate for the first quarter of 2024 refers to the Monthly indicator of real economic activity of the CNB (for more details on the calculation of the MRGA indicator, see CNB survey Kunovac, D., and B. Špalat: "Nowcasting GDP Using Available Monthly Indicators"). The models are estimated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



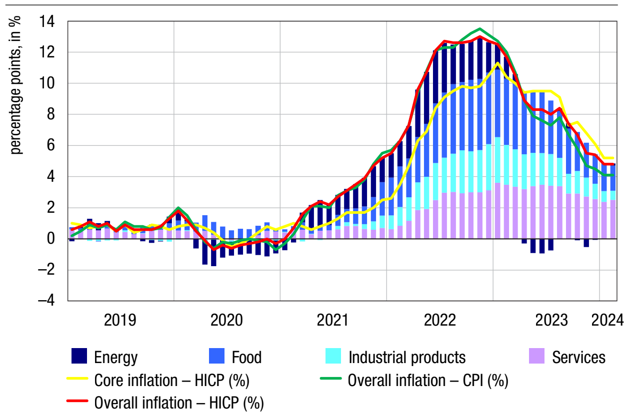
Note: Data on industry and trade in the first quarter of 2024 refer to January and February, while data on construction refer to January 2024.
Sources: CBS and eVisitor.

Figure 6 Momentums of the main inflation components



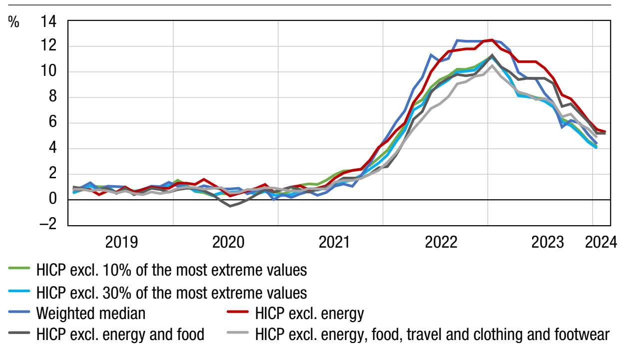
Note: The quarter-on-quarter rate of change on an annual level is calculated from the quarterly moving average of seasonally adjusted harmonised consumer price indices.
Sources: Eurostat and CNB calculations.

Figure 5 Inflation indicators in Croatia



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

and nights, according to eVisitor data, growing by around 15% on an annual level, also due to the earlier Easter holidays this year. By contrast, developments in industry remained relatively unfavourable; following a sharp downturn in late 2023 and stagnation in January, industrial production again dropped significantly in February, with the decrease being broadly based. This might also indicate a contraction in the exports of goods, after the slight increase in late 2023. Leading indicators suggest that business optimism in industry picked up noticeably in March, to above its long-term average, with favourable trends also seen in other activities.

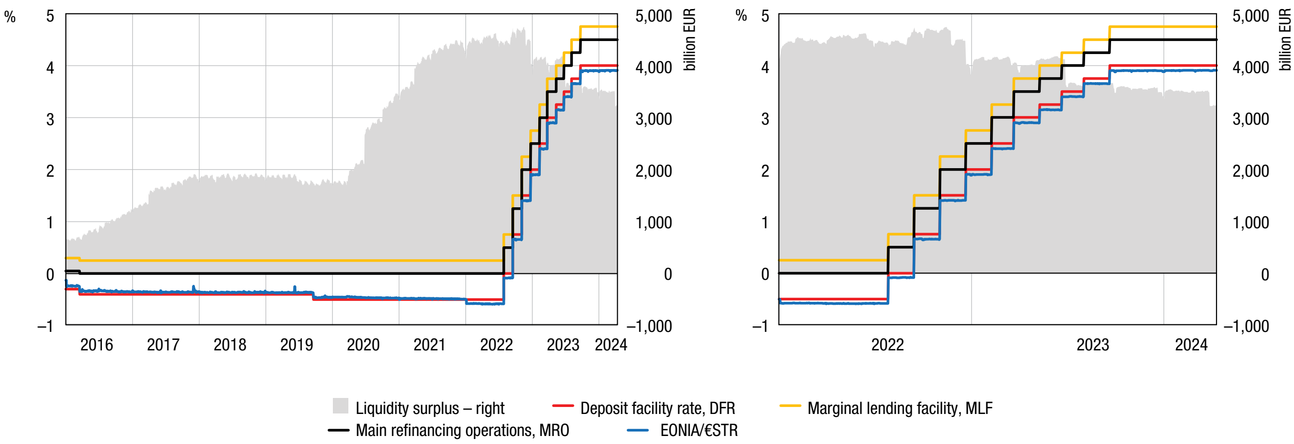
According to Eurostat's first estimate, overall annual inflation in Croatia measured by the harmonised index of consumer prices (HICP) edged up to 4.9% in March, after being 4.8% in the first two months of 2024.[1] The slight pickup in overall inflation (Figure 5) was fuelled by the rise in the annual growth rate of services prices (from 7.8% in February to 8.0% in March) driven by mounting current pressures in the services sector and the increase in the annual growth rate of energy prices (from 1.1% in February to 2.1% in March) due to a monthly increase in the prices of refined petroleum products. Industrial product inflation remained at 2.3% in the same period. Core inflation, the calculation of which excludes the prices of energy and food, also rose marginally, from 5.3% in February to 5.4% in March, due to the rise in services price inflation. By contrast, the annual rate of food prices inflation slowed down from 5.5% in February to 5.0% due to a positive base effect (that is, the exclusion of the high monthly growth rate of food prices last March from the calculation of the annual inflation rate), while current pressures on food prices remained at bay.

In spite of a mild increase in the previous two months, short-term indicators of current inflation remained relatively low and below long-term averages for all the main components of inflation except services. Overall inflation momentum[2] rose to 2.3% in March 2024 (from 1.4% in February), which is only slightly higher than the pre-pandemic long-term average

1 According to the first CBS estimate, inflation in Croatia, measured by the national consumer price index, remained at 4.1% in March.

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

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.

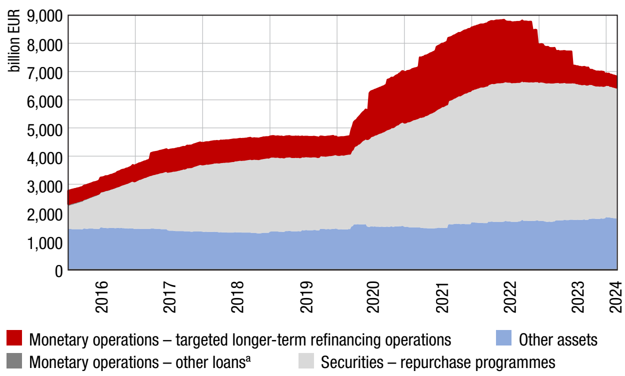
of 2.2%. However, somewhat more pronounced current inflationary pressures arising from services prices (Figure 6), whose momentum picked up further in March, remained much lower than in mid-2023. By contrast, the momentums of other main components of inflation were low and below their long-term averages. Only the momentum of energy prices grew slightly in March, but remained negative.

Amid the fading impact of past shocks and stronger impact of favourable base effects compared with the beginning of the year, the forthcoming months are expected to witness a slowdown in the annual rate of consumer price inflation, despite the lingering risks associated with movements in the prices of services. Inflationary pressures arising from the earlier stages of the price chain eased significantly. 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 February 2024, when inflation dropped to 1.3%, down by 16 percentage points from the peak in October 2022. The annual growth rate of producer prices of durable consumer goods and the annual rate of change in the prices of intermediate goods were also at low levels (0,6% and –1.3%, respectively). Both indicators were around 13 percentage points below their peaks in the second half of 2022. However, in conditions of slightly slower, but still pronounced growth in labour costs, there are noteworthy risks related to the movements in services prices.

At a meeting held on 11 April, 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 continued to fall, primarily led by lower food and goods price inflation, while strong domestic price pressures were keeping services price inflation high. In addition, the Governing Council of the ECB considered that the key interest rates were at levels that make a substantial contribution to the timely return of inflation to its target level. If the updated assessment of the inflation outlook, the dynamics of core inflation and the strength of monetary policy transmission were to further increase the Governing Council's confidence that inflation is converging to the target in a sustained manner, it would be appropriate to reduce the current level of monetary policy restriction. 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 Governing Council is not pre-committing to a particular rate path.

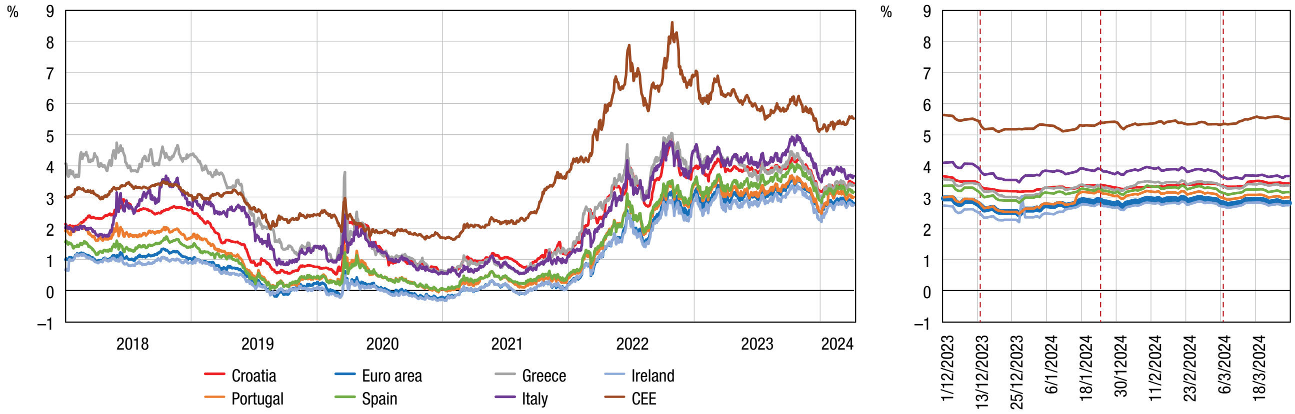
The size of the Eurosystem's balance sheet has continued to decrease gradually (Figure 9)**.** Banks are still repaying amounts borrowed under the targeted longer-term refinancing operations, whereas the portfolio of securities purchased within the asset purchase programme (APP) is declining steadily 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.

Figure 9 Eurosystem balance sheet



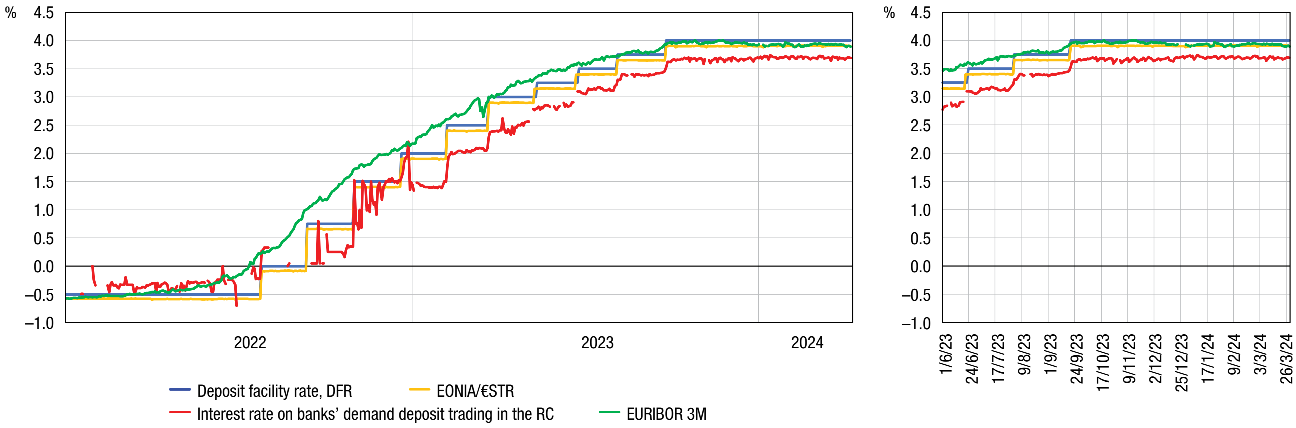
[a] Other loans include main refinancing operations, fine-tuning reverse operations, structural reverse operations, marginal lending facility and credits related to margin calls.
Note: The Eurosystem monetary balance sheet asset items are shown in grey and red and non-monetary in blue.
Source: ECB.

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



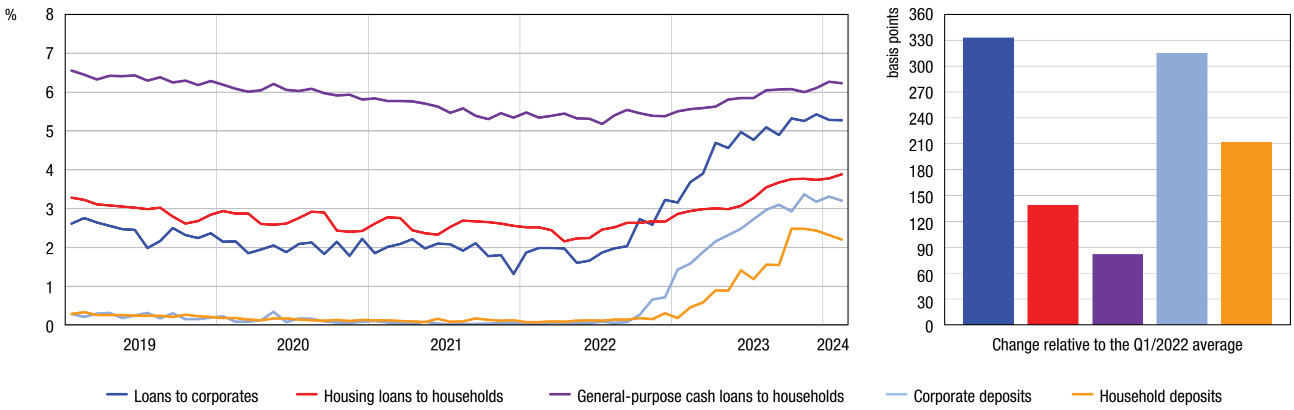
Notes: CEE – countries of Central and Eastern Europe (the Czech Republic, Hungary, Poland and Romania); yields for the euro area and CEE have been weighted by the share of GDP of the countries included. Data from the euro area do not include those from Estonia, Latvia, Luxembourg and Malta. The red dotted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

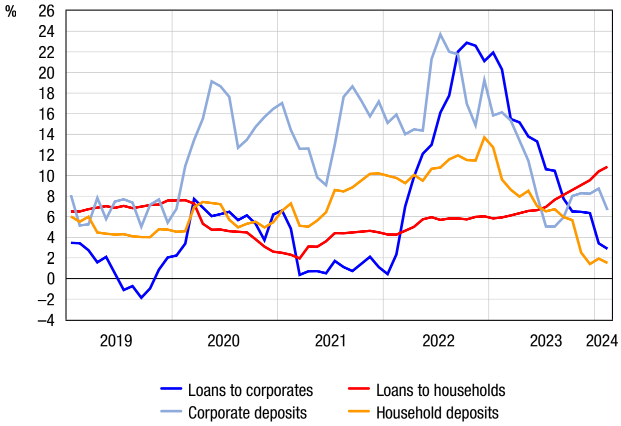
Stock indices in global financial markets continued on their upward trend in March, while there were no significant changes in bond and interbank markets. The substantial upturn in the value of global stock indices, present since November 2023, continued for the most part. Some indices hit new record highs, e.g. in the euro area the German DAX index exceeded 18.500 points, while the French CAC index went over 8.200 points. The growth in global stock indices reflects increasing risk appetite, that is, more favourable economic trends. In bond markets, the euro area GDP-weighted average of long-term government bond yields dropped mildly in March, by 11 basis points, to 2.8% (Figure 10). This was a result of the reduction of the risk premium, primarily on bonds of the peripheral euro area countries[3]. Yields on Croatian bonds also followed this trend. In early March 2024, the government issued a eurobond worth EUR 1.5bn maturing in 2034. The bond has a yield of 3.4%, i.e. around 110 basis points more than the German bond of similar maturity. The yield spread for bonds of that maturity was falling towards 100 basis points during March, but rose to around 110 basis points at the end of the month. The three-month EURIBOR moved within a narrow range around 3.9% in March, the same as at end-February (Figure 11).

Interest rates on corporate loans remained unchanged in February, while loans to households for house purchase were more expensive and loans for other purposes were slightly cheaper. After falling by 14 basis points, corporate borrowing costs at banks levelled off in February at the January level of 5.3% (Figure 12). The negative contribution of interest rates on investment and other loans was offset by the positive impact of interest rates on factoring. In terms of size, interest rates on loans to micro enterprises decreased, while rates on loans to medium-sized enterprises increased. The interest rate on pure new housing loans averaged 3.9% in February, up by 10 basis points from January, while the rate on general-purpose cash loans was 4 basis points lower than in January (6.2%). Interest rates are thus starting to stabilise at the levels seen in late 2023 and early 2024 (5.4% on corporate loans in December 2023 and 6.3% on general-purpose cash loans in January 2024), with only interest rates on housing loans still trending slightly higher. Interest rates on existing loans, i.e. on their stocks, continued to rise at a marginal pace. The average interest rate on the stock of corporate loans was 2 basis points higher in February than in January, reaching 4.5%, while interest rates on the stock of housing and general-purpose cash loans went up by only one basis point, still remaining lower than in early 2022, which reflects the relatively long average maturity of loans, the considerable share of fixed interest rates, the domination of the national reference rate (NRR) in the reference parameters and legal restrictions on the level of interest rates on variable interest rate loans.

Interest rates on corporate and household time deposits were somewhat lower in February than in January. The average interest rate on pure new household time deposits fell by 12 basis points from January, to 2.2%. As in January, the share of deposits with shorter maturities (from 3 to 6 months) was substantial, while the share of maturities from 6 to 12 months decreased. More specifically, in anticipation of lower key interest rates, banks raised their interest rates on deposits with shorter maturities and lowered the interest rates on slightly longer maturities, thereby increasing the attractiveness of short-term deposits. Notwithstanding the still present differences in deposit rates across banks, it is evident that individuals are increasingly less likely to transfer their deposits in search of higher yields, which has contributed to a decrease in interest rates on new deposits. Interest rates on corporate time deposits also fell in February, by 10 basis points from the previous month, to 3.2%. Interest rates on total deposits continued to rise, with rates on corporate and household deposits edging up to 0.9% and 0.5%, respectively. The interest rate on the stock of corporate time deposits grew by 3 basis points from January, reaching 2.9%, while the rate on the stock of household time deposits rose by 10% basis points, to 1.5%. At the same time, the interest rate on overnight corporate deposits increased by 2 basis points, to 0.14%, while the interest rate on household overnight deposits remained unchanged at 0.02%.

3 The peripheral countries recorded stronger economic growth than the euro area core countries in that period.

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



Source: CNB.

The growth in bank loans to non-financial corporations continued to decelerate in February, while the rise in household loans steadily accelerated. Loans to domestic sectors (excluding the general government) grew in February 2024 by EUR 0.2bn or 0.7% (transaction-based), largely due to the further increase in household loans (of EUR 0.2bn or 0.8%). This increase in household loans was mostly due to the continued sharp rise in general-purpose cash loans (of EUR 106m or 1.3%), while housing loans grew at a pace similar to that of the previous months, increasing by EUR 65m or 0.6% in February. On an annual level, the growth in household loans picked up further (from 10.4% in January to 10.9% in February, transaction-based), driven by the acceleration in general-purpose cash loans from 12.2% to 12.8%, a rate last seen in March 2019, and the slightly faster increase in housing loans, from 10.5% to 10.8% (Figure 13). The more rapid annual growth in housing loans is largely a result of the base effect given the fact that February 2023 was marked by the absence of any significant increase in housing loans as their rise was concentrated in late 2022, ahead of the notable increase in interest rates and after the beginning of another round of the housing loans subsidy programme. By contrast, corporate lending, which dropped sharply in January, almost entirely due to the repayment of a syndicated loan granted to companies in the energy sector, was subdued in February, amounting to only EUR 48m. The annual growth in corporate loans continued to lose steam, falling from 3.4% to 2.9%.

Domestic deposits declined in February as well. Total domestic deposits (excluding those of the general government) dropped by as much as EUR 1.4bn in February, or 2.4% from the previous month (transaction-based), mostly reflecting a decrease in household deposits (of EUR 0.9bn), with overnight deposits falling and time deposits growing marginally. The fall in household transaction account balances was associated with investments in T-bills that bring higher yields than time deposits with banks, which also increased the balance of government deposits with the CNB. The share of time deposits in total household deposits steadily increased, albeit at a slightly slower pace than in the previous months, reaching 28.5% in February 2024, up from 23% in mid-2023. Corporate deposits also shrank in February (by EUR 0.4bn), with the bulk of the decrease being attributable to overnight deposits (EUR 0.3bn), whereas time deposits accounted for a minor share of the decrease (EUR 0.1bn).