Information on economic, financial and monetary developments

October 2024

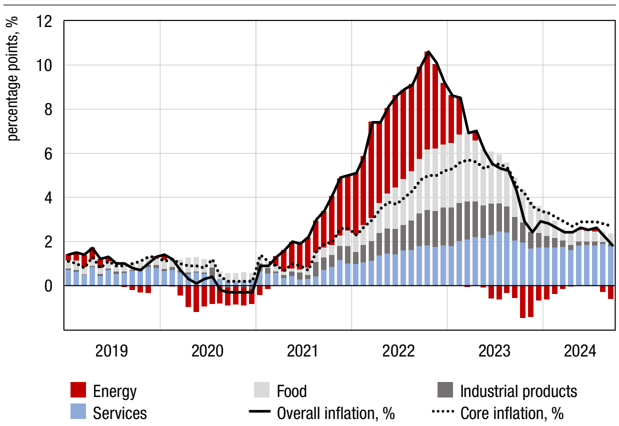
Summary

The euro area economy grew by 0.2% in the second quarter, and is likely to continue to expand at the same pace in the third. Most of the available data suggest that the growth in the real GDP during the summer months might be of the same intensity as that seen in the second quarter (Figure 1) and have a similar structure of growth characterised by an expansion of the services sector and a contraction in manufacturing. The predicted growth in the euro area economy in the third quarter can mostly be ascribed to countries with a strong services sector (Spain, France), while the contribution of countries with a larger share of manufacturing (Germany, Austria) might be very small or negative. If leading indicators of economic activity in the euro area are observed, the purchasing manager index (PMI) worsened considerably in September suggesting a modest outlook for growth in the last quarter. The indicator of industrial activity in September recorded a significant contraction as well as the worst performance since the beginning of the year, with the indicator for the services sector also worsening, once the positive effect of the Olympic Games in France in August wore off.

According to a flash estimate from Eurostat, inflation in the euro area slowed down in September to 1.8%, from 2.2% in August (Figure 2). This was mostly due to the continued decrease in energy inflation, which fell to –6.0% from –3.0% in August, largely reflecting lower prices of crude oil on the global market and the favourable effect of the base period following a sharp increase in energy prices in September last year. Core inflation in the euro area continues to be higher than overall inflation but slowed down in September to 2.7% from 2.8% in August. This was the result of a small fall in services inflation to 4.0% from 4.1% in August, while industrial goods inflation held steady at 0.4%. Services inflation remains elevated but there is a noticeable trend of decreasing short-term inflationary pressures in the services sector, with the momentum of services inflation in the euro area falling gradually as a result from 5.3% in May to 4.1% in September. The momentum of overall inflation in the euro area has been stable in the past four months, standing at about 2.2%. Domestic inflationary pressures in the euro area arising from a robust wage growth are gradually easing, although they remain relatively strong.

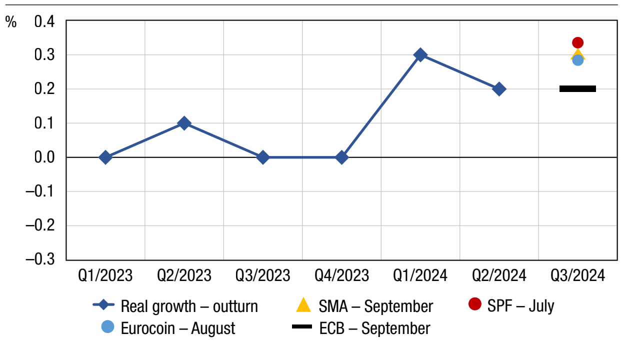
High-frequency data for the Croatian economy for the third quarter of 2024 suggest a further growth in economic activity, albeit at a somewhat slower pace than in the previous quarter. According to the CNB's nowcasting model of economic activity, after growing by 0.8% in the second quarter of this year, Croatia's real GDP might grow by 0.5% on a quarterly level in the third quarter, with its growth on an annual level accelerating to 4.1%, from 3.3% in the second quarter (Figure 3). Real retail trade turnover decreased on a monthly level in August, but in the first two months of the third quarter was higher than in the second quarter, continuing the current growth seen since the beginning of last year. Construction activity also rose sharply in July on a monthly level, and even more so relative to the average in the second quarter, with the growth being recorded in the volume of construction works on buildings and civil engineering works. Despite a significant drop in August, in the first two months of the third quarter industrial production held steady above the average seen in the previous quarter. Survey-based indicators of business optimism for September continue

Figure 2 Inflation indicators in the euro area



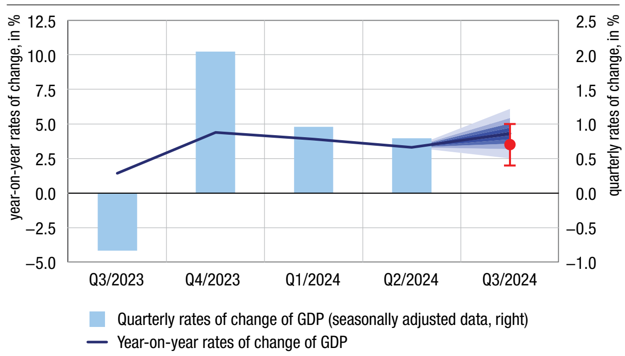
Note: Core inflation is measured by the harmonised index of consumer prices, which excludes energy, food, alcoholic beverages and tobacco prices.
Sources: Eurostat and CNB calculations.

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



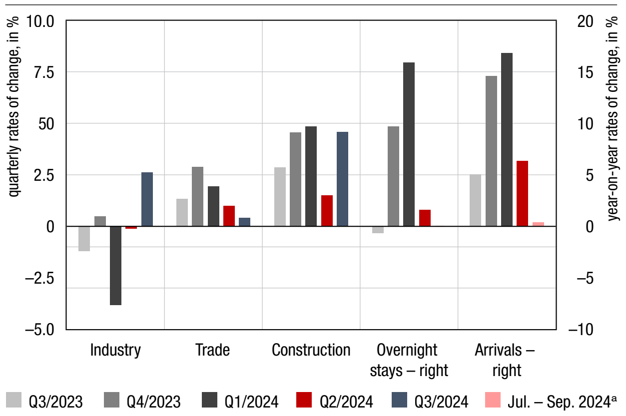
Notes: Abbreviation ECB – September refers to ECB September projections of real growth in the euro area (Macroeconomic Projection Exercise, MPE). Abbreviations SMA, Survey of Monetary Analysts and SPF, Survey of Professional Forecasters refer to the results of the ECB survey of market participants in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

Figure 3 Quarterly gross domestic product



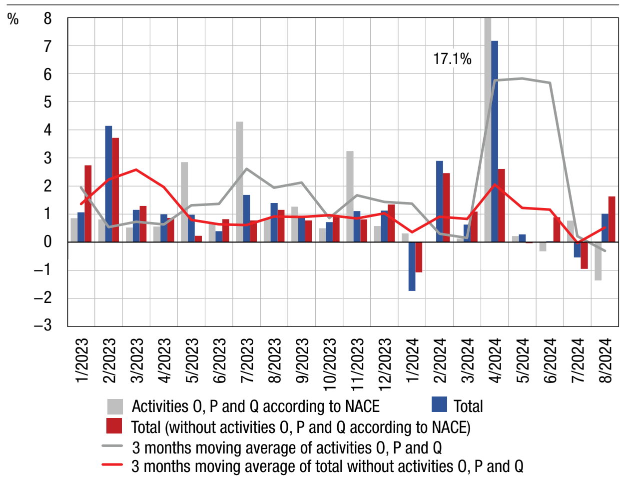
Notes: The estimate for the third quarter of 2024 refers to the Monthly indicator of real economic activity of the CNB (for more details on the calculation of the MRGA indicator, see CNB survey Kunovac, D., and B. Špalat: "Nowcasting GDP Using Available Monthly Indicators"). The models are estimated on the basis of data published up to 1 October 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 indicators of economic activity in Croatia



ª Data on overnight stays and arrivals for the first 20 days in September are included.
Note: Data for the third quarter of 2024 for industry and trade refer to July and August, and for construction to July 2024.
Sources: CBS and eVisitor.

Figure 5 Nominal gross wages
monthly rate of change

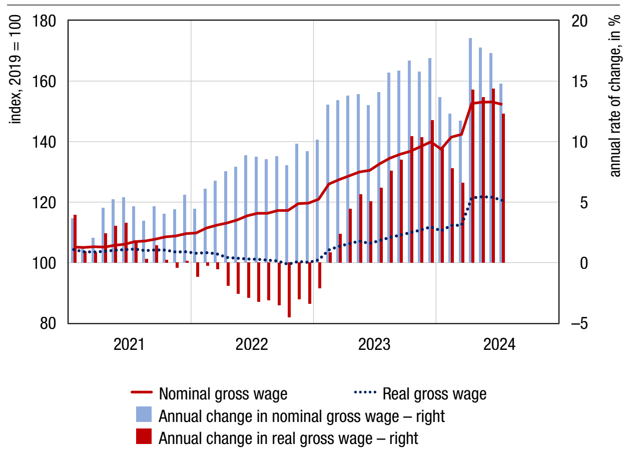


Sources: CBS and CNB calculations (seasonally adjusted by the CNB).

to be relatively favourable with confidence in trade reaching its highest value since surveys began, despite the fall in consumer optimism.

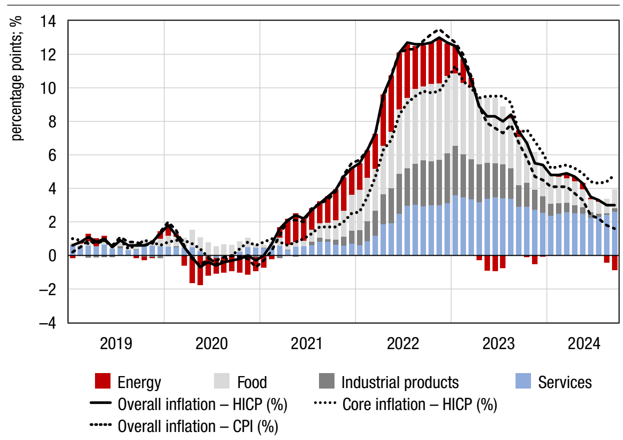
The labour market saw a further rise in employment and a fall in unemployment in the third quarter, although slower paced than in the first half of the year, while wages remained almost unchanged from the second quarter. Although slower paced, employment in Croatia continued to grow in August 2024, leading to a slowdown in the average rate of change from the previous quarter. Thus, in July and August, employment rose on average by 0.9% from April and May in contrast with 1.2% in the second quarter. While employment growth in public administration, education, health care and social services (activities O, P and Q) was almost equal (up 1.6% from 1.4%), the rise in the number of employed persons in the rest of the economy slowed down to 0.7% from 1.1% in the second quarter. This reflects diverse developments in the number of employed persons in different activities. More specifically, average employment in construction and transportation and storage in July and August grew at the rate similar to that seen in the previous quarter, in trade, IT and business services employment growth slowed down and held steady in industry but fell in financial activities and accommodation and food service activities, with the contribution of individual activities falling the most in trade and business services while that in accommodation and food service activities turned negative. Unemployment also continued to fall at a slower pace in the third quarter, having dropped by 5.6% from 6.2% in the second quarter. The registered unemployment rate in July and August stood at 5.2% of the labour force (5.5% in the second quarter). Data for the ILO unemployment rate are available for the second quarter when it stood at 4.7% (5.2% in the first quarter). Following the July decline, in August 2024, the average nominal gross wage in Croatia rose by 1.0% from the month before. As a result, the average nominal gross wage in July and August remained almost unchanged from the previous quarter, having risen by 0.1%, which is in contrast with the growth of 8.9% in the second quarter (Figure 5). However, during the observed period wages in activities loosely comprising the public sector (O, P and Q) remained at the level recorded in the previous quarter while those in the rest of the economy rose slightly (0.5%). Viewed in relation to the third quarter of the previous year, the average nominal gross wage in July and August rose by 14.1%, in contrast with 17.8% in the second quarter.

Figure 6 Nominal and real gross wages
index, 2019 = 100, annual rate of change



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

Figure 7 Inflation indicators in Croatia

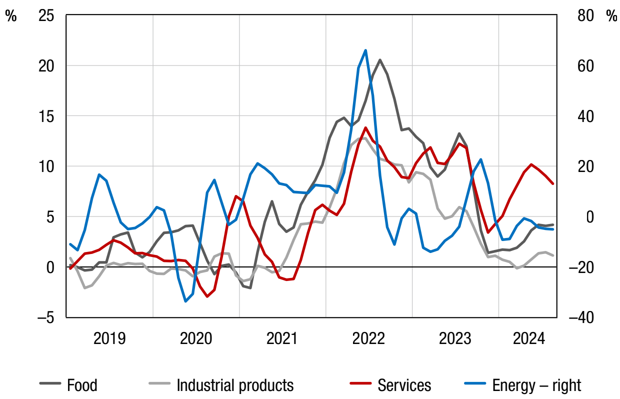


Note: Core inflation is measured by the harmonised index of consumer prices, which excludes energy, food, alcoholic beverages and tobacco prices.
Sources: Eurostat, CBS and CNB calculations.

The slowdown in the annual rate of change in the average wage largely reflects the base effects of a sharp rise in public sector wages in mid–2023, which since July no longer affects the annual rate of wage growth (Figure 6). As regards real wages, the average real wage in July and August has fallen for the first time since end-2022 from the previous quarter (–0.4%) and risen by 12.2% from the same period of the year before.

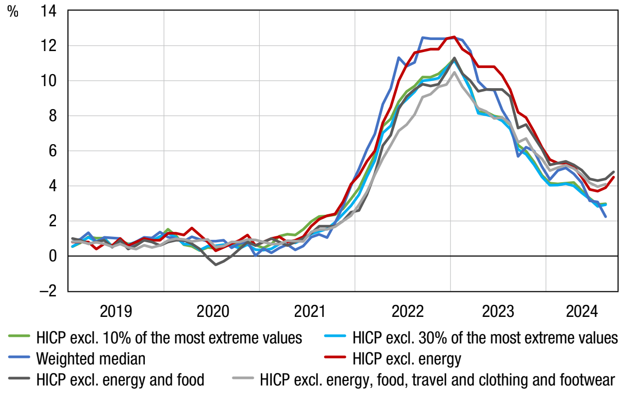
Inflation in Croatia in September 2024 remained unchanged from the previous month since the unfavourable base effects attributable to a pronounced drop in prices in September last year were fully offset by low current inflationary pressures. According to Eurostat's flash estimate, inflation measured by the harmonised index of consumer prices (HICP)[1] held steady in September 2024 at 3.0%, the level also recorded in August (Figure 7). After slowing down overall inflation in the first eight months of 2024, in September 2024, the base effects accelerated price inflation of all main components except energy owing to a pronounced drop in prices in September last year. However, the unfavourable base effects were offset by the easing of current inflationary developments in all main components except food, particularly energy, which resulted in overall inflation holding steady at the previous month's level. The annual rate of change in energy prices fell considerably, to –7.1% in September from –3.6% in August. In contrast, food inflation rose to 3.9% from 2.9% in August and industrial goods inflation accelerated slightly to 0.7% from 0.4% in August. Services inflation also rose to 8.2% from 7.6% in August, adding to services' significance for overall inflationary developments in Croatia, with services contributing 2.6 percentage points to the overall consumer price inflation of 3.0%). Although current pressures in the segment of services prices are gradually easing, the momentum[2] of services inflation continues to hover well above the usual historical values (Figure 8). Thus, the annual rate of services inflation accelerated additionally, driven by domestic inflationary pressures associated with the robust labour market and wage growth, as well as the pronounced domestic and foreign demand for catering and accommodation services. Industrial goods inflation also accelerated, fuelling core inflation, which excludes energy and food prices, to 4.8% from 4.4% in August (Figure 9).

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.

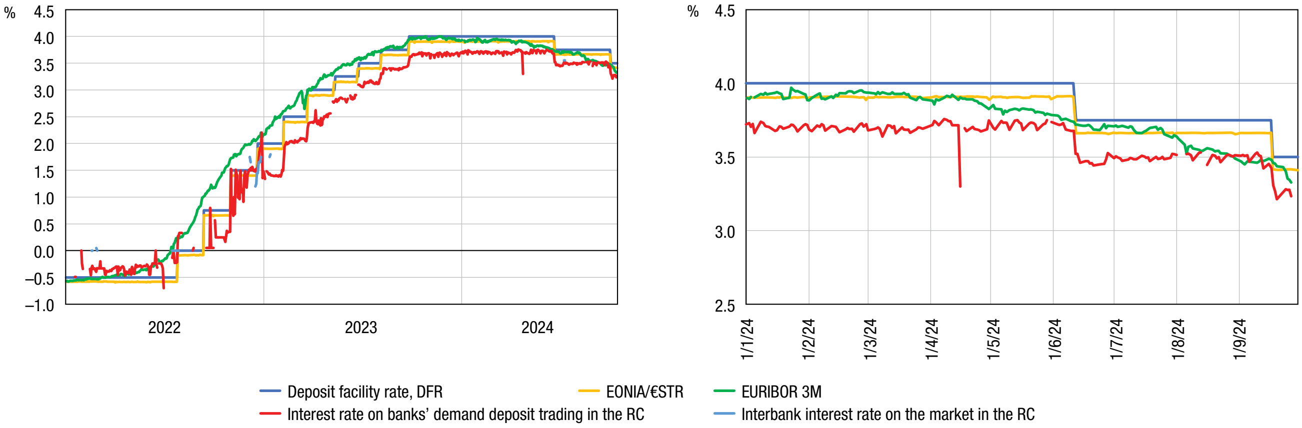
The reduction in key ECB interest rates by 25 basis points in September quickly spilled over to interest rates on the money market, but poorer economic indicators and a fall in inflation in September prompted a change in the expectations of financial market participants regarding a faster easing of monetary policy restriction. The €STR decreased by the amount of the decrease in key interest rates, to 3.4%, and remained at that level until the end of September (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 23 basis points to 3.3% in September. As regards the short-term costs of government financing, the government issued 91-day T-bills in mid-September. Yield at issue was 3.55% for individual investors and 3.30% for institutional investors, 20 and 35 basis points, respectively, lower than the June issue. The €STR forward curve shifted to lower values in September, influenced by market expectations of a faster and larger cut in key ECB interest rates (Figure 11). Such expectations were fuelled by economic developments in the U.S. and the euro area, which fared worse than expected, and a further easing of inflationary pressures.

The fall in inflation expectations and the worsening of the expectations regarding future economic developments led to a fall in yields on long-term government bonds. The euro area GDP-weighted average of long-term government bond yields stood at 2.7% at the end of September, 18 basis points down from the end of August (Figure 12). Rating agencies Standard & Poor's and Fitch Ratings have upgraded Croatia's credit rating to A– but this did not have any significant impact on yields on long-term Croatia bonds, which fell in Croatia in September just as much as the euro area average.

The costs of corporate financing by credit institutions in August remained almost unchanged, holding steady at the lowest level in the past year, reached in July. Interest rates on housing loans also held steady, continuing to maintain the highest level reached during the recent cycle of monetary tightening at the beginning of the year. At the same time, interest rates on general-purpose cash loans again rose very slightly and came close to the peak at the beginning of the year. The average interest rate on pure new corporate loans stood at 4.9% in August, down 1 basis point from July (Figure 15). The positive contribution of interest rate growth to working capital loans

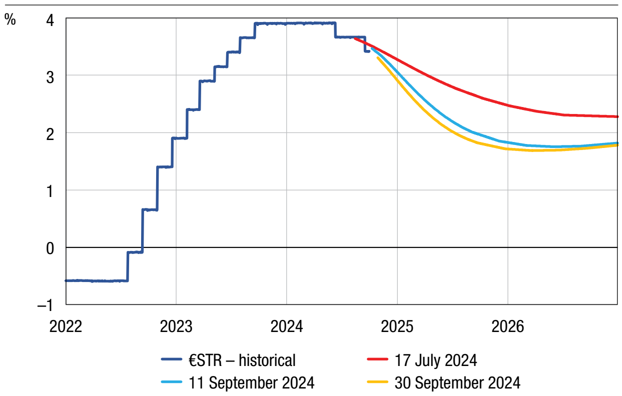
1 Inflation measured by the national consumer price index (CPI), which does not cover consumption of non-residents and institutional households, slowed down from 1.8% in August to 1.6% in September.
2 Momentum is a short-term inflation indicator which shows annualised three month-on-three month rates 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.
Source: ECB.

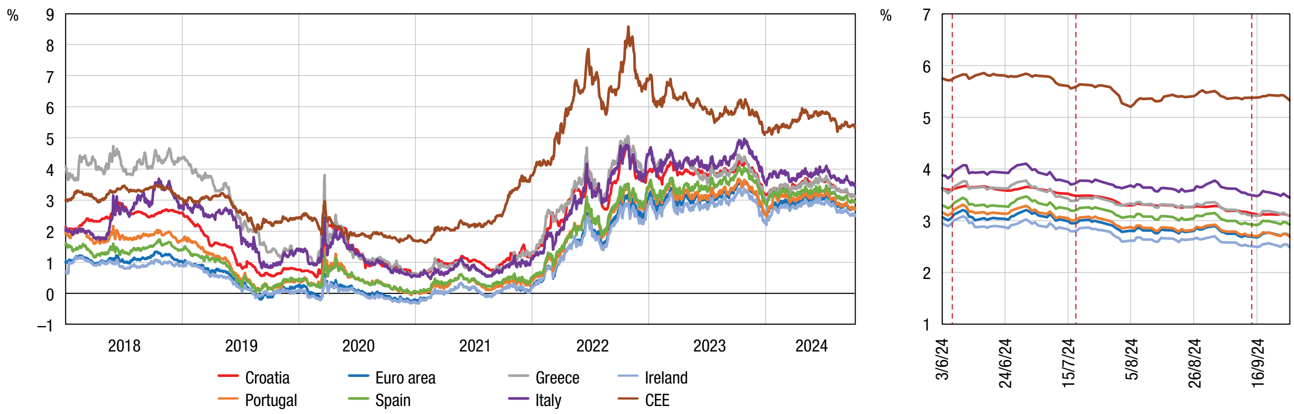
Figure 11 €STR forward curve



Notes: The forward curve is estimated using the rate from the spot overnight indexed swap (OIS) rate. Forward curves indicate selected forward curves formed on the day before the meeting of the Governing Council of the ECB in July and September 2024 and on the last day of September 2024.
Sources: Bloomberg and CNB calculations.

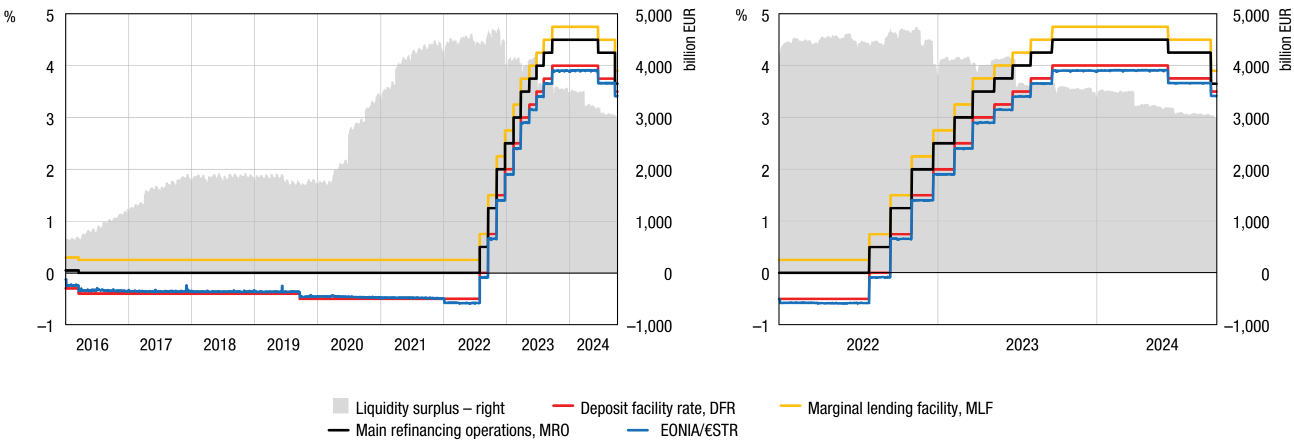
was cancelled by a fall in the interest rates on other corporate loans, most notably by the fall in the interest rates on investment loans and syndicated loans. In terms of corporate size, unlike small and medium-sized enterprises that borrowed at a higher interest rate than in July, loans to micro and large enterprises carried a somewhat lower interest rate. In August, the interest rate on pure new general-purpose cash loans to households averaged 6.2%, up by 8 basis points from the previous month, while the rate on housing loans was 1 basis point higher than in July (3.9%). The interest rate on corporate loans in August was 56 basis points lower than the peak reached in December 2023, while the large share of fixed interest rates and long maturity make interest rates on housing loans less sensitive to changes in short-term interest rates. Similarly, the interest rate on general-purpose cash loans to households was reduced by only 3 basis from the maximum of 6.3% in January this year. With regard to housing loans to households, interest rates stabilised at the elevated level reached at the beginning of the year. The average interest rate on existing loans, i.e. on their balances in August for corporates was the same as in July (4.6%) while that on housing loans to households rose by 2 basis points (3.1%) and that

Figure 12 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.

Figure 13 Key ECB interest rates



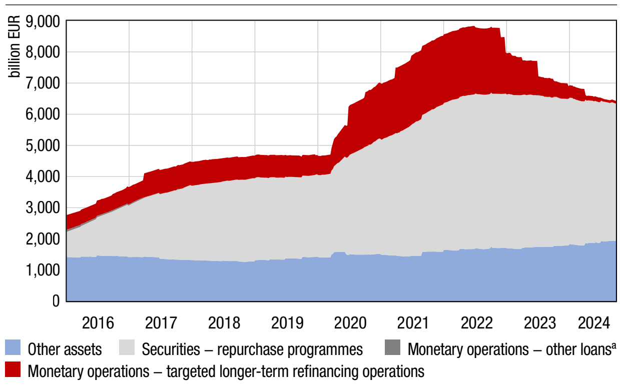
Notes: DFR (deposit facility rate); MLF (marginal lending facility); MRO (main refinancing operations). The EONIA was replaced by €STR in early 2022.
Source: ECB.

on general-purpose cash loans by 1 basis point (6.0%). After a considerable increase in July, the interest rates on the existing household loans granted at a variable interest rate linked to the NRR continued to rise in August, albeit slower, rising 3 basis points to 3.2% for housing loans and 5 basis points to 5.5% for non-housing loans. This increase reflects the gradual spillover of the rise in the NRR on financing 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, particularly those on household deposits, decreased in August. The average interest rate on pure new household time deposits in August was down 31 basis points from July and stood at 2.1%, similar to the level seen at the beginning of the year, before the rates increase in June and July. All systemically important banks recorded a fall in interest rates, as did most smaller banks. In terms of maturity, this was largely due to the fall in the interest rates on maturities between 6 and 12 months. The interest rate on pure new corporate time deposits fell by 4 basis points from July and amounted to 3.1% (Figure 15). The interest rate on the existing total deposits in August was down 3 basis points (0.7%) for corporates and 1 basis point (0.5%) for households. The interest rate on corporate time deposits increased by 2 basis points, to 2.9%, while the interest rate on household time deposits fell by 1 basis point, to 1.8%. At the same time, the interest rate on overnight corporate deposits fell by 4 basis points (0.17%), while that on household overnight deposits remained unchanged at 0.02%.

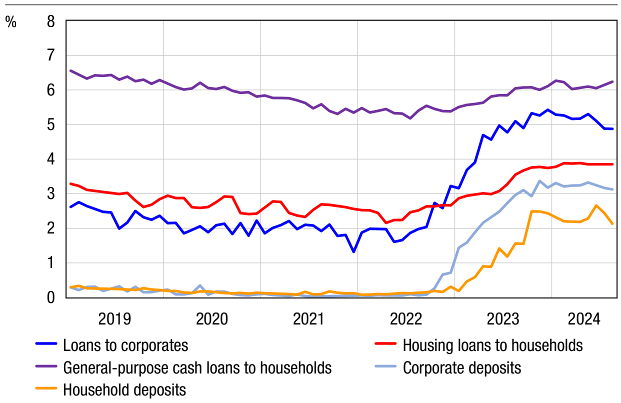
The annual growth rate of loans to households slowed down slightly in August because of the effect of the base period associated with the large number of loans that were granted in the same month last year under the government housing loan subsidy programme. In contrast, the annual growth of general-purpose cash loans continued to accelerate, although at a slower rate than in the previous months. Corporate loans fell in August, with their growth also slowing down on an annual level. Loans to domestic sectors (excluding the general government) rose slightly in August by EUR 0.1bn or 0.2% (transaction-based), reflecting further relatively strong household lending (EUR 0.1bn or 0.6%). In contrast, as in July, loans to corporates also fell in August (EUR 64m or 0.4%). The growth in household loans can be attributed equally to the

Figure 14 Eurosystem balance sheet



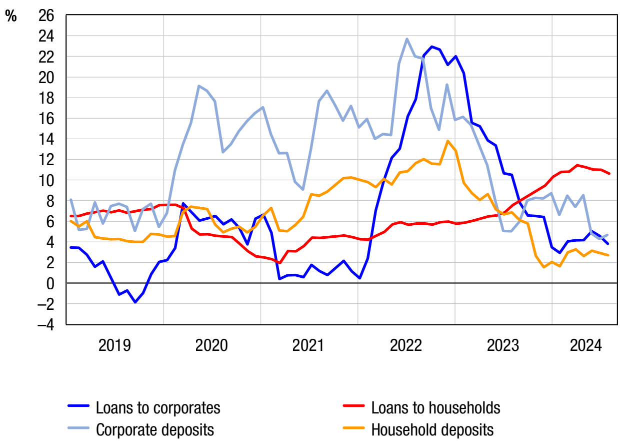
[a] Other loans include main refinancing operations, fine-tuning reverse operations, structural reverse operations, marginal lending facility and credits related to margin calls.
Note: The Eurosystem monetary balance sheet asset items are shown in grey and red and non-monetary in blue.
Source: ECB.

Figure 15 Interest rates on pure new loans and time deposits of corporates and households



Notes: Data up to December 2022 refer to loans and deposits in kuna, in kuna with a currency clause in euro and in euro, and from January 2023 to loans and deposits in euro. Data refer to pure new loans and time deposits. Deposits with a maturity of up to 1 month have been excluded.
Source: CNB.

Figure 16 Corporate and household loans and deposits
year-on-year rates of change, transaction-based



Source: CNB.

growth in housing and that in general-purpose cash loans. On an annual level, the growth in total household loans edged down, from 11.0% in July to 10.7% in August (transaction-based), with the annual growth rate of housing loans going down from 9.2% to 8.6%, largely due to the base effect, that is, the sharp increase in housing loans last August spurred by the government subsidy programme, which ceased this year. By contrast, the growth in general-purpose cash loans continued to pick up, from 15.4% in July to 15.5% in August, the strongest annual growth rate seen since December 2011, driven by exceptionally strong new lending activity. The fall in corporate loans is related to large enterprises and largely reflects loan repayment by one large firm.

The annual growth in corporate loans slowed down from 4.5% in July to 3.7% in August (Figure 16), under the influence of the fall in lending activity and the base effect. The momentum of general-purpose cash loans remains robust (15.2%) although it is weakening for the third consecutive month and has fallen slightly below the annual growth rate and in August, the housing loans segment has also lost some of its momentum. The momentum of corporate loans moderated further in August.

Domestic deposits picked up strongly in August. Total domestic deposits (excluding the general government) rose sharply in August, having risen by EUR 1.5bn or 2.7%, transaction-based, from July, a common increase during the main part of the tourist season. In terms of deposit structure, time deposits and overnight deposits rose by EUR 0.9bn and EUR 0.7bn, respectively. Non-financial corporations and other financial institutions increased their time deposits with banks, while the growth in overnight deposits was particularly strong in the household sector and to a lesser extent in that of non-financial corporations. Corporate deposits rose by EUR 0.8bn with time deposits rising by EUR 0.6bn and overnight deposits by EUR 0.2bn. In August, household deposits rose by EUR 0.6bn, entirely attributable to the growth in overnight deposits, in contrast to time deposits, which fell by EUR 19m. In early September, citizens subscribed slightly below EUR 400m worth of "national" T-bills of the Ministry of Finance for a three month term. This was the sixth issue of government securities in which citizens have so far subscribed a total of EUR 4.7bn of which EUR 0.2bn fell both in June and September. The share of time deposits in total deposits of corporates rose markedly from 26.0% in July to 28.1% in August in contrast with that for households, which continued to decrease, having fallen from 29.0% to 28.5%. Deposits of other non-bank financial institutions also rose (EUR 0.2bn) with the growth in time deposits (EUR 0.3bn) being stronger than the fall in overnight deposits.