Information on economic, financial and monetary developments

July 2024

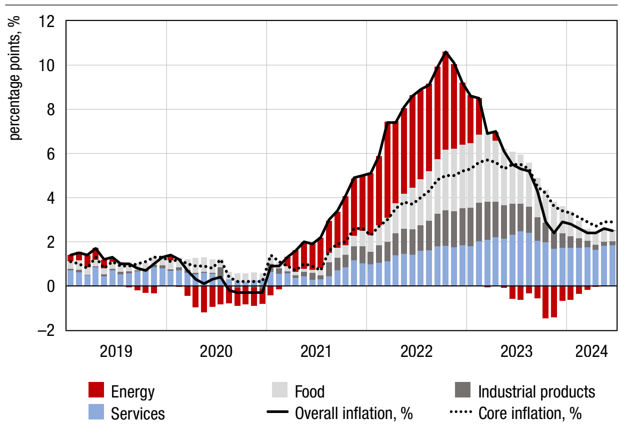
Summary

After a modest performance in 2023, the euro area economy grew by 0.3% in early 2024, exceeding earlier expectations (Figure 1). Real growth was broadly based across the countries of the monetary union. In terms of components, growth was concentrated, with the sharpest contribution to the economic pick-up coming from exports (in particular of services), while the contribution of other components was modest or negative (investments and inventories), which is not surprising given the persistent negative trends in industry. Most estimates for the second quarter suggest that the euro area economy continued to rise at a similar pace as at the beginning of the year. This is supported by available monthly indicators, in particular the purchasing manager index (PMI) for April and May, which point to steady growth. However, the latest available data, for June, show an unexpected deterioration of the outlook in terms of declining indicators for industry and the services sectors, underscoring the continued significant weaknesses in the euro area economy.

According to a flash estimate from Eurostat, overall euro area inflation measured by the harmonised index of consumer prices slowed down marginally, from 2.6% in May to 2.5% in June (Figure 2). This was the outcome of the continued slowing of food price inflation and the slight drop in the inflation of energy prices. Core inflation (which excludes energy and food prices) levelled off at 2.9% in June amid stagnant inflation of both its main components (services and industrial products). Against the backdrop of a sharp annual increase in wages, euro area inflation of service prices has held steady at a high level in the last eight months, standing at 4.1% in June, the same as in May. The inflation of the prices of industrial products, which has been slowing down continuously over the past year, dropped to 0.7% in May and remained at that level in June. The low inflation of prices of industrial products is largely the outcome of lower prices of energy and other raw materials in the global market, the decrease in the prices of imported goods and the low producer price inflation for consumer goods in the euro area. The momentum of overall inflation, as shown by the annualised quarterly inflation rate, which is a good indicator of current inflationary pressures, decreased to 2.1% in the euro area in June, reflecting a weakening of the momentum of all the main components (except food). Services were the only component whose momentum continued to exceed its long-term average.

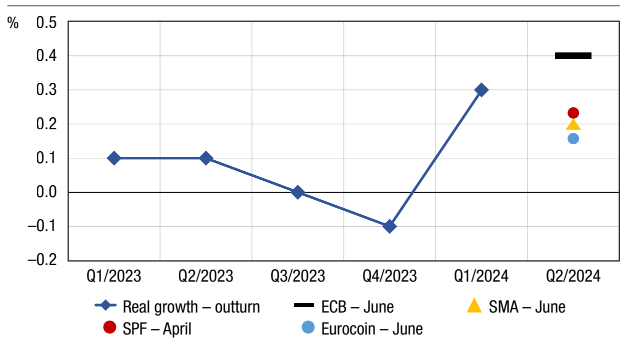
Monthly data for the second quarter suggest that economic activity in Croatia continued to grow relatively strongly, albeit at a somewhat slower pace than in the first three months of 2024. Croatia's real GDP in the second quarter could rise by 0.7% from the beginning of 2024, while its annual growth might reach 3.3%. Monthly data for April and May point to steady, robust growth in domestic demand. The sharp increase in real retail trade turnover (Figure 4), present since mid-2023, continued. The rise in personal consumption was supported by positive labour market developments and the growth in the real disposable income of households. Developments in construction were also favourable in April, primarily reflecting the growing volume of construction works on buildings, whereas civil engineering works, mostly associated to investment activity of the public sector, stagnated at the high level reached in the first quarter. In addition, following a plunge in the first quarter and stagnation in April, industrial production recorded a monthly increase in May, particularly in the production of energy and capital goods. However, as the May increase was insufficient to offset the decrease

Figure 2 Inflation indicators in the euro area



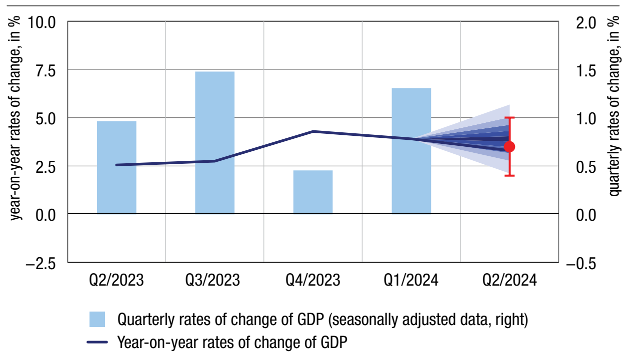
Note: Core inflation is measured by the harmonised index of consumer prices, which excludes energy, food, alcoholic beverages and tobacco prices.
Sources: Eurostat and CNB calculations.

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



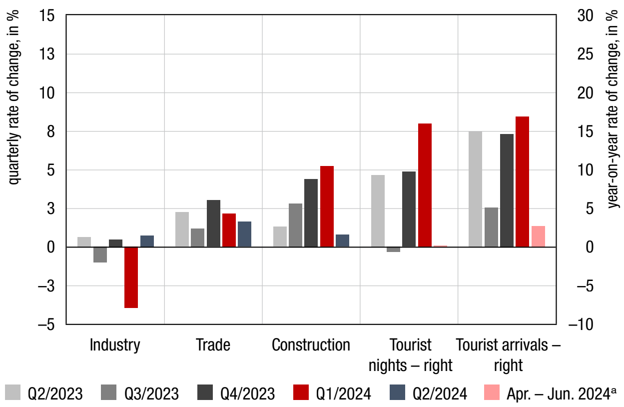
Notes: Abbreviation ECB – June refers to ECB June projections of real growth in the euro area (Broad Macroeconomic Projection Exercise, BMPE). Abbreviations SMA, Survey of Monetary Analysts and SPF, Survey of Professional Forecasters refer to the results of the ECB survey of market participants in June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

Figure 3 Quarterly gross domestic product



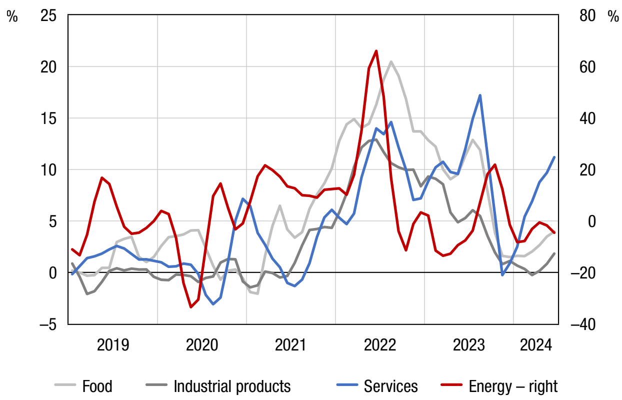
Notes: The estimate for the second quarter of 2024 refers to the Monthly indicator of real economic activity of the CNB (for more details on the calculation of the MRGA indicator, see CNB survey Kunovac, D., and B. Špalat: "Nowcasting GDP Using Available Monthly Indicators"). The models are estimated on the basis of data published up to 28 June 2024. The red dot denotes an estimate of the quarterly change in real GDP, with historical errors of estimates within ±1 standard deviation.
Sources: CBS (seasonally adjusted by the CNB) and CNB calculations.

Figure 4 Monthly economic indicators for Croatia



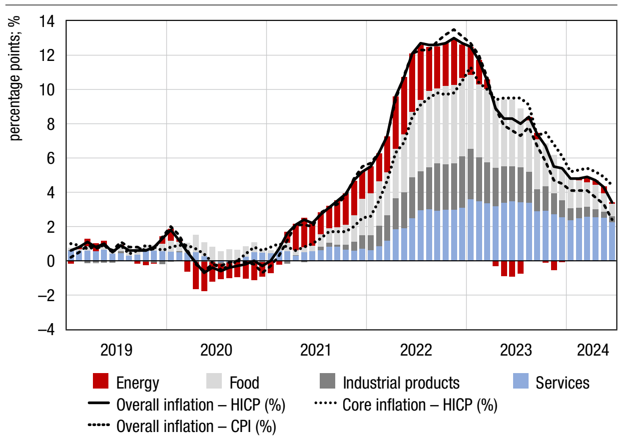
ᵃ Including data on tourist arrivals and nights in the first 20 days of June.
Note: Data on industry and trade in the second quarter of 2024 refer to April and May, while data on construction refer to April 2024.
Sources: CBS and eVisitor.

Figure 6 Momentums of the main inflation components



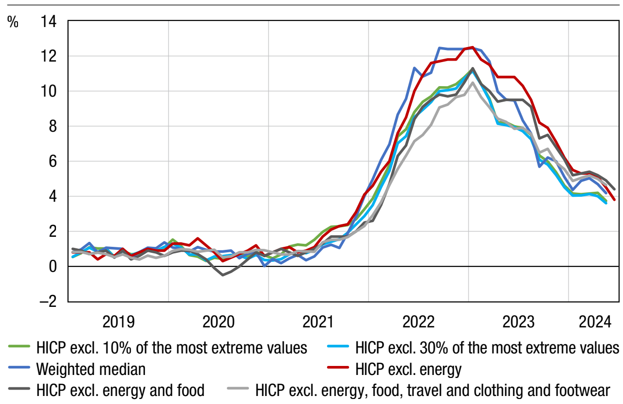
Note: The quarter-on-quarter rate of change on an annual level is calculated from the quarterly moving average of seasonally adjusted harmonised consumer price indices.
Sources: Eurostat and CNB calculations.

Figure 5 Inflation indicators in Croatia



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

Figure 7 Core inflation indicators



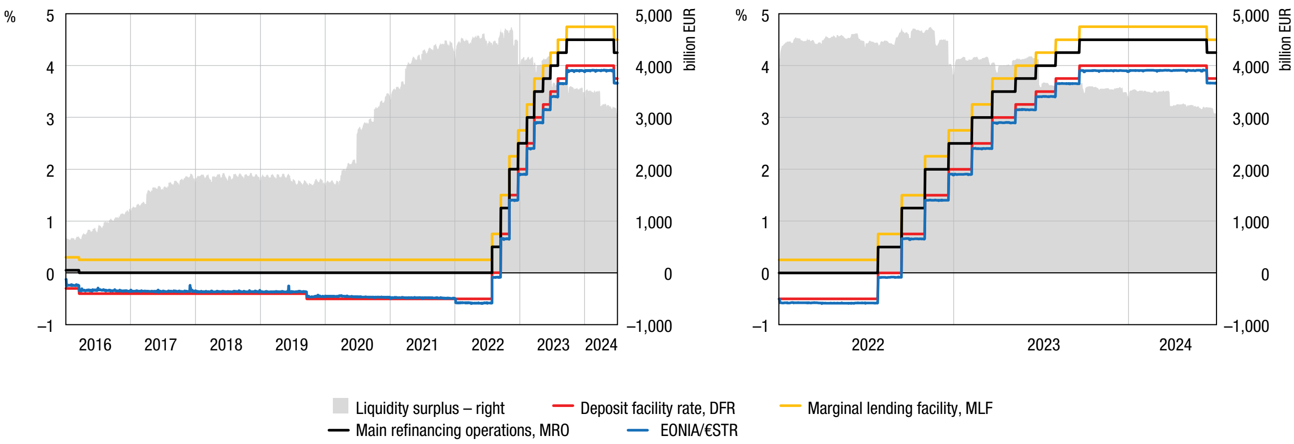
Notes: Trimmed mean eliminates 5% (15%) of components (out of a total of 87 components) with maximum and minimum annual rates of change. The weighted median excludes all values but the weighted median of the distribution of price change.
Sources: Eurostat and CNB calculations.

from the beginning of the year, industrial production remained significantly below the levels seen in late 2023. Business confidence data for June also point to an increase in confidence in industry, which thus returned to a level above its long-term average. Optimism in construction and trade also edged up. By contrast, optimism in service activities dropped, which may be related to relatively weak volume indicators in tourism in the first 20 days of June, which were, however, partly influenced by the dates of public holidays (Corpus Christi) being different from those of last year.

Inflation slowed down noticeably in Croatia in June 2024, mirroring lower rates for all main components, which was due to the favourable base effects amid relatively low current inflationary pressures, except in the case of service prices. According to Eurostat's flash estimate, overall annual inflation measured by the harmonised index of consumer prices (HICP)[1] slowed down markedly, to 3.4% in June, from 4.3% in May (Figure 5). Energy inflation decelerated the most (to 0.6%, from 3.0% in May), as a result of the decrease in the prices of refined petroleum products. The lower prices of energy and other raw materials, down from their highs of 2022, and the resolution of supply chain disruptions still have a positive impact on food price inflation (which slowed down to 2.6%, from 3.7% in May) and the inflation of the prices of industrial products (which fell to 1.3%, from 1.4% in May). The inflation of services prices also slowed down perceptibly (to 7.0%, from 7.8% in May), although it remained much higher than other inflation components, accounting for about two thirds of overall inflation. The persistence of the inflation of service prices is partly the result of their higher sensitivity to wage growth amid strong demand, in particular for food and accommodation services. The moderation in overall inflation in June reflects a favourable base effect, observed in all main components, due to the sharp increase in prices in June last year. However, current inflationary pressures arising from services prices remained pronounced, so that the momentum[2] of service inflation gained more traction, albeit remaining lower than in mid-2023 (Figure 6). Core inflation (excluding the prices of energy and food) slowed down slightly less

1 Inflation measured by the national consumer price index (CPI), which does not cover consumption of non-residents and institutional households, slowed down from 3.3% in May 2.4% in June.

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.

than overall inflation, from 4.9% in May to 4.4% in June (Figure 7), reflecting the lower inflation of prices of services and, to a lesser extent, of industrial products.

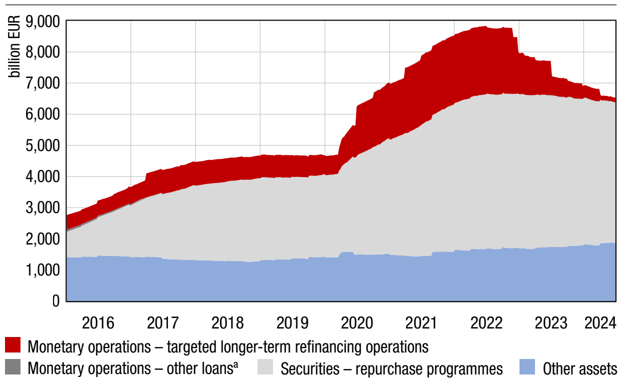
At its meeting on 6 June, the Governing Council of the ECB slightly reduced the degree of monetary policy restrictiveness by lowering its key interest rates, after keeping them stable since September last year (Figure 8). The deposit facility rate (currently a relevant indicator of the ECB's monetary policy) has been set at 3.75% starting from 12 June, a reduction of 25 basis points. The moderation of the degree of monetary policy restriction followed the most rigorous cycle of tightening since the introduction of the euro. Since the Governing Council meeting in September 2023, inflation has fallen by more than 2.5 percentage points and the likelihood that inflation will reach the target level has improved. Overall inflation has also eased, reinforcing the signs that price pressures have weakened, and inflation expectations have declined. The Governing Council will keep ECB key interest rates sufficiently restrictive for as long as necessary for inflation to return to the target level in a timely manner, and it will base its decisions on a data-dependent approach. The Governing Council is not pre-committing to a particular rate path.

The Eurosystem balance sheet 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 ECB's Governing Council at its June meeting confirmed that it would reduce the PEPP portfolio by EUR 7.5 billion per month on average in the second half of the year and discontinue reinvestments under the PEPP at the end of 2024. Until the end of 2024, the Governing Council will continue applying flexibility 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.

The reduction in key ECB interest rates by 25 basis points in June spilled over quickly to money market interest rates. The €STR decreased by the amount of the decrease in key interest rates, to 3.7%, and remained at that level until the end of June (Figure 10). The reduction in key ECB interest rates spilled over quickly to the Croatian money market. Thus the overnight interest rate on banks' demand deposits trading fell by 21 basis points in June, to 3.5%. The three-month EURIBOR continued to decline in response to the expectations of further cuts in key interest rates, falling to 3.7% at the end of June. As regards short-term government financing costs, T-bills were issued in early June, almost three-quarters of them having a maturity of 364 days, as in February. Yield at issue of 91-day T-bills stood at 3.75% for individual investors and at 3.65% for institutional investors, while yield at issue of 364-day T-bills stood at 3.65% and 3.44% for individual and institutional investors, respectively. Yields on bills for individual investors remained unchanged from February, while yields on bills for institutional investors decreased slightly.

Political uncertainty following the announcement of early parliamentary elections in France briefly raised fluctuations in and increased the dispersion of euro area sovereign bond yields. The announcement of early parliamentary elections

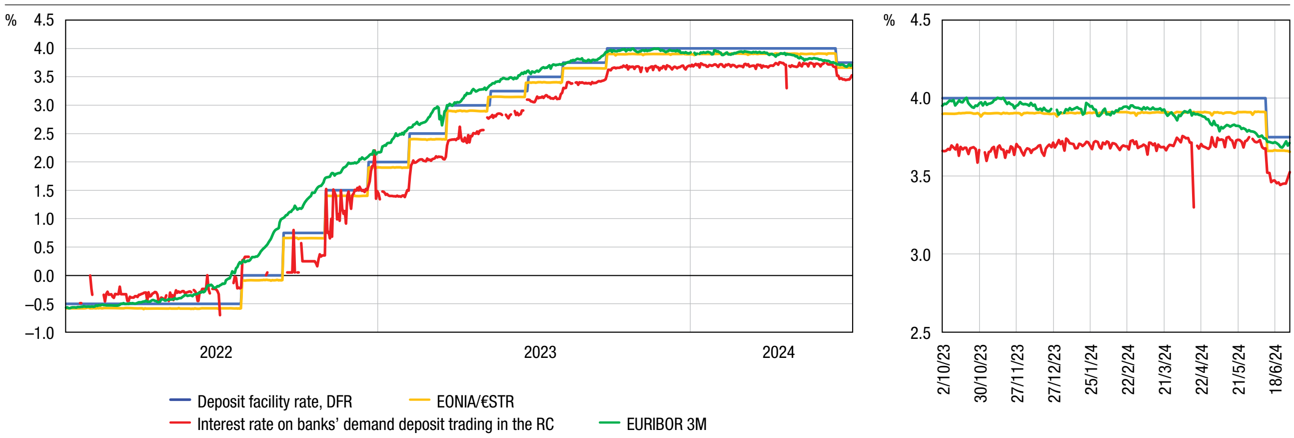
Figure 9 Eurosystem balance sheet



[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.

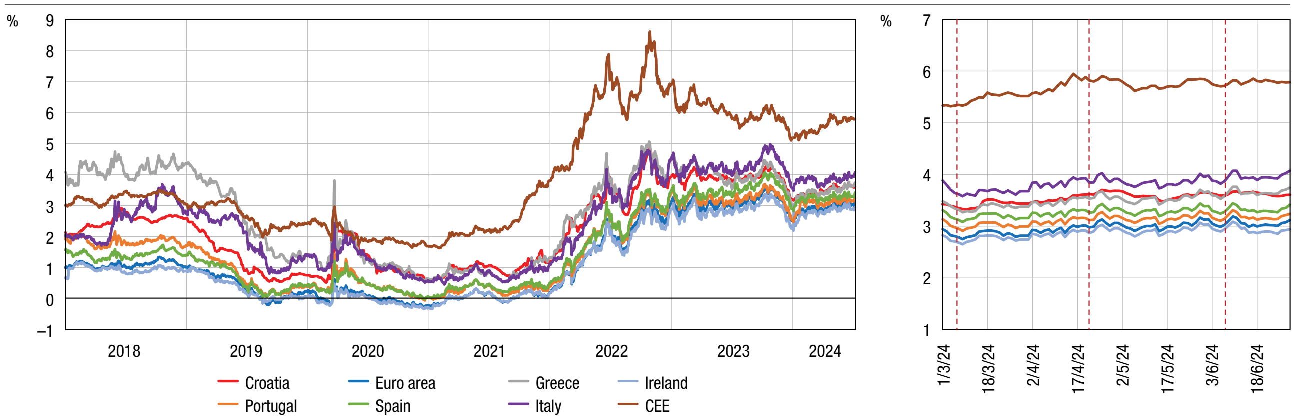
2 Momentum is a short-term inflation indicator which shows annualised three months-on-three months rates of price change, seasonally adjusted.

Figure 10 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 11 Yields on long-term government bonds with the remaining maturity of approximately 10 years

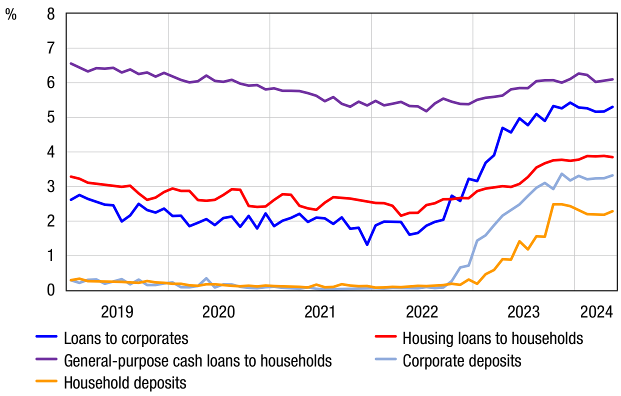


Notes: CEE – countries of Central and Eastern Europe (the Czech Republic, Hungary, Poland and Romania); yields for the euro area and CEE have been weighted by the share of GDP of the countries included. Data from the euro area do not include those from Estonia, Latvia, Luxembourg and Malta. The red dotted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

in France on 9 June increased uncertainty about the course of economic and fiscal policy in France. This almost immediately raised the yields on French government bonds, by 13 basis points, and the yields on bonds of most other euro area countries also increased, albeit to a lesser degree. Soon thereafter, yields on government bonds of France and most other euro area countries returned to the levels seen before the announcement and remained relatively stable until the very end of June, when they began to rise again gradually. At the same time, yields on German government bonds, which otherwise represent a safe haven for investors in times of heightened uncertainty, declined. As a result, the spread between yields on government bonds of France and Germany grew by around 30 basis points, reaching the highest level since 2017. The euro area GDP-weighted average of long-term government bond yields stood at 3.1% at the end of June, which was slightly higher than before the announcement and almost equal as at the end of May (Figure 11). The yield on Croatian long-term bonds grew less than the euro area average, standing at 3.6% at end-June, i.e. almost the same as at the end of May.

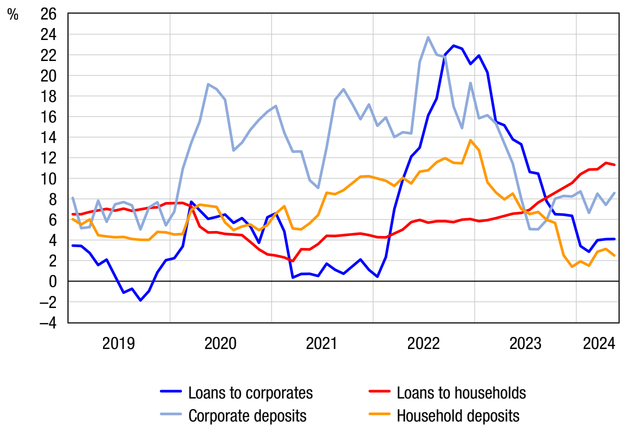
After decreasing slightly in the first quarter of 2024 and holding steady in April, the costs of corporate financing by credit institutions grew in May. At the same time, interest rates on general-purpose cash loans grew very moderately, while the rates on housing loans fell only slightly. The average interest rate on pure new corporate loans stood at 5.3% in May, up by 13 basis points from the month before. The rise was mostly driven by higher interest rates on loans to micro enterprises, while, broken down by loan purpose, the largest positive contribution came from interest rates on factoring and working capital loans. The interest rate on pure new general-purpose cash loans to households averaged 6.1% in May, up by 4 basis points from April, while the rate on housing loans was 3 basis points lower than in April (3.8%). Despite the moderate increase in May, interest rates on corporate loans and general-purpose cash loans to households remained below their peaks of late 2023 and early 2024, respectively (5.4% in December 2023 on corporate loans and 6.3% in January 2024 on general-purpose cash loans to households) (Figure 12). Interest rates on housing loans to households, which showed signs of stabilisation in the late first quarter, edged down in May. Average interest rates on existing loans, i.e. on their stocks, grew only marginally in May,

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 and currencies indexed to the kuna and in euros, and from January 2023 to loans and deposits in euro. Data refer to pure new loans and deposits. Deposits with a maturity of up to 1 month have been excluded.
Source: CNB.

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



Source: CNB.

by 2 basis points on corporate loans (to 4.6%) and by 1 basis point on the stock of housing and general-purpose cash loans (to 3.0% and 6.0%, respectively).

Interest rates on household and corporate time deposits rose slightly in May from the month before. The average interest rate on pure new corporate time deposits was 8 basis points higher in May than in April (standing at 3.3%), while in the household sector it grew by 10 basis points, reaching 2.3% (Figure 12). The increase was mostly attributable to several banks having raised their interest rates on time deposits in May. Households again opted for deposits with maturities between 6 and 12 months, despite the fact that the interest rate on deposits with shorter maturities (from 3 to 6 months) has remained somewhat higher. Interest rates on total existing deposits remained almost unchanged from April to May, standing at 1.0% for corporates and at 0.5% for households. Interest rates on specific components of existing deposits also changed only a little, with the rate on corporate time deposits going up by 1 basis point, to 2.9%, and the rate on household time deposits rising by 5 basis points, to 1.7%. At the same time, the interest rate on overnight corporate deposits grew by 1 basis point, to 0.16%, while the interest rate on household deposits remained unchanged (0.02%).

The annual growth rate of household loans slowed down slightly in May as the base effect had an impact on the deceleration of housing loan growth, while the rise in general-purpose cash loans continued to accelerate, supported by the robust current activity. On an annual level, corporate loans grew at the same rate as in April. Loans to domestic sectors (excluding the general government) grew in May as well, by EUR 0.4bn or 1.0% (transaction-based), due to the further increase in household loans (of EUR 0.2bn or 1.0%) and the steady rise in corporate loans (of EUR 0.1bn or 0.8%). The increase in household loans was mostly driven by the sharp rise in general-purpose cash loans (of EUR 124m or 1.5%), while housing loans continued to grow at a pace similar to that of the previous months, increasing by EUR 82m or 0.7% in April. On an annual level, the growth in total household loans decelerated slightly, from 11.5% in April to 11.3% in May (transaction-based), with the annual growth rate of housing loans going down from 11.3% to 10.5% due to the base effect, that is, the sharp increase in housing loans last May spurred by the beginning of the government subsidy programme, which ceased this year. By contrast, the growth in general-purpose cash loans picked up from 13.8% in April to 14.3% in May, the strongest growth rate seen since December 2011, driven by exceptionally strong new lending activity. Corporate loans grew by EUR 0.1bn (0.8%) in May, which is half as much as in April. The bulk of this growth, which was spread across various activities and business entities, was accounted for by investment loans, while loans for working capital accounted for a smaller share. The annual growth in corporate loans remained at 4.1% in May, holding steady from April (Figure 13).

Domestic deposits continued to grow moderately, up at an annual rate of 4.1% in May. Total domestic deposits (general government excluded) rose in May from April, by EUR 0.4bn (transaction-based), after declining over the previous four months. Both time and overnight deposits increased (by EUR 0.3bn and EUR 0.1bn, respectively). Corporate deposits grew by EUR 0.3bn, with time deposits rising by EUR 0.2bn and overnight deposits going up by EUR 0.1bn. Household deposits grew only slightly (by EUR 12m), reflecting the increase in overnight deposits and the stagnation in time deposits. The new round of subscription of T-bills that began in late May was intended for individual investors; they invested a total of EUR 0.8bn, of which EUR 0.6bn was subscribed by the month's end. However, there were no significant changes in the data on household deposits with banks at the end of the month. This can partly be explained by the falling due of three-month T-bills in late May (EUR 0.2bn), with the funds thus raised being available for investing in the new issue of bills. As the deadline for subscription as well as payment was set at the beginning of June, it is possible that the impact of these investments will be visible in monetary statistics data for the end of June. The share of time deposits in total deposits stabilised at slightly under 30%, standing at 29.6% for corporate deposits and at 28.8% for household deposits. Deposits of other non-bank financial institutions also increased in May (by EUR 0.1bn), especially time deposits, while overnight deposits grew to a lesser extent.