Information on economic, financial and monetary developments

September 2024

Summary

The euro area economy continued to expand in the second quarter of 2024 (Figure 1). Having grown by 0.3% in the first quarter, real GDP went up by 0.2% in the second quarter from the previous three months. Growth was broadly based across member states, with Spain being the most prominent among the larger economies in terms of positive results. On the other hand, the German economy remained weak and economic activity shrank by 0.1% in the second quarter from the previous quarter. A more pronounced contraction of the largest European economy was avoided owing to a strong growth in government consumption and inventories, with a noticeable decline in investments due to unfavourable trends in construction and industry. Despite the revival of economic growth in the euro area, labour market pressures abated slightly. The number of vacant posts thus continued to decrease, while the unemployment rate edged up, from 6.4% of the labour force in May to 6.5% in June. With regard to the euro area economic outlook in the third quarter, most of the available projections show that growth is set to continue at a similar pace, suggesting that the stagnation, which lasted from the second half of 2022 until the end of 2023, seems to have come to an end. Monthly indicators, such as the purchasing manager index (PMI), continue to show that growth is concentrated in the services sector, while industrial activity has continued its downward path.

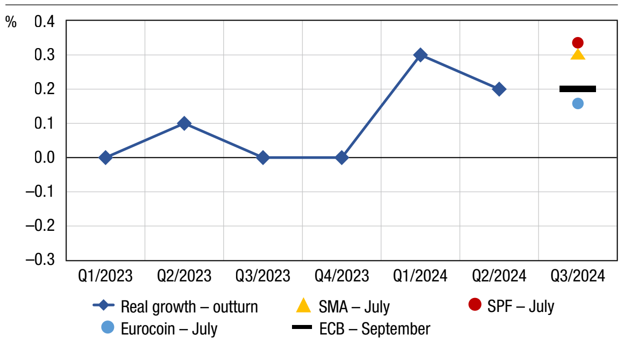
According to a flash estimate from Eurostat, overall euro area inflation measured by the harmonised index of consumer prices slowed down, from 2.6% in July to 2.2% in August (Figure 2). This was primarily due to the decrease in the inflation of energy prices, most notably refined petroleum products. In contrast, food price inflation accelerated slightly. Core inflation, which excludes the prices of energy and food, eased from 2.9% in July to 2.8% in August. This was driven by the slowdown in the inflation of the prices of industrial products, while the services price inflation picked up. Core inflation in the euro area has remained relatively high, underpinned by the persistence of services price inflation, which has been hovering around the level of 4.0% since November last year, more than double the long-term average. The momentum of overall inflation in the euro area, as shown by the annualised quarterly inflation rate, held steady in the last three months at the level of slightly above 2%. Core inflation momentum remained above 3% due to the still elevated current inflationary pressures in the services sector.

Economic activity in Croatia continued its relatively strong upward path in the second quarter of 2024, mirroring a steady increase in domestic demand, while exports of goods and services eased. According to the first CBS estimates, real GDP grew by 0.8% on a quarterly level, whereas its annual growth rate stood at 3.3% in the second quarter of 2024 (Figure 3). Personal consumption remained relatively strong due to the growth in the real disposable income of households, partly supported by a stimulative fiscal policy and an abatement of inflation. In addition, investment activity also increased significantly, and the annual rate of change of gross fixed capital formation reached almost 13% in the second quarter. Exports of goods and services declined, with a noticeable fall in the exports of services on an annual basis, partly associated with the timing of large sports events, even though it seems that such trends also resulted from a subdued recovery in some EU member states and a considerable rise in the prices of services, which had a negative effect on real tourist consumption. The production side of GDP shows that the growth in economic activity in the second quarter can primarily be attributed to the still strong activity in construction and some service activities, while the production volume in manufacturing decreased noticeably.

Monthly data for the third quarter of this year, mainly available for July only, show that economic activity continued to expand relatively strongly at the beginning of the second half of 2024. Croatian real GDP might increase by 0.7% in the third quarter from the quarter before, and its annual growth rate might accelerate to 4.3% (Figure 4). Industrial production picked up strongly in July, which more than offset the fall recorded in June, so that it increased by 6.1% from the average level recorded in the second quarter of 2024. Its monthly growth was relatively broad-based, with a large contribution from the production of capital goods, non-durable consumer goods and energy. The rise in the latter category is likely due to above-average temperatures in July and increased electricity consumption. Real retail trade turnover also increased relatively strongly in July (a growth of almost 3% from June and of 1.2% from the average recorded in the second quarter) and continued its steady growth on a quarterly basis that started in early 2023.

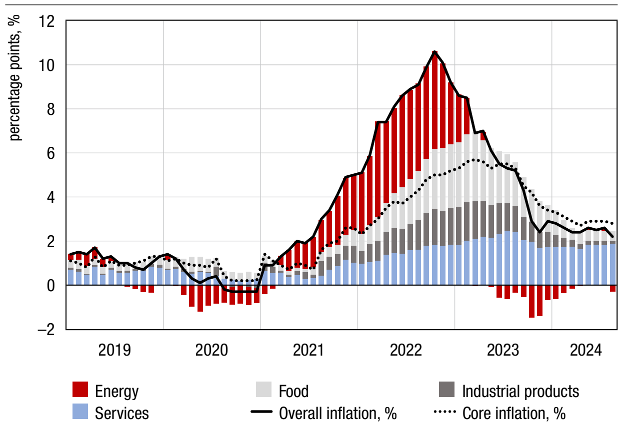
Favourable economic activity trends spurred employment

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



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

Figure 2 Inflation indicators in the euro area

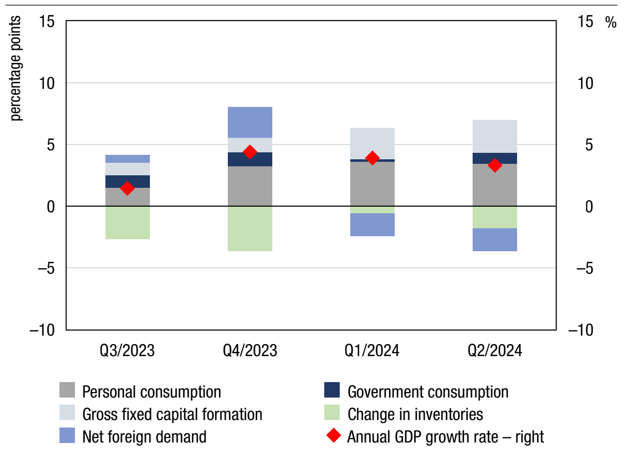


Note: Core inflation is measured by the harmonised index of consumer prices, which excludes energy, food, alcoholic beverages and tobacco prices.
Source: Eurostat and CNB calculations.

growth and a reduction of unemployment in Croatia at the end of the second quarter and the beginning of the third quarter. Following an exceptionally sharp growth in April, wages stagnated in May and June and decreased in July. Employment growth continued to accelerate in the second quarter and went up from 0.9% in the first quarter to 1.2%. In July, the number of employed persons continued its upward trend and rose by 0.7% from the month before, with a similar structure of growth by activities as in the previous quarter. The largest individual contribution to employment growth came from employment in construction and tourism-related service activities (accommodation and food service activities, trade and transportation and storage activities), but there was also intensified employment in the public sector. Unemployment continued to trend down in the second quarter and the number of unemployed persons decreased by 6.2% from the quarter before. The decline in unemployment slowed down in July and the registered unemployment rate stood at 5.3% of the labour force (down from 5.5% in the second quarter). Following an exceptionally strong monthly growth in April 2024, wages remained almost unchanged in May and June and decreased in July (Figure 5). In July, the average nominal gross wage declined by 1% from June due to the decrease in wages in the rest of the economy. In the second quarter, nominal gross wages increased by 9% on average from the beginning of the year. Wages in activities O, P and Q of the National Classification of Economic Activities (which are generally used to approximate developments in the public sector) grew by 17.1%, while wages in the rest of the economy rose by 5.3%. According to the currently available data, this suggests that the strong rise in public sector wages in April this year has so far not had a significant impact on wage developments in the rest of the economy. Largely due to the base effect, the growth in the average nominal gross wage in July from the same period last year slowed down to 14.4% (the average annual rate was 17.8% in the second quarter), while real wages went up by 11.9% (Figure 6).

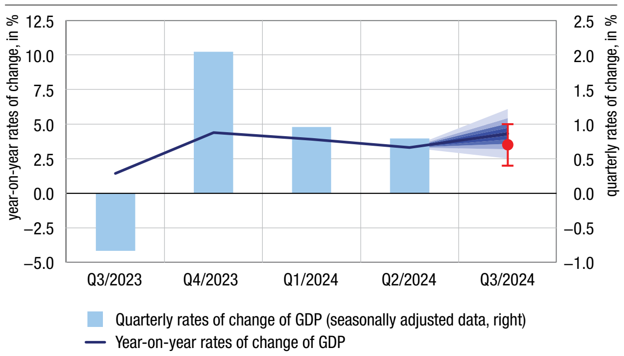
Inflation in Croatia eased further in August 2024, largely due to a noticeable fall in the inflation of energy prices, with pronounced current pressures on services prices during the peak tourist season. According to a flash estimate from Eurostat, overall inflation measured by the harmonised index of consumer prices (HICP)[1] slowed down from 3.3% in July to 3.0%

Figure 3 Contributions to the annual growth of GDP in Croatia



Source: CBS.

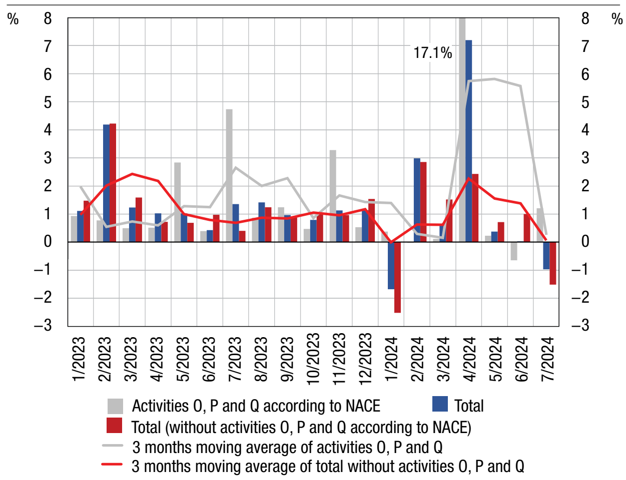
Figure 4 Quarterly gross domestic product



Notes: The estimate for the third quarter of 2024 refers to the Monthly indicator of real economic activity of the CNB (for more details on the calculation of the MRGA indicator, see CNB survey Kunovac, D., and B. Špalat: "Nowcasting GDP Using Available Monthly Indicators"). The models are estimated on the basis of data published up to 2 September 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 5 Nominal gross wages

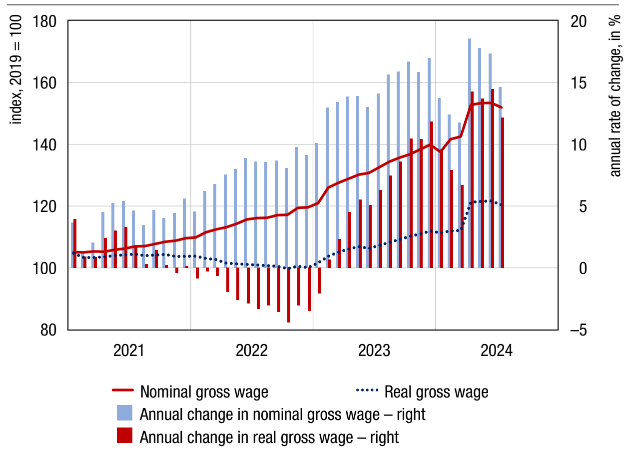
monthly rate of change



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

Figure 6 Nominal and real gross wages

index, 2019 = 100, annual rate of change



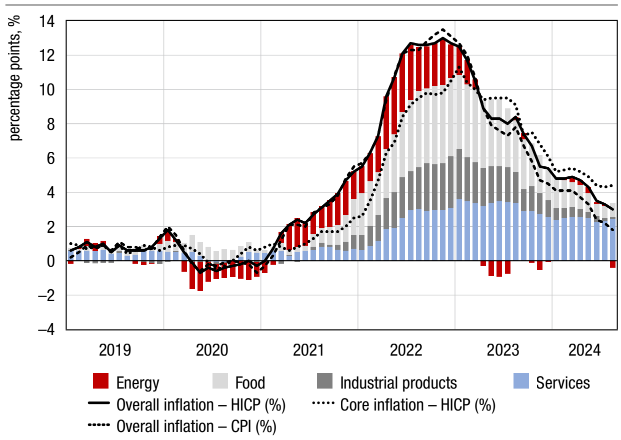
Sources: CBS and CNB calculations (seasonally adjusted by the CNB).

in August (Figure 7). This was mostly due to the strong decrease in the annual rate of change in energy prices (from 0.7% in July to –3.3%) owing to very favourable base effects (due to the spike in prices in August last year) and, to a significantly smaller extent, due to the monthly decrease in the prices of refined petroleum products. The inflation of the prices of industrial products also eased further amid weak imported pressures (from 0.7% in July to 0.4%), albeit at a slower pace than the inflation of energy prices. By contrast, the slowdown in food price inflation came to a halt and inflation accelerated (from 2.5% in July to 2.9%). In addition, the acceleration in the inflation of services prices continued for the second consecutive month during the peak tourist season (up from 7.2% in July and 7.0% in June to 7.6%). This further increased the importance of services for the overall inflation path in Croatia; services accounted for more than four fifths of overall inflation in August. The pick-up in the services price inflation mirrors the strong current inflationary pressures in the services sector due to their sensitivity to wage growth amid strong demand for catering and accommodation services. Thus, unlike other components where current inflationary pressures held steady at relatively low levels, the already elevated momentum[2] of services price inflation increased further (Figure 8). Due to the acceleration of services price inflation, which was more pronounced than the slowdown in the inflation of the prices of industrial products, core inflation (excluding the prices of energy and food) edged up, from 4.3% in July to 4.4% (Figure 9). With the end of the peak tourist season, current pressures in the services sector are expected to abate. Notwithstanding this, following the impact of the favourable base effects on the slowdown in the annual rate of overall inflation in the first eight months of 2024, the base effects will work in the opposite direction towards the end of this year, so that overall inflation might remain slightly above its current level until the end of the year.

At its meeting on 12 September, the Governing Council of the ECB decided to further moderate the degree of monetary policy restriction (Figure 10). The deposit facility rate, a relevant indicator of the ECB's monetary policy, was set at 3.50% starting from 18 September, a reduction of 25 basis points. The Governing Council noted that the latest projections confirmed its previous assessment of the medium-term inflation outlook. Although domestic inflation remains high as wages are still rising at an elevated pace, labour cost pressures are moderating, and profits are partially buffering the impact of higher wages on inflation. Financing conditions remain restrictive, and economic activity is still subdued, reflecting weak private consumption and investment. 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.

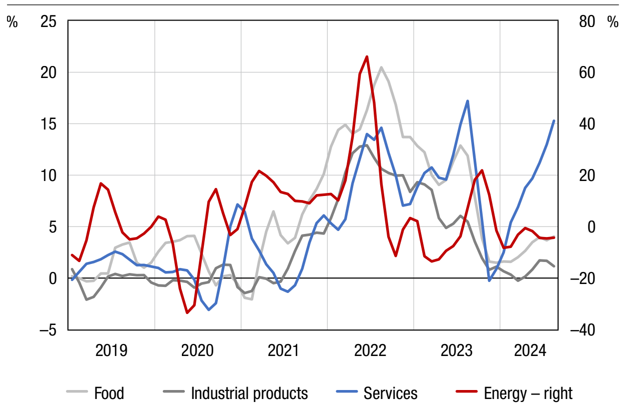
As announced on 13 March 2024, some changes to the operational framework[3] for implementing the ECB's monetary policy will take effect from 18 September in order to continue transmitting the Governing Council's monetary policy decisions to short-term money market rates in conditions of

Figure 7 Inflation indicators in Croatia



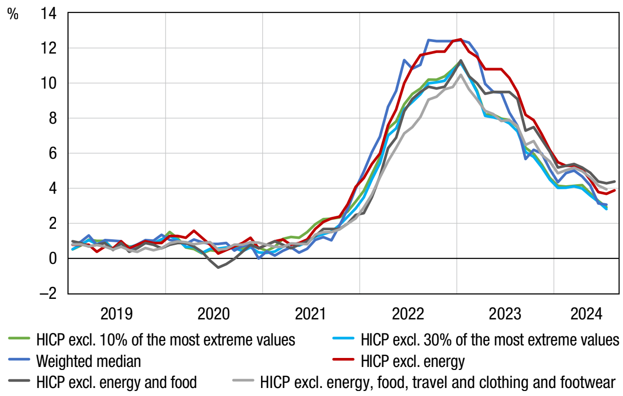
Notes: Core inflation is measured by the harmonised index of consumer prices, which excludes energy, food, alcoholic beverages and tobacco prices.
Sources: Eurostat, CBS and CNB calculations.

Figure 8 Momentums of the main inflation components



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

Figure 9 Core inflation indicators



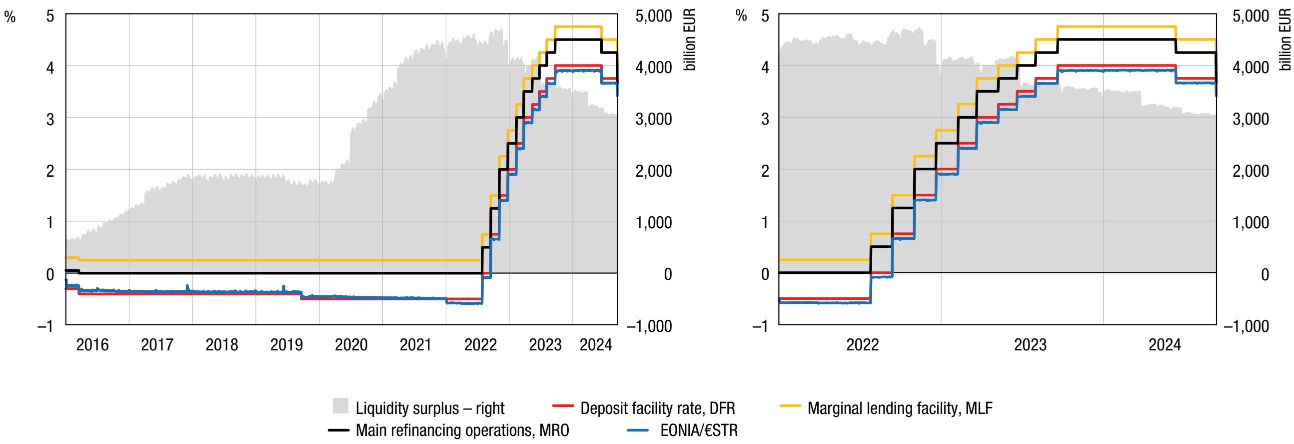
Notes: Trimmed mean eliminates 5% (15%) of components (out of a total of 87 components) with maximum and minimum annual rates of change. The weighted median excludes all values but the weighted median of the distribution of price change.
Sources: Eurostat and CNB calculations.

1 Inflation measured by the national consumer price index (CPI), which does not cover consumption of non-residents and institutional households, slowed down from 2.2% in July to 1.8% in August.

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

3 For more information, see Box 2 New framework for the implementation of ECB monetary policy in Macroeconomic Developments and Outlook No IX.

Figure 10 Key ECB interest rates

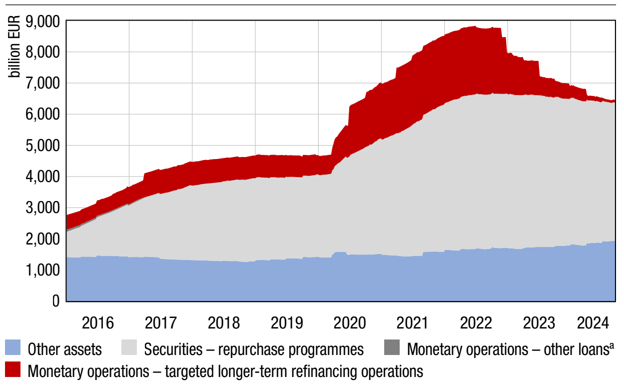


Notes: DFR (deposit facility rate); MLF (marginal lending facility); MRO (main refinancing operations). The EONIA was replaced by €STR in early 2022.
Source: ECB.

reduced excess liquidity. The operational framework has been adjusted to ensure that the deposit facility rate remains the key ECB interest rate even in the conditions of the normalisation of the Eurosystem balance sheet, that is, the gradual decrease of excess liquidity from the very high level. Thus, the spread between the rate on the main refinancing operations and the deposit facility rate will be reduced to 15 basis points from the current spread of 50 basis points by adjusting the rate on the main refinancing operations. This narrower spread will incentivise banks' bidding in the weekly operations, so that short-term money market rates are likely to remain in the vicinity of the deposit facility rate, and will limit the potential scope for volatility in short-term money market rates. At the same time, it will leave room for money market activity and provide incentives for banks to seek market-based funding solutions. The spread between the rate on the marginal lending facility and the rate on the main refinancing operations will remain unchanged at 25 basis points. Accordingly, the interest rates on the main refinancing operations and the marginal lending facility will be decreased to 3.65% and 3.90% respectively, with effect from 18 September.

The size of the Eurosystem's balance sheet has continued to decrease gradually (Figure 11). Banks are still repaying amounts borrowed under the targeted longer-term refinancing operations, with these amounts already being almost fully repaid. 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. With regard to the pandemic emergency purchase programme (PEPP), the PEPP portfolio will be reduced by EUR 7.5bn per month on average in the second half of 2024, while reinvestments under the PEPP will be completely discontinued at the end of 2024. Until the end of 2024, 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.

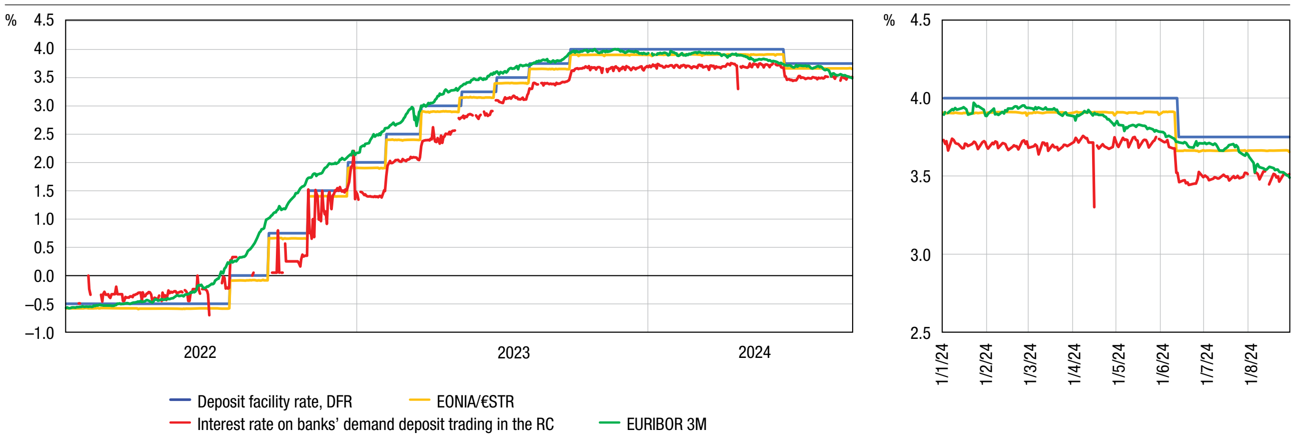
Figure 11 Eurosystem balance sheet



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

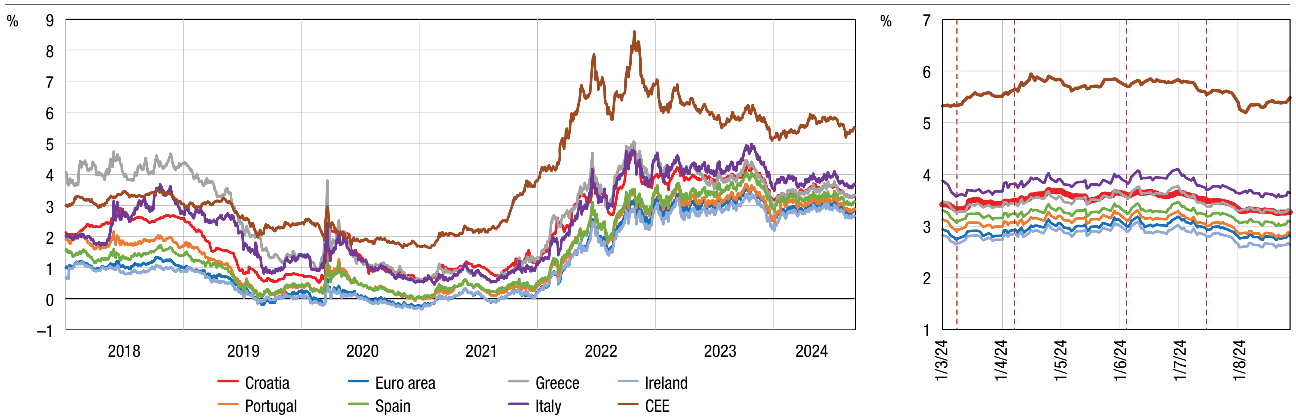
Capital markets saw strong market shifts in early August, driven, among other things, by worse than expected data from the US labour market for July. These developments followed after bad performance by some US tech companies and the unexpectedly high increase of the benchmark interest rate in Japan. Overall, this led market participants to conclude that there was an increased likelihood of a recession in the US. In early August, the VIX index, that is, the measure of uncertainty in financial markets, reached its highest levels since the outbreak of the pandemic. The US S&P 500 index plunged by almost 10% from its record-high level reached in July this year. This trend was also followed by European stock indices. In early August, the German DAX and the French CAC lost slightly more than 9% of their value compared to the levels recorded in mid-July. The increase in uncertainty was reflected in the greater investor propensity towards bonds. The US ten-year bond yield fell below 3.70% at one point, the lowest level since June last year, while the euro area GDP-weighted average of long-term government bond yields dropped below 2.75%, the lowest level since March this year (Figure 13). It may be that reduced trading volumes in the summer months further intensified these market shifts. In any case, these shifts were short-lived and the VIX index returned to the levels recorded before this episode after two weeks. By the end of August, stock indices also almost entirely wiped out losses. However, bond markets have not returned to their previous levels, mirroring expectations of market participants that a number of central banks will ease the degree of monetary policy restrictiveness at a faster pace. After the European Central

Figure 12 Key ECB interest rate and overnight market interest rates in the euro area and Croatia



Notes: DFR (deposit facility rate). The EONIA was replaced by €STR in early 2022. The overnight interest rate on the money market in Croatia in 2022 is based on euro transactions.
Sources: ECB and CNB.

Figure 13 Yields on long-term government bonds with the remaining maturity of approximately 10 years

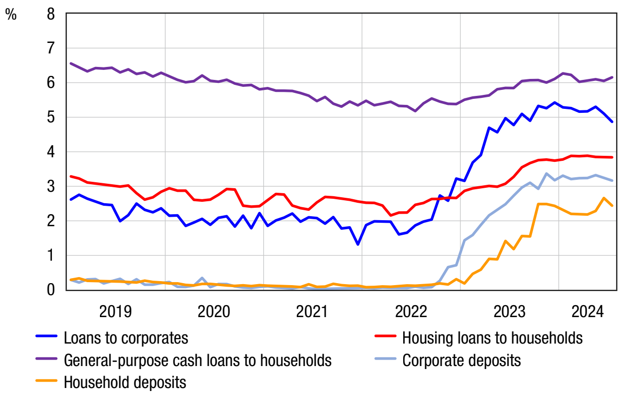


Notes: CEE – countries of Central and Eastern Europe (the Czech Republic, Hungary, Poland and Romania); yields for the euro area and CEE have been weighted by the share of GDP of the countries included. Data from the euro area do not include those from Estonia, Latvia, Luxembourg and Malta. The red dotted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

Bank first cut its key interest rate by 25 basis points in June, the Fed could soon follow this path, according to the latest statements by the institution's top executives. The markets attribute a non-negligible probability to the outcome of a 50 basis points cut as early as September. This has also raised expectations of new cuts by the European Central Bank. Thus, the three-month EURIBOR declined to 3.50% at end-August, the lowest level in more than a year (Figure 12). In such a setting, the yield on the Croatian ten-year foreign bond went down and hovered around 3.23% at end-August, the lowest level since the end of last year.

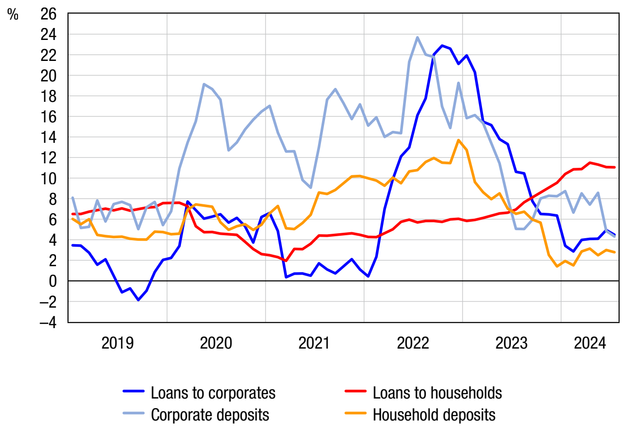
The costs of corporate financing by credit institutions decreased markedly and in July they hit a record low for the past year. Interest rates on general-purpose cash loans continued their upward path after having slightly decreased in June. Interest rates on housing loans remained almost unchanged and stood at the highest level during the recent cycle of monetary tightening reached at the beginning of the year. The average interest rate on pure new corporate loans stood at 4.9% in July, down by 24 basis points from June. In terms of enterprise size, all enterprises, except those classified as small enterprises, borrowed at lower interest rates. In terms of purpose, noteworthy are lower interest rates on working capital loans and factoring. The interest rate on pure new general-purpose cash loans to households averaged 6.2% in July, up by 10 basis points from the month before, while the interest rate on housing loans was almost the same as in June (3.8%). In July 2024, the interest rate on corporate loans fell by 56 basis points from its highest level, which was reached in December 2023. The interest rate on general-purpose cash loans to households dropped by 11 basis points from the maximum level of 6.3% recorded in January this year (Figure 14). With regard to housing loans to households, interest rates stabilised at an elevated level. In July, the average interest rates on existing loans, i.e. on their stocks, edged down by 4 basis points on corporate loans (4.6%) and increased by the same amount on housing loans to households (3.1%). The interest rate on the stock of general-purpose cash loans recorded a very small increase of 2 basis points (6.0%). Interest rates on existing household loans granted at a variable interest rate linked to the NRR rose markedly for the first time in July relative to June, by 16 basis points (3.2%) and 15 basis points (5.4%) for housing and non-housing loans, respectively. This increase reflects the gradual spillover of the rise in the NRR on financing

Figure 14 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 15 Corporate and household loans and deposits
year-on-year rates of change, transaction-based



Source: CNB.

costs, given that the 6-month NRR (6m NRR1) rose by 25 basis points in the first quarter of 2024 from the level recorded in the third quarter of 2023.

Interest rates on household and corporate time deposits decreased in July, with a more pronounced decline in household deposits. The average interest rate on pure new household time deposits fell by 22 basis points in July from the level recorded in June and stood at 2.4%. This decrease was largely due to one bank, which cut its interest rates in July by almost 1 percentage point following an increase in June, spurring inflows of funds on time deposits. Observed by maturity, the interest rate on deposits with maturities from six to 12 months went down, which led to a decrease in the share of deposits with these maturities. The interest rate on deposits with shorter maturities (from three to six months) remained unchanged and the share of such deposits increased. The interest rate on pure new corporate time deposits fell by 7 basis points from June, to 3.2% (Figure 14). The interest rate on total household time deposits rose by 4 basis points in July, to 1.8%, and fell by 2 basis points (to 2.9%) on total corporate time deposits. The interest rate on overnight household deposits remained unchanged at 0.02%, while the interest rate on overnight corporate deposits went up by 5 basis points, to 0.21%. Due to these changes and the decrease in the share of time deposits, the interest rate on total existing household deposits rose by 1 basis point, to 0.5%, while the interest rate on total existing corporate time deposits fell by 5 basis points, to 0.9%.

The annual growth rate of household loans edged down in July as the base effect had an impact on the deceleration of housing loan growth, while general-purpose cash loans continued to increase. The growth of corporate loans also slowed down on an annual level. Loans to domestic sectors (excluding the general government) grew in July, by EUR 0.2bn or 0.6% (transaction-based), reflecting the still relatively strong lending to households (EUR 0.2bn or 1.1%). On the other hand, corporate loans edged down in July (EUR 36m or 0.2%). The increase in household loans was largely driven by general-purpose cash loans, which increased by EUR 129m or 1.5%, while housing loans recorded a somewhat sharper growth than in the previous months, increasing by EUR 107m or 0.9% in July. On an annual level, the growth in total household loans edged down, from 11.1% in June to 11.0% in July (transaction-based), with the annual growth rate of housing loans going down from 9.8% to 9.2%, largely due to the base effect, that is, the sharp increase in housing loans last July spurred by the government subsidy programme, which ceased this year. By contrast, the growth in general-purpose cash loans continued to pick up, from 14.7% in June to 15.4% in July, the strongest annual growth rate seen since December 2011, driven by exceptionally strong new lending activity. A slight fall in corporate loans in July was widespread across business entities, mostly large enterprises, and activities, particularly trade. The annual growth in corporate loans decreased, from 4.9% in June to 4.5% in July (Figure 15), under the influence of the fall in lending activity and the base effect. The momentum of general-purpose cash loans has remained strong, even though it weakened slightly in the last two months, while the momentum of housing loans increased slightly. The momentum of corporate loans moderated further in July.

Domestic deposits picked up in July. Total domestic deposits (general government excluded) went up considerably in July from June, by EUR 1.1bn (or 1.9%, transaction-based), as is usual during the tourist season. In the deposit structure, overnight deposits increased (EUR 1.4bn), while time deposits recorded the sharpest decrease since November 2020 (EUR 0.3bn), reflecting the fall in time deposits of other financial institutions and non-financial corporations. Corporate deposits grew by EUR 0.7bn, with overnight deposits rising by EUR 0.9bn and time deposits going down by EUR 0.2bn. Household deposits rose by EUR 0.4bn, which was almost entirely due to the growth of overnight deposits (EUR 0.4bn), while time deposits edged up by EUR 48m. In addition, at the beginning of July, citizens invested a little less than EUR 160m in "national" bonds issued by the Ministry of Finance, less than in the previous issues of government securities. This was the fifth issue of government securities in which citizens have so far subscribed a total of EUR 4.3bn. With regard to corporate deposits, the share of time deposits in total deposits continued to trend down markedly, from 28.2% in June to 26.0% in July. After picking up in June, the share of household time deposits in total deposits edged down in July, from 29.2% to 29.0%. Deposits of other non-bank financial institutions decreased slightly in July, by EUR 73m, with the fall in time deposits (EUR 203m) being somewhat sharper than the increase in overnight deposits (EUR 138m).