



Information on economic trends

November 2016

Summary

Monthly indicators suggest that in the third quarter of 2016 economic activity intensified under the predominant influence of favourable results in tourism. Favourable trends in the labour market continued, at a weaker intensity, however, than in the first half of the year. The annual fall in consumer prices slowed down from -1.5% in August to -0.9% in September. Throughout September and early in the fourth quarter, the CNB continued its expansionary monetary policy by increasing the funds placed through regular weekly reverse repo operations, as well as by lowering the fixed repo rate. In the first nine months of the year, total placements to domestic sectors (excluding the central government) expanded by 1.1% (transaction-based), boosted by more vigorous lending to corporates. Fiscal data for the first half of the year indicate that a strong fiscal adjustment was achieved, and favourable developments continued throughout the summer.

The GDP nowcasting model¹ shows a strong acceleration in current economic activity in the third quarter of 2016 aided by the favourable results of the peak tourist season (Figure 1). The real retail trade turnover growth also accelerated in the third quarter this year from the average in the past two quarters (Figure 7). Having fallen in July and August, industrial production increased significantly in September, stagnating at the quarterly level (Figure 3). The real volume of construction works fell in July and August after a slightly more favourable dynamics was seen at the turn of the year (Figure 5). Business confidence grew in the third quarter across the majority of the activities under review (excluding the trade sector) and similar trends continued to be observed in October. Business confidence in construction has thus shown an upward trend, noticeable since the beginning of 2015. After having been on a downward slope since the beginning of the year, confidence in industry grew as well, as did confidence in the services sector (Figure 8).

Employment continued to rise but at a slower pace than over the previous two quarters. For the most part the growth in employment reflects the increase in the number of the employed in service activities of the private sector, while the positive contribution of other activities was negligible (Figure 14). The third quarter was also marked by the continued decline in the number of the unemployed. However, the dynamics was slower than in the first half of 2016 due to fewer removals from the CES register on account of non-compliance with legal provisions, failure to report, registration cancellation or outflow from the labour force. The registered unemployment rate went down from 15.1% in the second quarter to 14.5% in the third quarter of 2016 (Figure 15). With respect to wages, both gross and net wages fell slightly in the third quarter in contrast to the previous three quarters, when wages grew on a quarterly basis (Figure 16).

The indicators of current development in inflation increased in September, getting into positive territory (Figure 17). Consumer prices went up by 1.1% in September on a monthly level (Table 1). The largest contribution to this came from an increase in industrial producer prices, primarily those of clothing and footwear, whose seasonal growth was more pronounced than in the preceding years. Energy prices increased as well, especially prices of refined petroleum products due to the increase in global crude oil prices (Figure 19). The annual decrease in consumer prices slowed down, from -1.5% in August to -0.9% in September, primarily due to energy prices (Figure 18). Namely, the contribution of energy prices went down from -1.2 percentage points in August to -0.7 percentage points in September as a result of their growth at a monthly level and the base effect.

The annual decrease in the core CPI slowed down as well, from -0.7% in August to -0.1% in September, primarily as a result of the increase in industrial producer prices mentioned.

Trade in goods in the third quarter (according to data for July and August) was marked by unfavourable trends on the side of both exports and imports, which grew in the second quarter. Goods exports fell by 5.9% relative to the average of the previous three months (Figure 10). To a large extent, this was a consequence of unfavourable developments in the narrow aggregate, with ships and oil excluded (-6.3%), and was observed in a large number of activities, in particular exports of chemical products, leather manufactures, textile products, capital equipment, road vehicles and miscellaneous manufactured articles. In contrast, exports of ships, oil and refined petroleum products trended up. Concurrently, imports of goods fell by 0.7% in July and August (Figure 11), a downward trend being recorded in the majority of activities. On the other hand, the upward trend continued in imports of medical and pharmaceutical products and capital equipment (Figure 12).

The kuna/euro exchange rate was stable in October. At the end of the month it stood at EUR/HRK 7.50, down by only 0.2% on the end of September (Figure 21). Similarly, the index of the nominal effective kuna exchange rate at the end of October was almost equal to its value at the end of the previous month (Figure 22). The weakening of the kuna against the US dollar and the yuan renminbi was offset by the strengthening of the kuna against the pound sterling.

The continued expansionary monetary policy of the ECB and abundant banking sector liquidity in the euro area during September and October 2016 triggered a further fall in euro benchmark interest rates. The six-month EURIBOR stood at -0.21% at the end of October, while the overnight interest rate EONIA was -0.35% (Figure 24). The assessed general degree of risk in European emerging market economies also decreased (Figure 25) as did the financing costs for parent banks of the largest domestic banks (Figure 26) and the risk premium for Croatia. This premium still remained much higher than in Central and Eastern European peer countries (Figure 25), although the difference continued to shrink in the period under review. At the end of October, the risk premium for Croatia totalled 226 basis points.

The CNB continued to support high liquidity in the domestic financial market through its monetary policy measures. Therefore the money market activities of credit institutions remained weak, the weighted interest rate on overnight interbank loans in October totalling 0.42% (Figure 27). An auction of MoF T-bills was held in October, at which one-year kuna and euro T-bills were placed at the lowest interest rates thus far: totalling 0.80%

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

for kuna and 0.17% for euro T-bills (Figure 28).

Lending and deposit interest rates of banks continued their fall in August and September 2016 (Figure 29). As for deposit interest rates, interest rates on euro corporate deposits decreased slightly, but within the limits of their usual monthly volatility range (Figure 31). Lending interest rates on all types of loans continued to fall, with a somewhat stronger fall being observed in interest rates on corporate loans (Figure 30). The overall interest rate spread on loan balances continued to rise, standing at 4.93 percentage points at the end of September (Figure 32).

Net foreign assets (NFA) and total liquid assets (NDA) went down in September (Figure 33) and thus their strong growth in the previous months came to an end. The growth in total liquid assets on an annual level, excluding the effect of exchange rate changes, totalled 5.5% at the end of September vis-à-vis the 5.0% in December 2015 (Figure 41). The annual growth in total liquid assets was predominantly a result of the increase in money (M1), whose growth rate increased to 14.3% in September, from 11.4% at the end of the previous year (Figure 40).

The credit activity of domestic credit institutions started increasing this year, stimulated by the recovery of economic activity. Despite stagnating in September, placements to domestic sectors (excluding the central government) increased cumulatively by 1.1% in the first nine months of the year, with corporate loans (2.7%) growing more than household loans (0.4%) (Figures 36 and 37). Thanks to this, a positive annual rate of change in placements, totalling 0.4% and calculated on the basis of transactions, was achieved for the first time since March 2014 (Figure 35). By contrast, the 5.1% annual decrease in the nominal value of placements 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-September 2016. This nominal decrease in placements was also influenced by the sale of banks' non-performing loans, which totalled HRK 3.9bn in the first half of 2016, of which placements to non-financial corporations accounted for the lion's share. This process is expected to continue at a similar intensity until the year end. Bank placements to the central government decreased in September. However, in the first nine months of 2016 they cumulatively increased, based on transactions, by 3.0%. Since August this year bank claims on the central government exceed their claims on non-financial corporations, while five years ago they were around half the size of corporate placements.

The CNB continued to pursue an expansionary monetary policy. The interest rate on regular weekly reverse repo operations was lowered from 0.5% to 0.3% in mid-September. The amount of funds placed through these operations increased substantially, their average balance in September totalling HRK 224.5m vis-à-vis the HRK 103.2m in the previous part of the

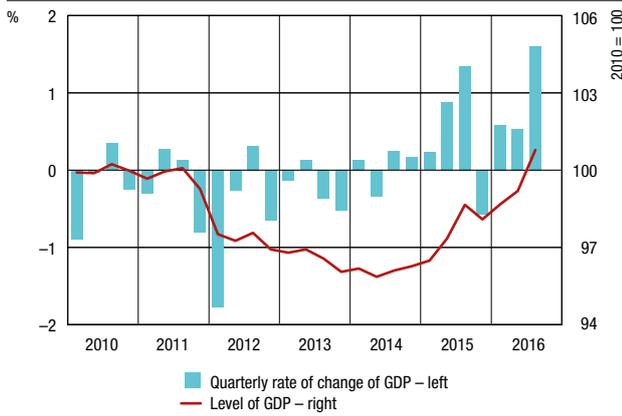
year. In addition to conducting regular weekly reverse repo operations, the CNB held three structural repo auctions, placing a total of HRK 945.9m to banks for a four-year term, with the interest rate at the last auction in July being lowered to 1.4%, from the 1.8% of the first two auctions.

After having fallen (by EUR 1.0bn) in the second quarter, net external debt (Figure 51) fell even further in July and August 2016 (by EUR 2.7bn), as a result of a growth in foreign claims that was several-fold higher than the increase in foreign liabilities (Figure 52). All domestic sectors improved their net foreign position, especially credit institutions, whose foreign assets exceeded the amount of liabilities to foreign creditors at the end of August by almost 5% of GDP. The central bank's positive net foreign position improved as well, aided by the growth of the foreign currency deposit of the government with the CNB, while the investment of international reserves in repo agreements contributed to a pronounced, equal growth of gross international reserves and foreign liabilities of the CNB. Net external debt of other domestic sectors decreased as a result of deleveraging to non-affiliated creditors. However, due to the mentioned growth of the central bank's liabilities total gross external debt increased by EUR 0.2bn in July and August, reaching EUR 43.7bn (Figure 53).

Fiscal data at the level of the general government (ESA 2010) indicate strong fiscal consolidation in the first half of 2016 (Table 3). The general government deficit was lowered to HRK 1.9bn, or by as much as HRK 6.6bn from the same period a year ago. The growth of all main revenues continued under the favourable influence of the economic cycle. The greatest contribution to this growth came from tax revenues, the rate of growth of direct taxes being particularly noticeable. The first half of 2016 also registered growth in the majority of expenditure categories, except for intermediate consumption. This growth was especially pronounced in the second quarter with the commencement of the regular execution of the state budget and financial plans of extrabudgetary funds. The greatest contribution to the increase in expenditures came from social benefits, reflecting a rise in expenditures on health care, pension insurance and social work activities.

The available consolidated central government data, on a cash basis (GFS 2001 methodology), indicate a stagnation in July and August 2016 on an annual level. By issuing kuna bonds and euro T-bills early in the second half of year, the government managed to refinance maturing liabilities at favourable terms and maintain high liquidity. The consolidated general government debt at the end of July was lower (due to the exchange rate effect and favourable fiscal trends) than at the end of last year, totalling HRK 288.9bn (Table 5). In addition, there were positive changes in the debt structure – the share of kuna debt instruments was enlarged and their maturity was extended.

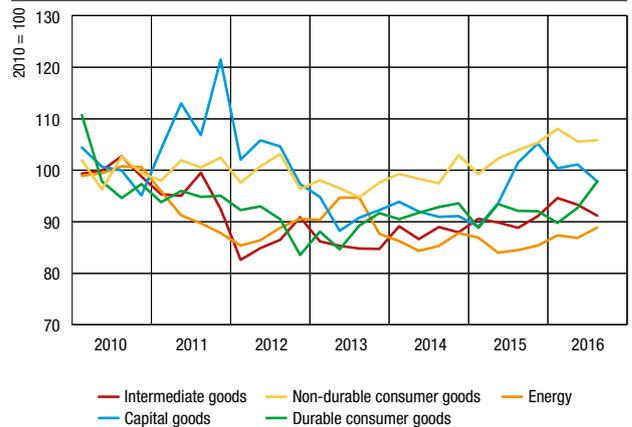
Figure 1 Quarterly gross domestic product seasonally adjusted real values



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 3 November 2016.

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

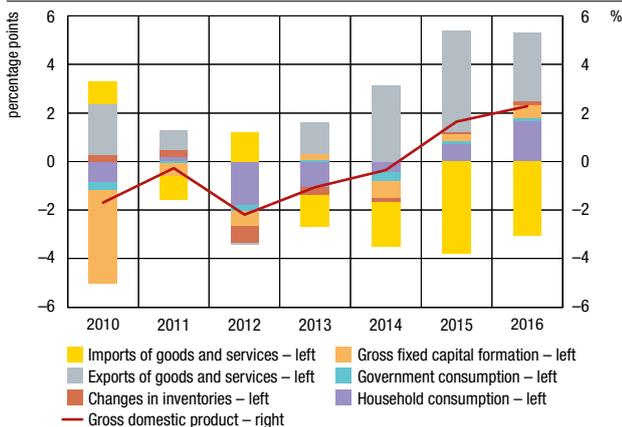
Figure 4 Industrial production by main industrial groupings seasonally adjusted indices



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

Source: CBS data seasonally adjusted by the CNB.

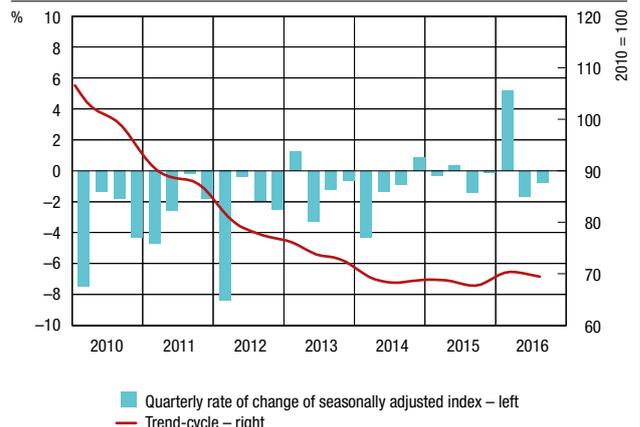
Figure 2 GDP rate of change contribution by components



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

Source: CBS.

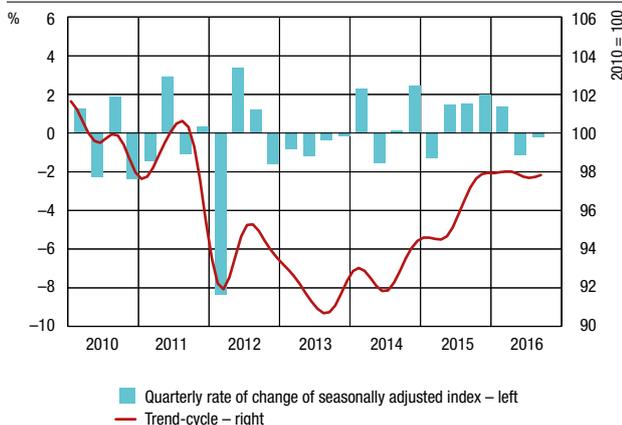
Figure 5 Total volume of construction works



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

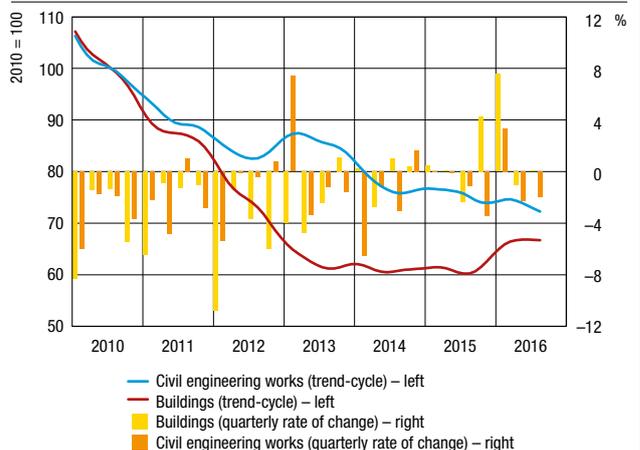
Source: CBS data seasonally adjusted by the CNB.

Figure 3 Industrial production



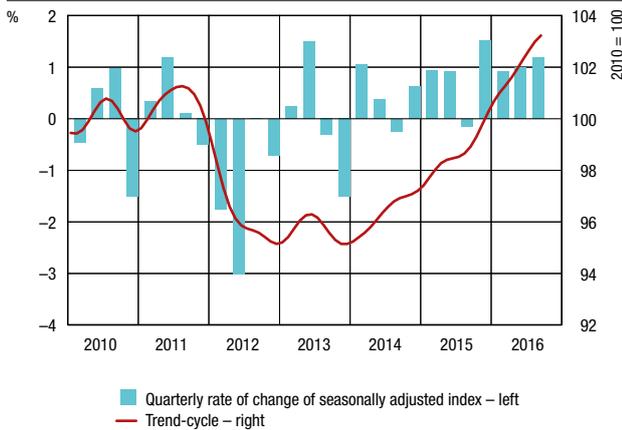
Source: CBS data seasonally adjusted by the CNB.

Figure 6 Buildings and civil engineering works



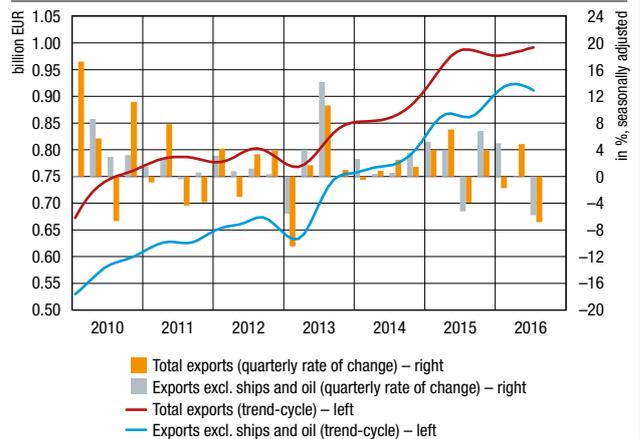
Source: CBS data seasonally adjusted by the CNB.

Figure 7 Real retail trade turnover



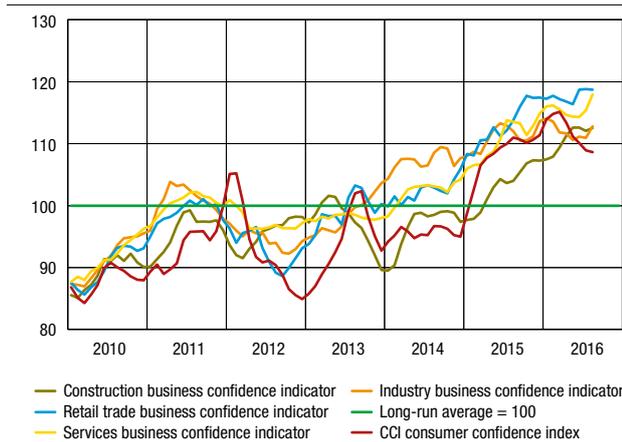
Source: CBS data seasonally adjusted by the CNB.

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



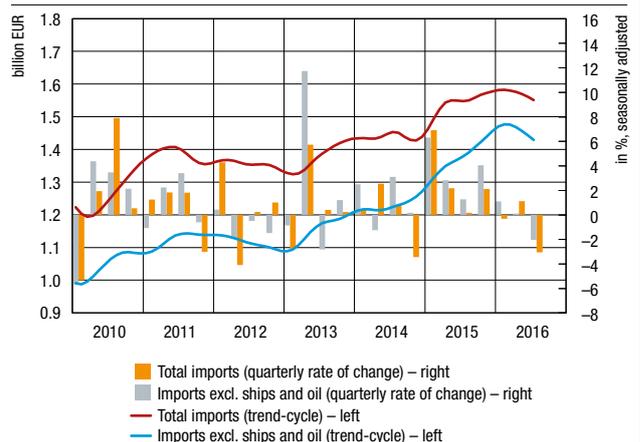
Note: Data for the third quarter of 2016 refer to July and August.
Source: CBS data seasonally adjusted by the CNB.

Figure 8 Business confidence indicators standardised and seasonally adjusted values, three-member moving averages



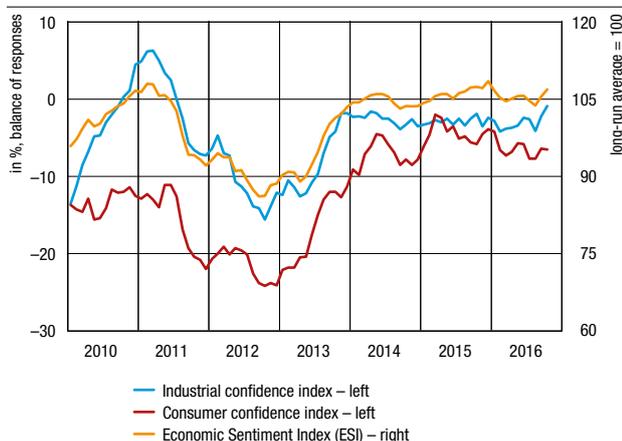
Sources: Ipsos and CNB data seasonally adjusted by the CNB.

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



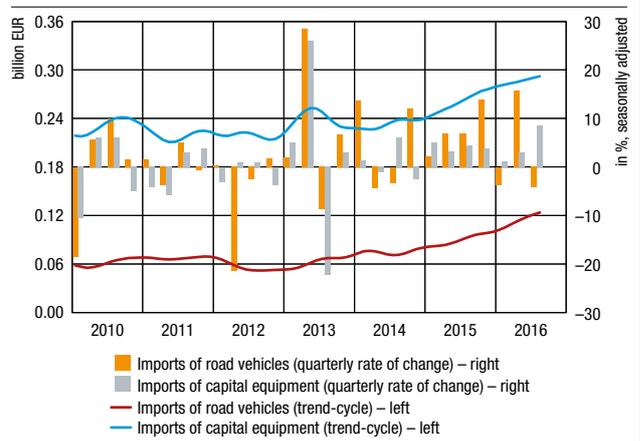
Note: Data for the third quarter of 2016 refer to July and August.
Source: CBS data seasonally adjusted by the CNB.

Figure 9 EU confidence indices seasonally adjusted series



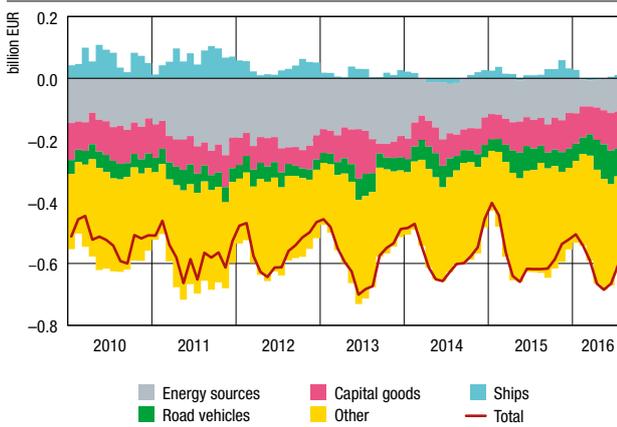
Source: Eurostat.

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



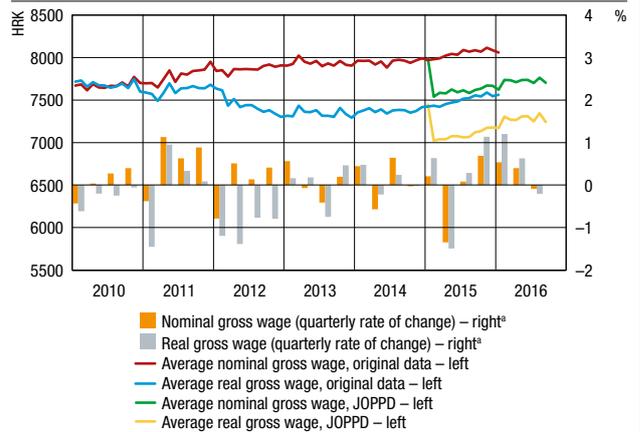
Note: Imports of capital equipment (SITC divisions 71 - 77). Data for the third quarter of 2016 refer to July and August.
Source: CBS data seasonally adjusted by the CNB.

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



Source: CBS.

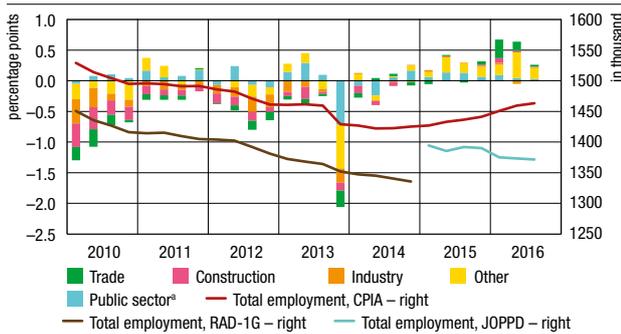
Figure 16 Average gross wages
seasonally adjusted series



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

Source: CBS data seasonally adjusted by the CNB.

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

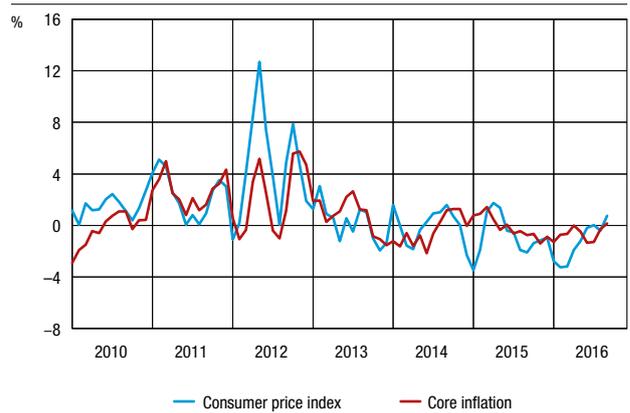


^a Public administration and defence, compulsory social security, education and human health and social work activities.

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.

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

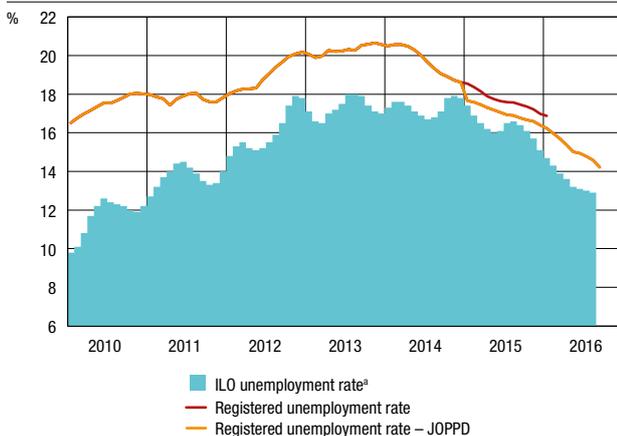
Figure 17 Consumer price index and core inflation
annualised month-on-month rate of change^a



^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.

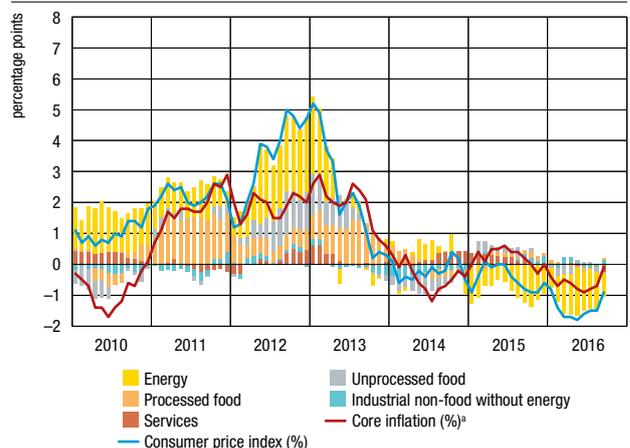
Figure 15 Registered and ILO unemployment rates
seasonally adjusted series



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

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

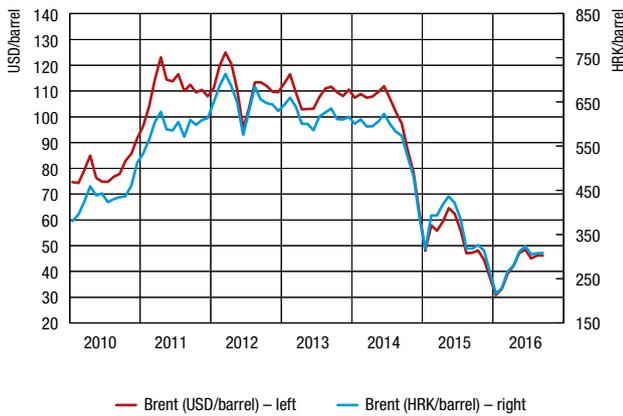
Figure 18 Year-on-year inflation rates and components' contribution to consumer price inflation



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

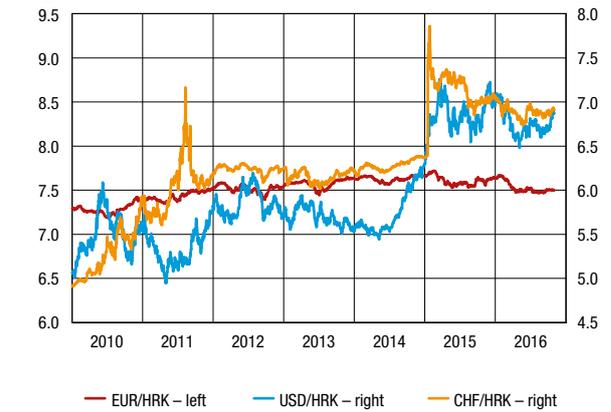
Sources: CBS and CNB calculations.

Figure 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



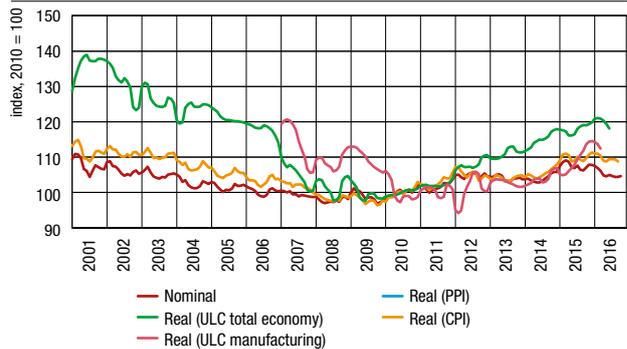
Source: CNB.

Table 1 Price indicators
year-on-year and month-on-month rates of change

	Year-on-year rates		Month-on-month rates	
	8/16	9/16	9/15	9/16
Consumer price index and its components				
Total index	-1.5	-0.9	0.4	1.1
Energy	-6.9	-4.2	-1.5	1.3
Unprocessed food	-1.3	-0.8	-0.9	-0.4
Processed food (incl. alcoholic drinks and tobacco)	-0.1	0.2	0.0	0.3
Industrial non-food without energy	-0.3	0.6	3.0	3.9
Services	-0.1	-1.0	0.5	-0.4
Other price indicators				
Core inflation	-0.7	-0.1	0.7	1.3
Index of industrial producer prices on the domestic market	-5.0	-3.0	-0.5	1.5
Brent crude oil price (USD)	-1.8	-2.2	0.5	0.1
HWWI index (excl. energy) ^a	4.9	4.5	-0.9	-1.3

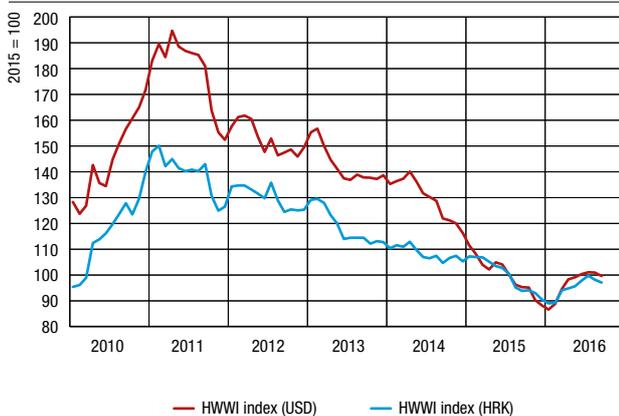
^a The index is calculated on the basis of raw materials prices expressed in US dollars.
Sources: CBS, Bloomberg, HWWI and Eurostat.

Figure 22 Nominal and real effective exchange rates of the kuna



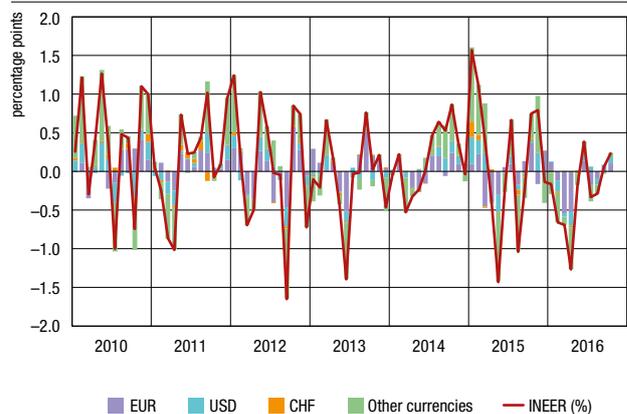
Note: Real effective exchange rate of the kuna deflated by producer prices includes the Croatian index of industrial producer prices on the non-domestic market, which is available from January 2010. The unit labour cost is calculated as the ratio between compensation per employee and labour productivity (expressed as GDP per person employed), while the 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 20 HWWI index (excl. energy)



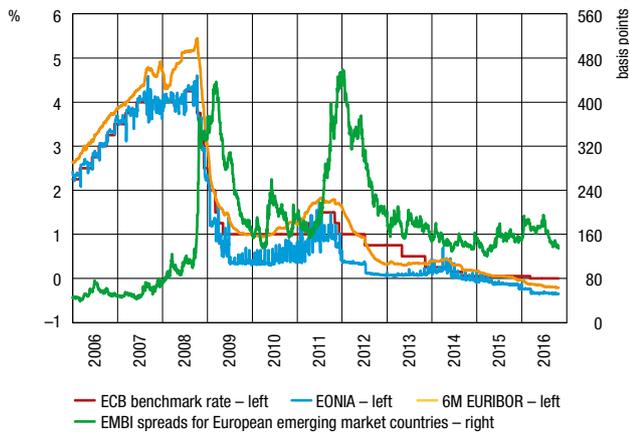
Sources: HWWI and CNB calculations.

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)



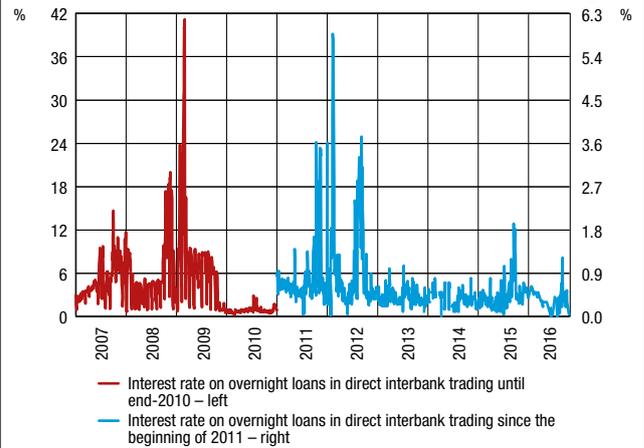
^a Negative values denote contributions to the appreciation of the INEER.
Source: CNB.

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



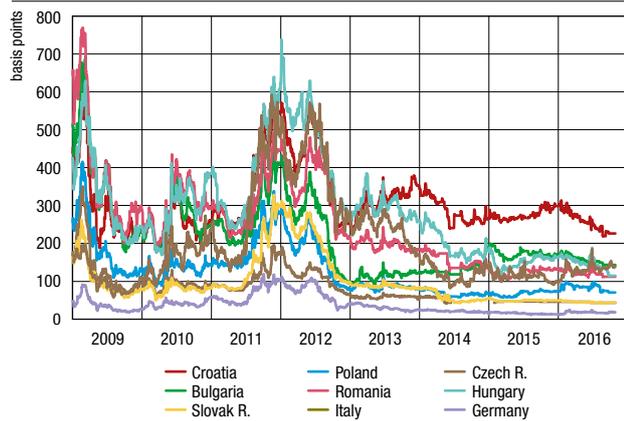
Sources: ECB, Bloomberg and J. P. Morgan.

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



Source: CNB.

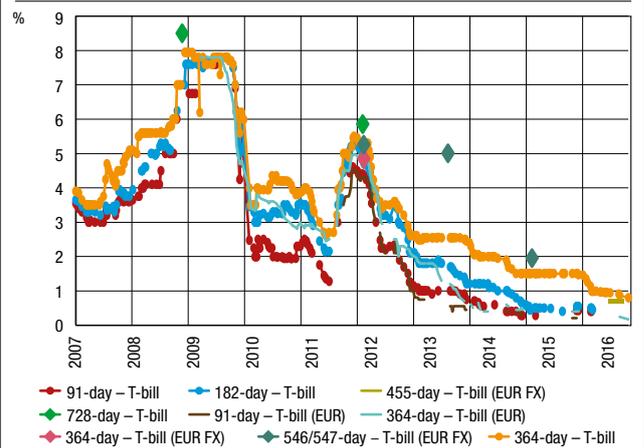
Figure 25 CDS spreads for 5-year government bonds of selected countries



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.

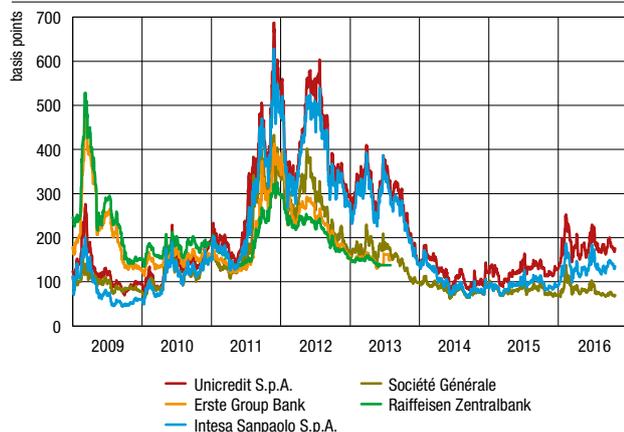
Source: Bloomberg.

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



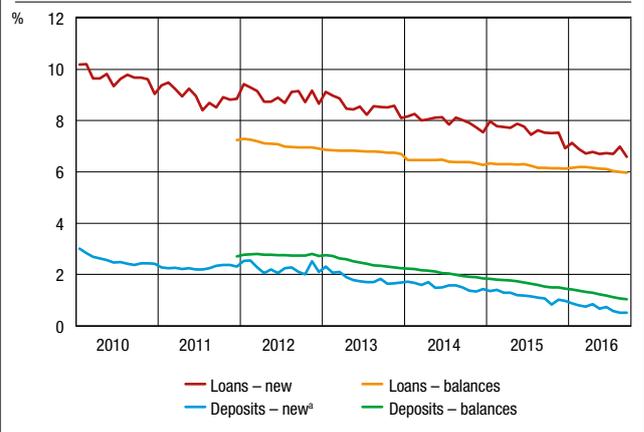
Source: CNB.

Figure 26 CDS spreads for selected parent banks of domestic banks



Source: Bloomberg.

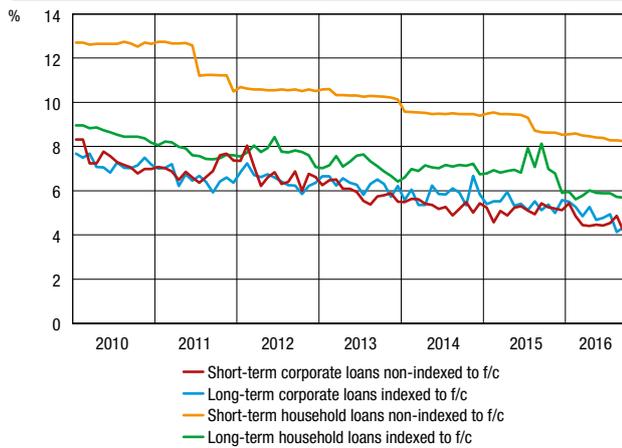
Figure 29 Average interest rates on loans (excl. revolving loans) and deposits on annual basis



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

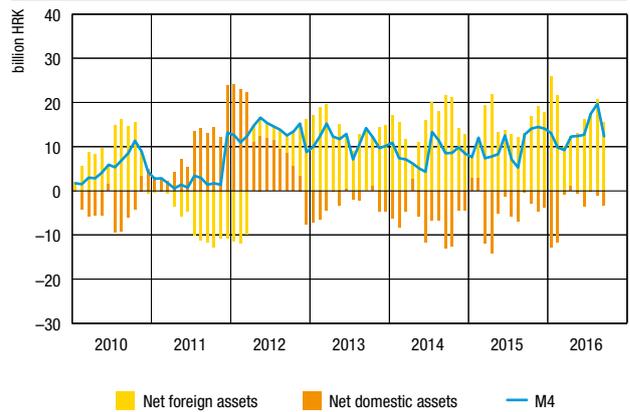
Source: CNB.

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



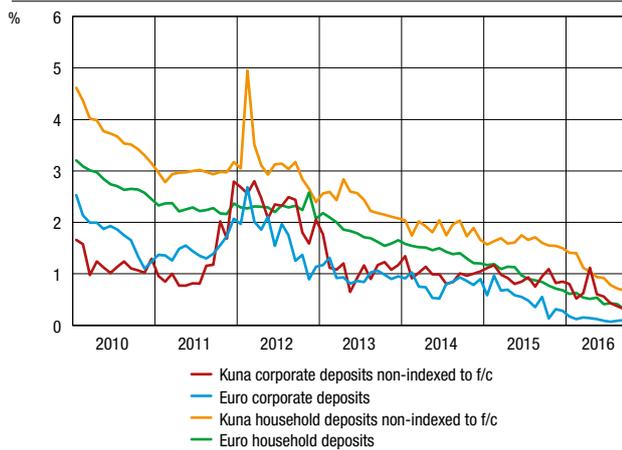
Source: CNB.

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



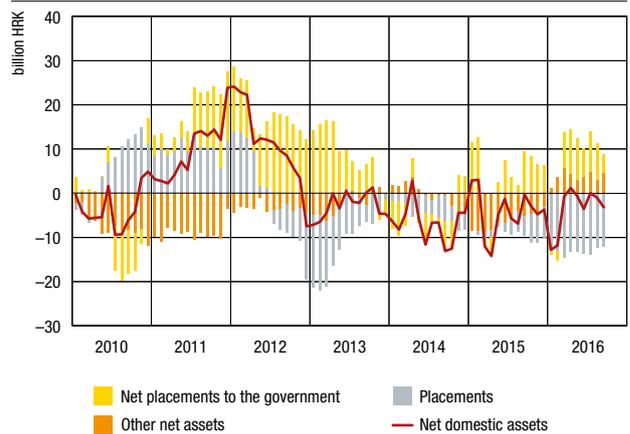
Source: CNB.

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



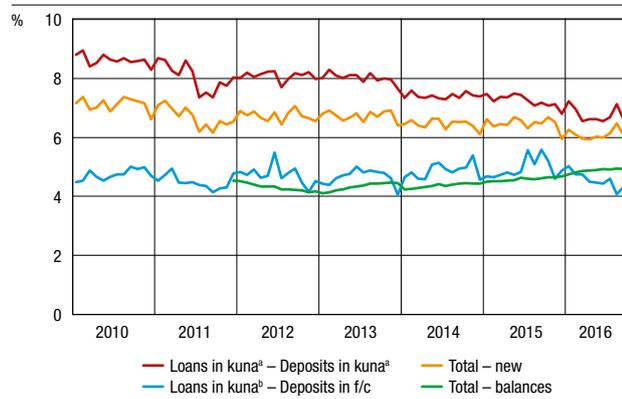
Source: CNB.

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



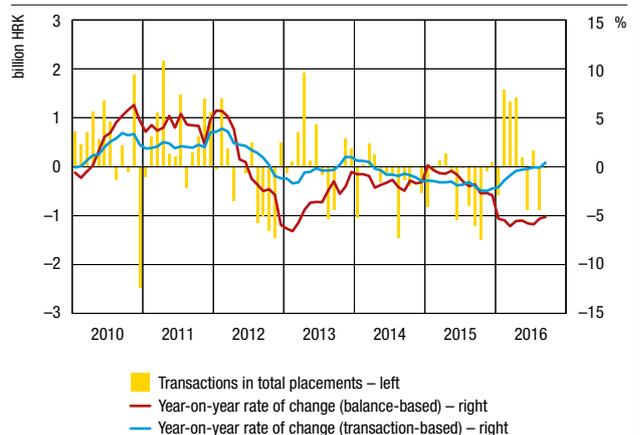
Source: CNB.

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



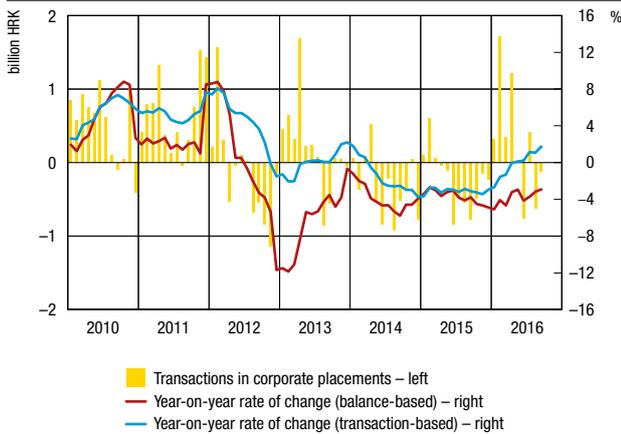
^a Non-indexed to f/c. ^b Indexed to f/c.
 Note: Spread between average interest rates on loans and average interest rates on deposits should be differentiated from net interest margin (the ratio of the difference between interest income and interest expenses to total assets of credit institutions).
 Source: CNB.

Figure 35 Placements



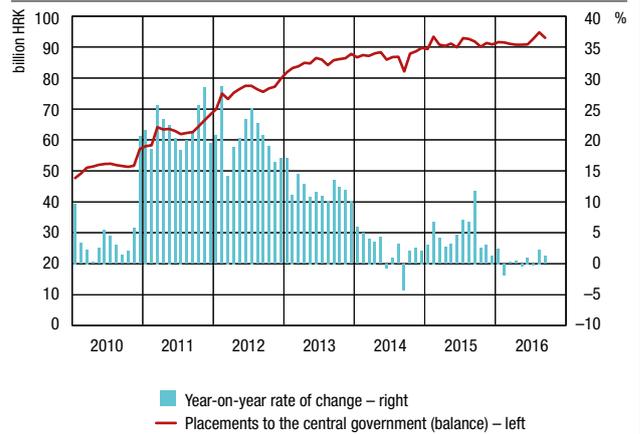
Source: CNB.

Figure 36 Placements to corporates



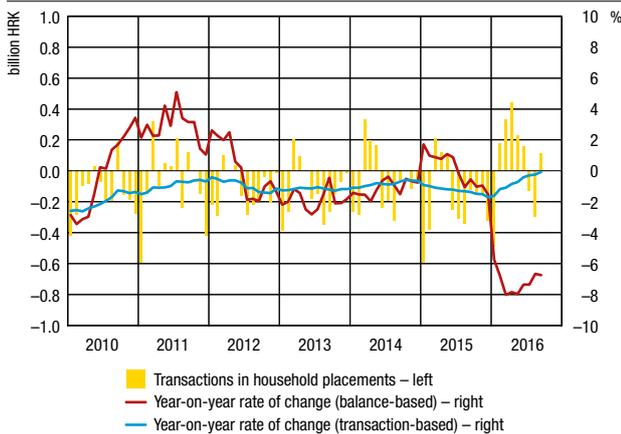
Source: CNB.

Figure 39 Credit institution and MMF placements to the central government



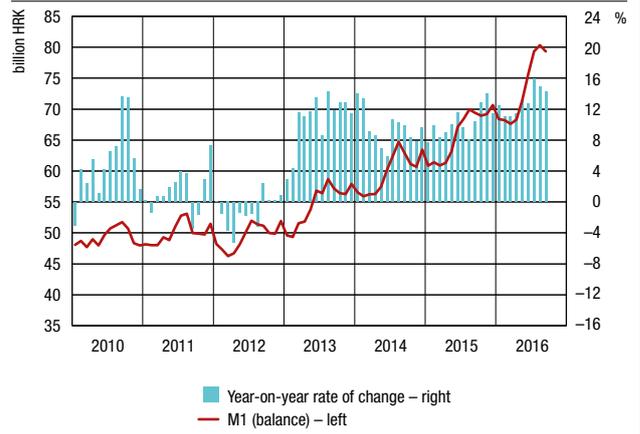
Source: CNB.

Figure 37 Placements to households



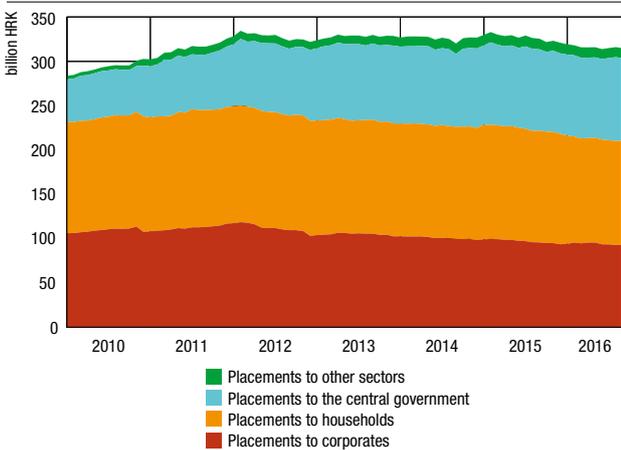
Source: CNB.

Figure 40 Money (M1)



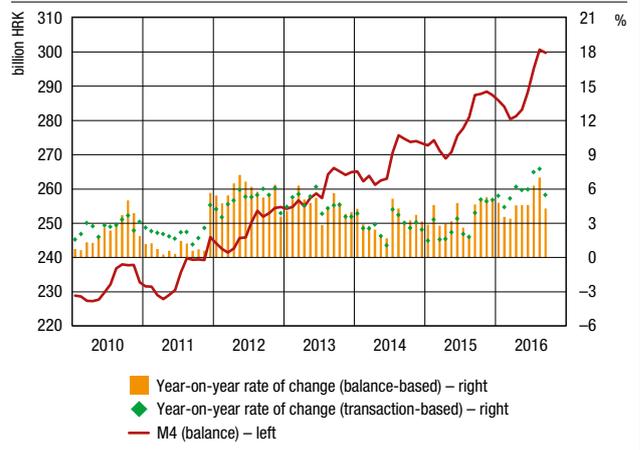
Source: CNB.

Figure 38 Structure of credit institution placements



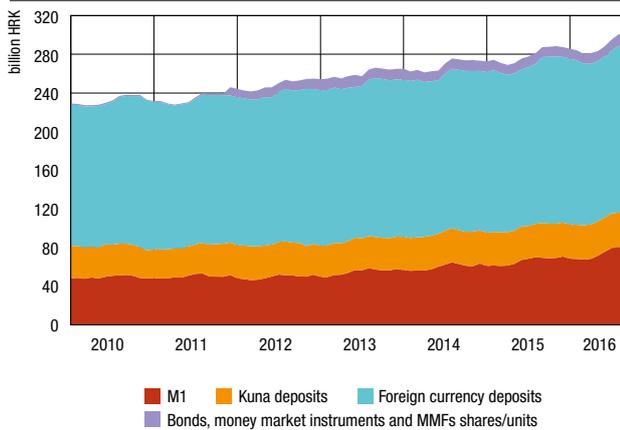
Source: CNB.

Figure 41 Total liquid assets (M4)



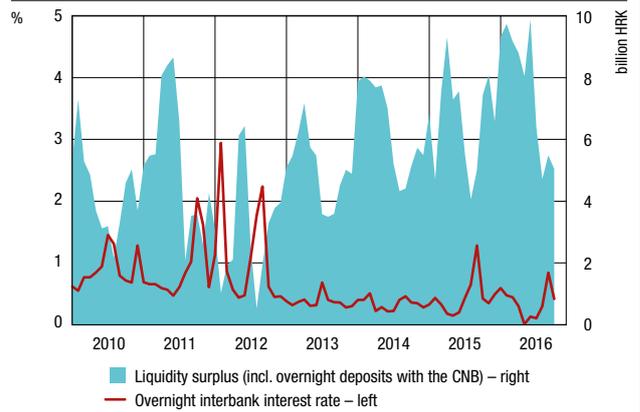
Source: CNB.

Figure 42 Structure of M4 monetary aggregate



Source: CNB.

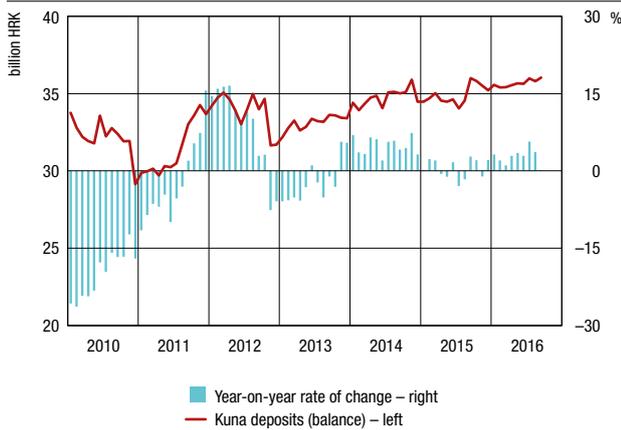
Figure 45 Bank liquidity and overnight interbank interest rate



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.

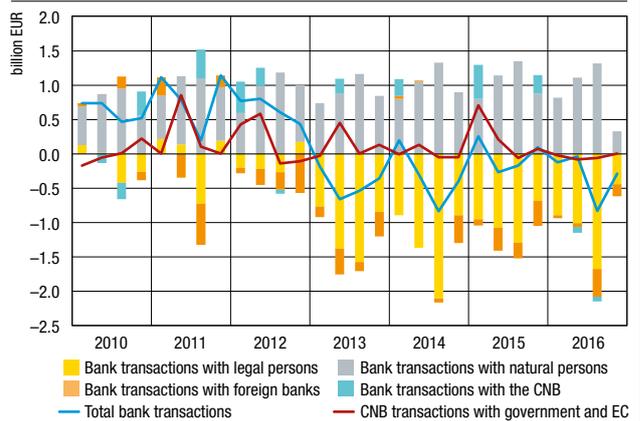
Source: CNB.

Figure 43 Kuna savings and time deposits



Source: CNB.

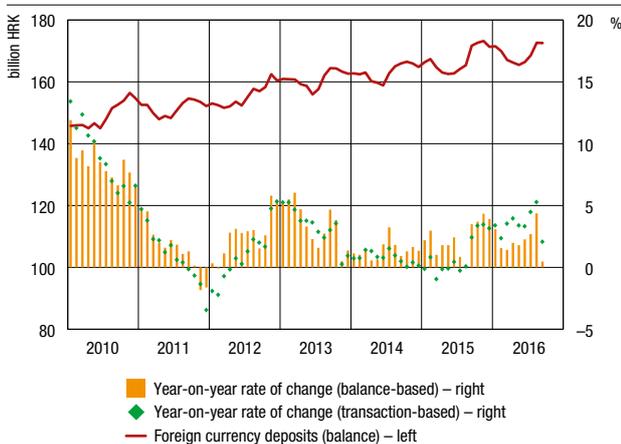
Figure 46 Spot transactions in the foreign exchange market (net turnover)



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

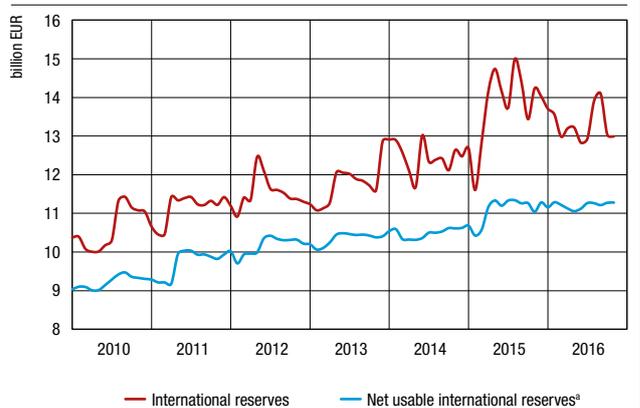
Source: CNB.

Figure 44 Foreign currency deposits



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.

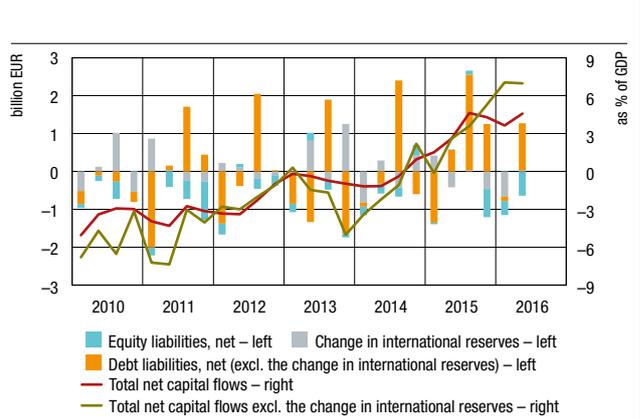
Table 2 Balance of payments^a
preliminary data, in million EUR

	2015	1st half 2015	1st half 2016	Indices	
				2015 / 2014	1st half 2016 / 1st half 2015
Current account	2,237.2	-1,227.0	-1,428.1	248.3	116.4
Capital account	277.2	83.9	196.0	419.0	233.7
Financial account (excl. reserves)	1,139.1	-1,533.9	253.9	120.6	-
International reserves	745.3	792.5	-836.6	-	-
Net errors and omissions	-630.0	401.7	649.3	114.0	161.7

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

Source: CNB.

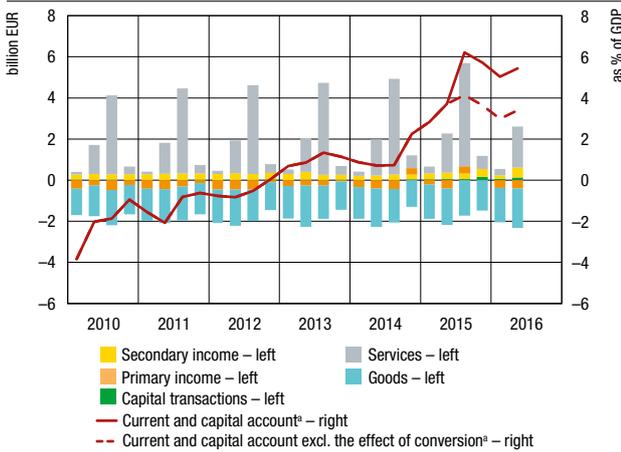
Figure 50 Financial account flows
by type of investment



Note: A positive value denotes net outflow of equity abroad. The change in gross international reserves is reported net of the liabilities of the CNB. 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.

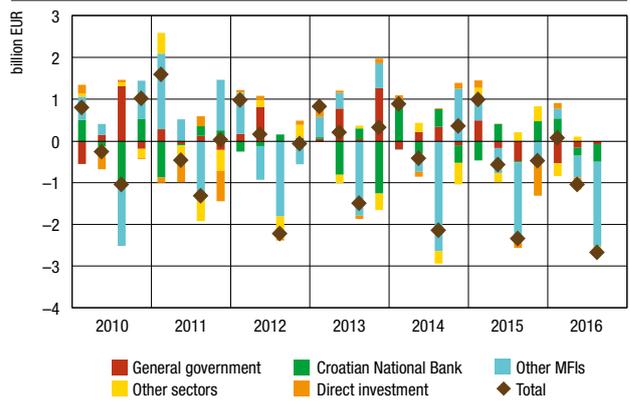
Figure 48 Current and capital account flows



^a Sum of the last four quarters.

Source: CNB.

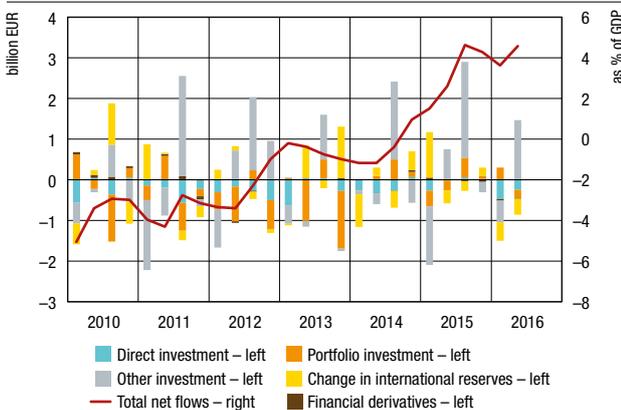
Figure 51 Net external debt (NED) transactions



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. Data for the third quarter of 2016 refer to July and August.

Source: CNB.

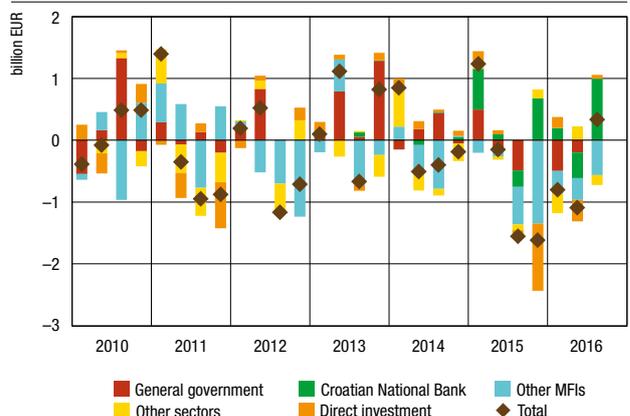
Figure 49 Financial account flows



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.

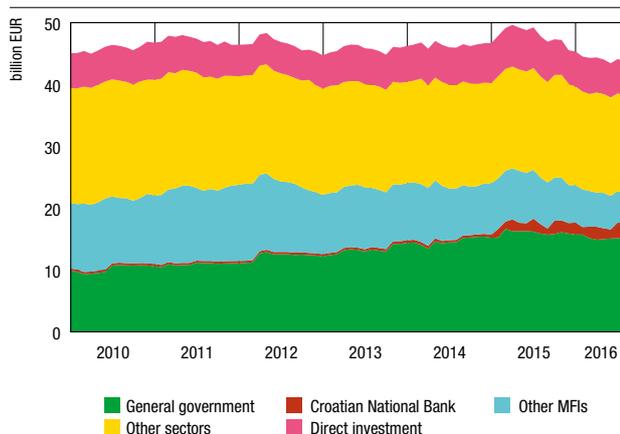
Figure 52 Gross external debt (GED) transactions



Note: Transactions refer to the change in debt excl. cross-currency changes and other adjustments. Data for the third quarter of 2016 refer to July and August.

Source: CNB.

Figure 53 Gross external debt
end of period



Source: CNB.

Table 3 Consolidated general government balance

ESA 2010, in million HRK

	Jan. – Jun. 2015	Jan. – Jun. 2016
Total revenue	69,208	77,529
Direct taxes	8,905	11,055
Indirect taxes	30,884	32,952
Social contributions	19,437	20,035
Other	9,982	13,487
Total expenditure	77,705	79,445
Social benefits	26,058	27,281
Subsidies	3,591	3,801
Interest	5,909	5,856
Compensation of employees	18,768	19,275
Intermediate consumption	13,520	12,626
Investment	5,309	5,510
Other	4,549	5,096
Net lending (+) / borrowing (-)	-8,497	-1,916

Sources: Eurostat and CBS.

Table 4 Consolidated central government net borrowing

GFS 2001, in million HRK

	Jan. – Aug. 2015	Jan. – Aug. 2016
1 Revenue	82,854	89,319
2 Disposal of non-financial assets	278	237
3 Expenditure	86,633	88,033
4 Acquisition of non-financial assets	2,674	2,545
5 Net borrowing (1 + 2 – 3 – 4)	-6,176	-1,023

Sources: MoF and CNB calculations.

Table 5 General government debt

in million HRK

	Jan. – Jul. 2015	Jan. – Jul. 2016
Change in total debt stock	9,337	-712
Change in domestic debt stock	7,126	5,780
– Securities other than shares, short-term	-2,788	-1,032
– Securities other than shares, long-term	7,936	9,323
– Loans	2,000	-2,499
Change in external debt stock	2,211	-6,491
– Securities other than shares, short-term	-451	-52
– Securities other than shares, long-term	4,645	-6,142
– Loans	-1,984	-297
Memo item:		
Change in total guarantees issued	-637	127

Source: CNB.

