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EUROSYSTEM

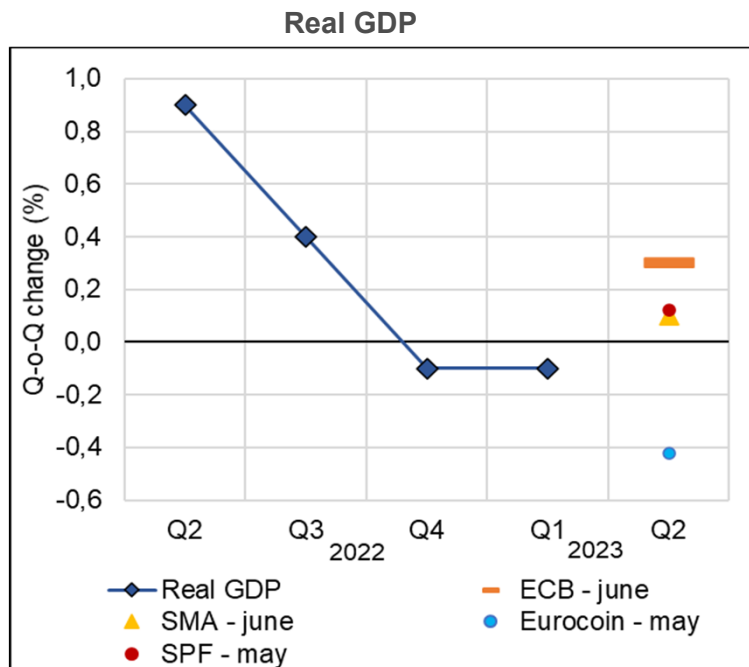
ECB policy and the outlook for Eurozone inflation and the economy

Boris Vujčić, Governor
July 12, 2023

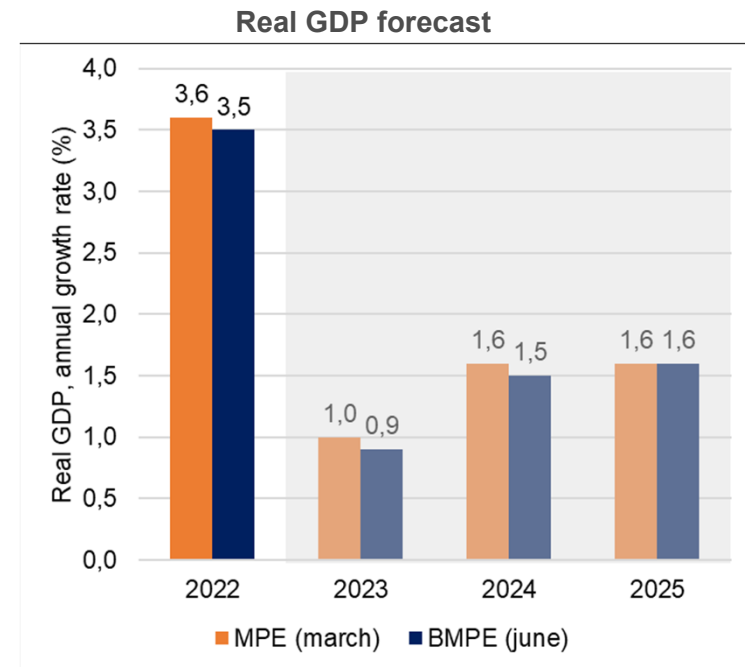


Outlook for the euro area

Following two consecutive quarters of slight decline, economic growth could turn positive, but will likely remain weak



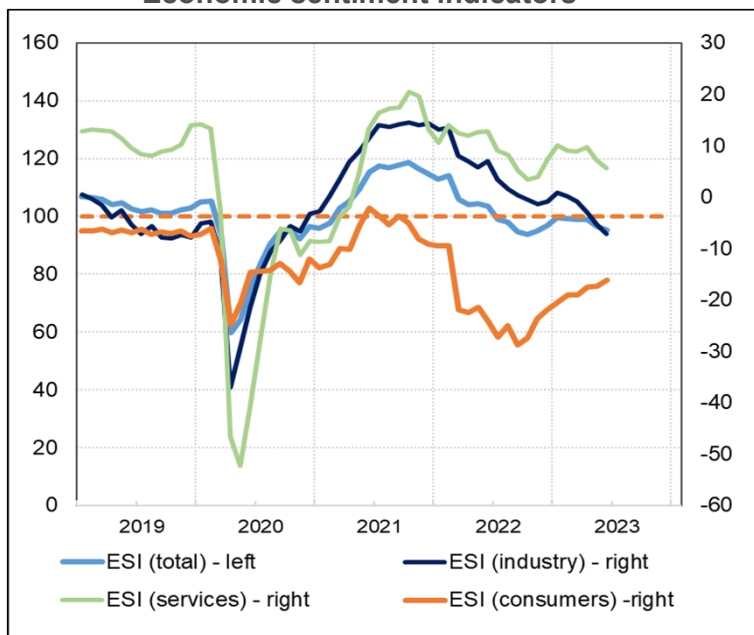
Note: The abbreviation ECB-june refers to the ECB's projections of real growth in the euro area from June (Broad Macroeconomic Projection Exercise, BMPE). The abbreviations SMA (Survey of Monetary Analysts) and SPF (Survey of Professional Forecasters) refer to the results of the ECB's surveys of market participants from June and May, respectively. The Eurocoin indicator was developed by the Bank of Italy and represents a model estimate of the three-month change in real GDP of the euro area derived from available high-frequency data (estimate from May).



Note: The abbreviations BMPE and MPE refer to projection exercises from the respective months.
Source: ECB

Service sector continues to support growth, albeit to a decreasing extent

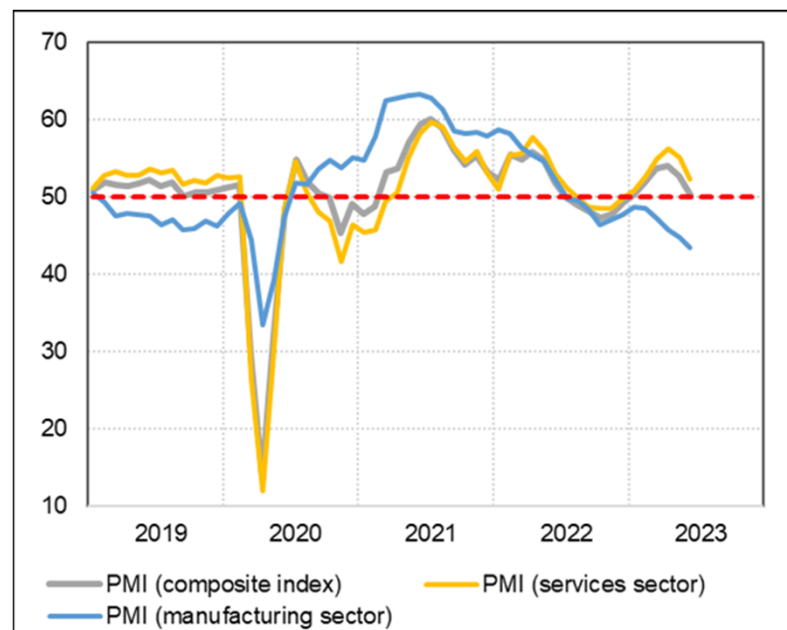
Economic sentiment indicators



Note: Index value above (below) 100 indicates higher (lower) than the long-term average. Latest observation as of June 2023.
Source: Eurostat

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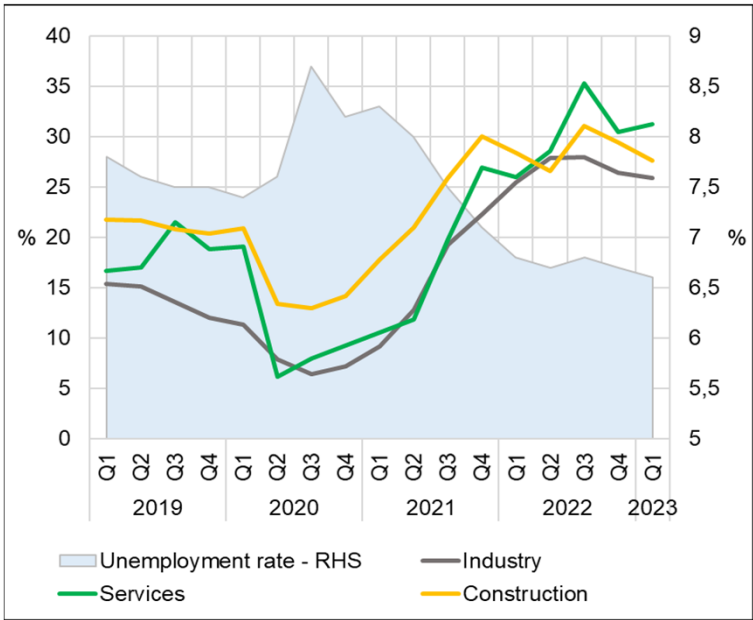
Purchasing Managers' Index



Note: Index value above (below) 50 indicates higher (lower) than the long-term average. Latest observation as of June 2023.
Source: S&P Global

Labour market remains tight adding to inflationary pressures

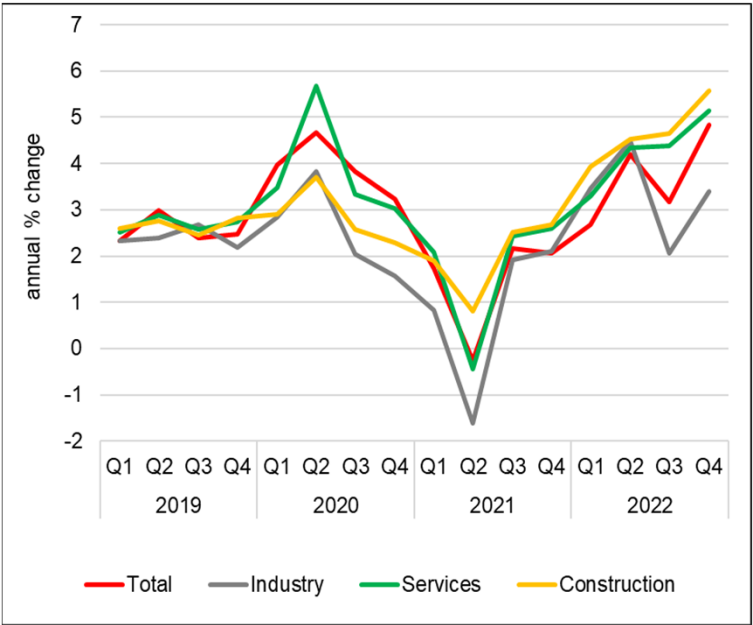
Labour shortages and unemployment rate



Note: Labour shortage is taken from the quarterly survey and represents the percentage of companies that state that the labour shortage is an obstacle to business.

Source: Eurostat
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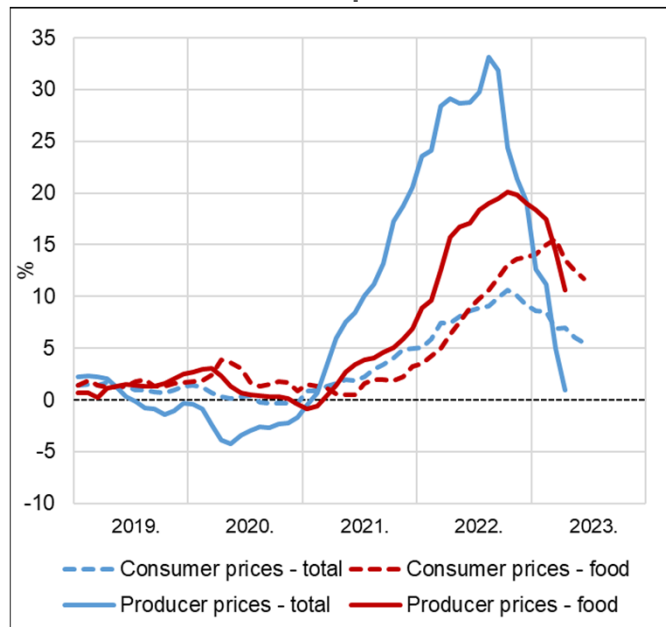
Compensation of employees



Source: Eurostat

While pressures from energy and food are easing, core inflation persists due to continued momentum in services

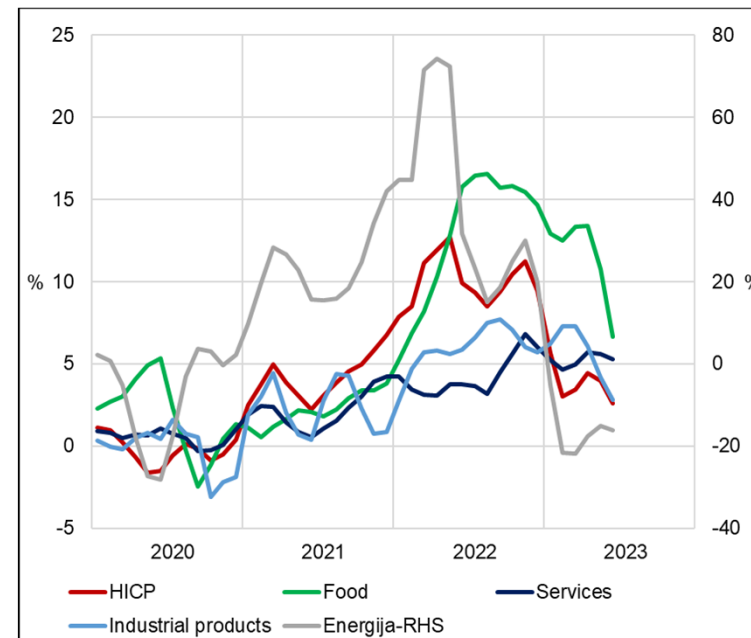
Selected indicators of producer and consumer prices



Note: Latest observations are June 2023 (consumer prices) and April 2023 (producer prices).
Source: Eurostat

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Momentum of key inflation components

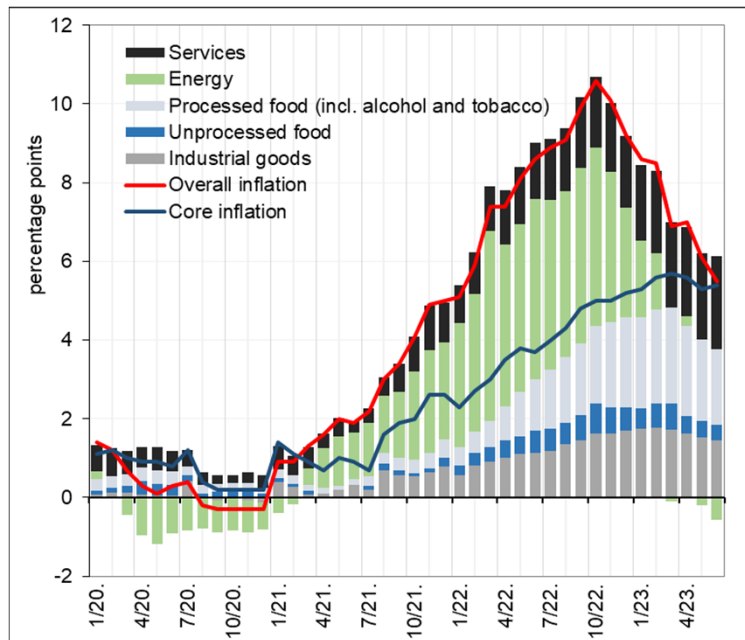


Note: Momentum is calculated from the three-month moving average of seasonally adjusted harmonized consumer price indices. Latest observation is June 2023.
Source: Eurostat, CNB calculations

Due to structural differences core inflation varies across members but the differences are narrowing

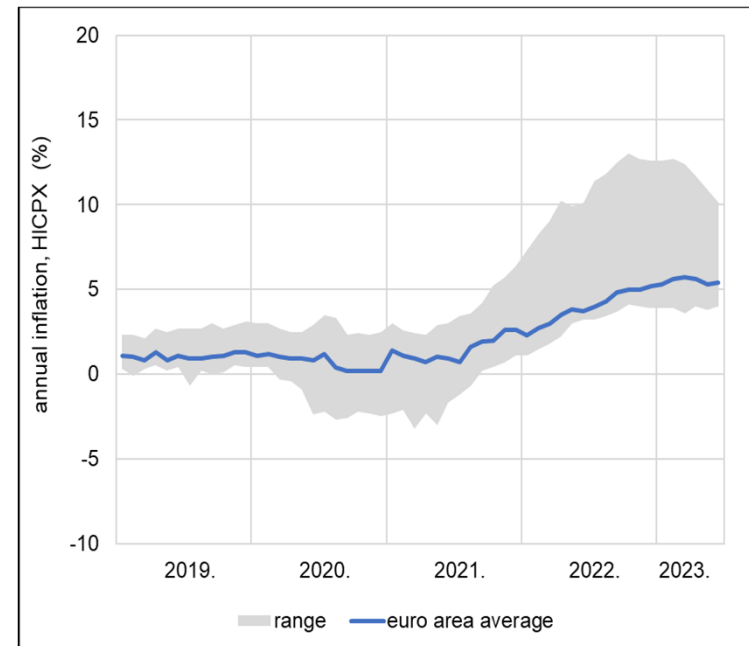


Cotributions to annual inflation



Note: Core inflation is overall inflation excluding energy, food, alcohol and tobacco.
Source: Eurostat

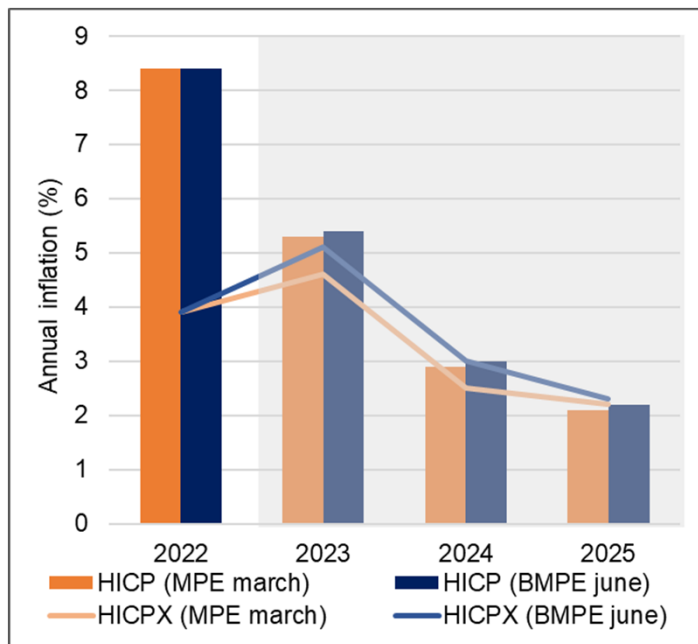
Core inflation across EA members



Note: Grey area is the range of core inflation outcomes for individual member states.
Source: Eurostat

Inflation forecast is revised slightly up as pressures from the labour market outweigh the effects of lower producer prices

Inflation forecast revision



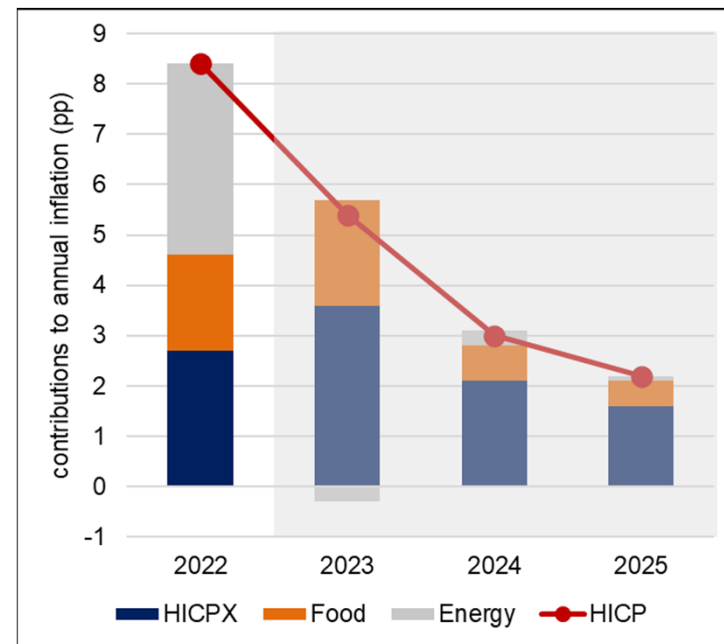
Note: Grey area is forecast.

Source: ECB

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Contributions to inflation



Note: Grey area is forecast.

Source: ECB

Risks to the outlook are still elevated but more balanced

Inflation outlook

upside ↑

- higher energy prices and raw materials
- climate change (extreme weather conditions frequency impact on food prices)
- faster wage growth
- companies' efforts to maintain higher profits

downside ↓

- lower prices of energy and raw materials
- stronger pass-through from monetary policy tightening

GDP outlook

upside ↑

- favorable trends in the labour market could support the recovery of consumer spending

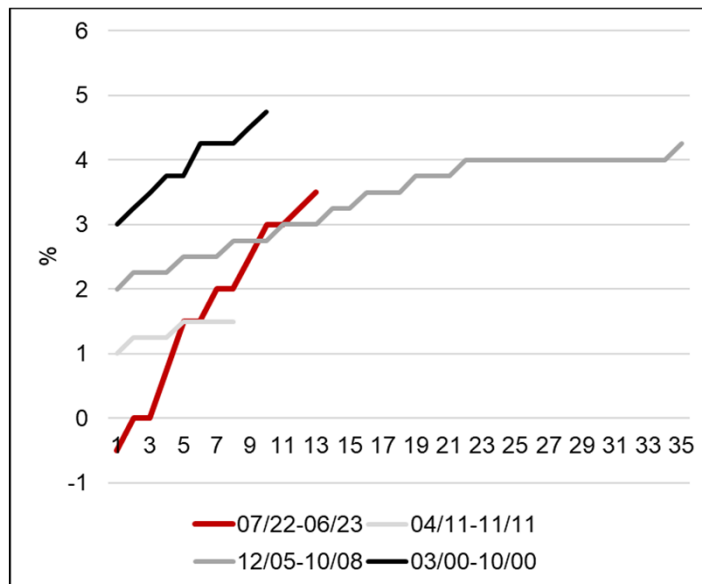
downside ↓

- prolonged uncertainty / geopolitical tensions could result in weaker global demand and/or renewed price pressures
- tighter financing conditions could have stronger effect on domestic demand

Monetary policy and transmission effects

Strongest tightening since the introduction of euro and we are most probably not done yet

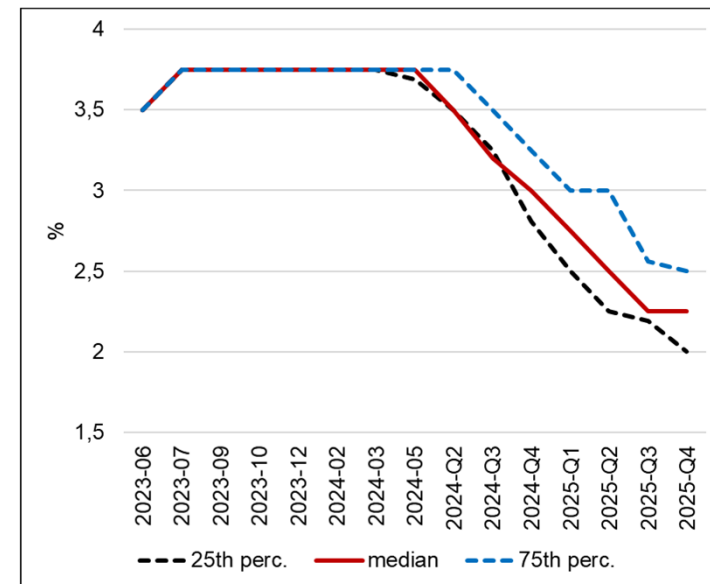
ECB tightening cycles



Note: X axis refers to number of months since the start of the hiking cycle. MRO is shown for each cycle except for the last (07/2022 – 06/2023) where DFR is shown.

Source: ECB; CNB calculations

Expectations for DFR



Note: first DFR cut in 2024-Q2.

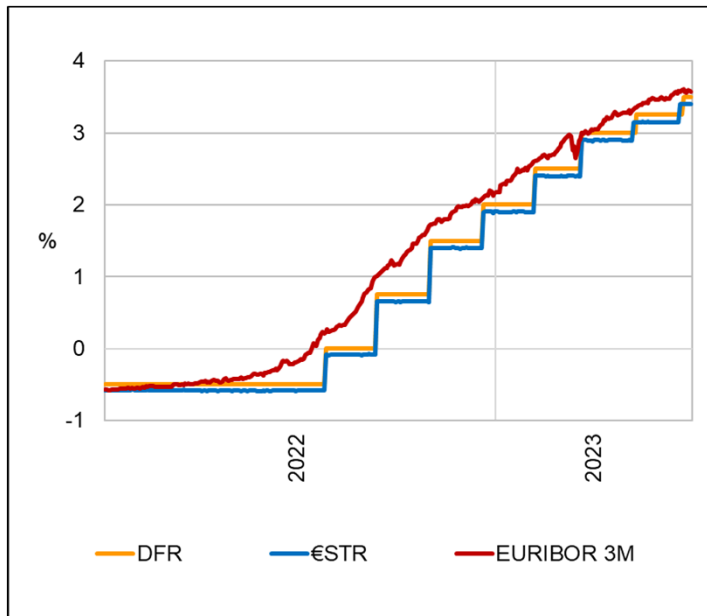
Source: Survey of Monetary Analysts (SMA); June 2023

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Transmission to money market interest rates is smooth, while yields on government bonds stay still

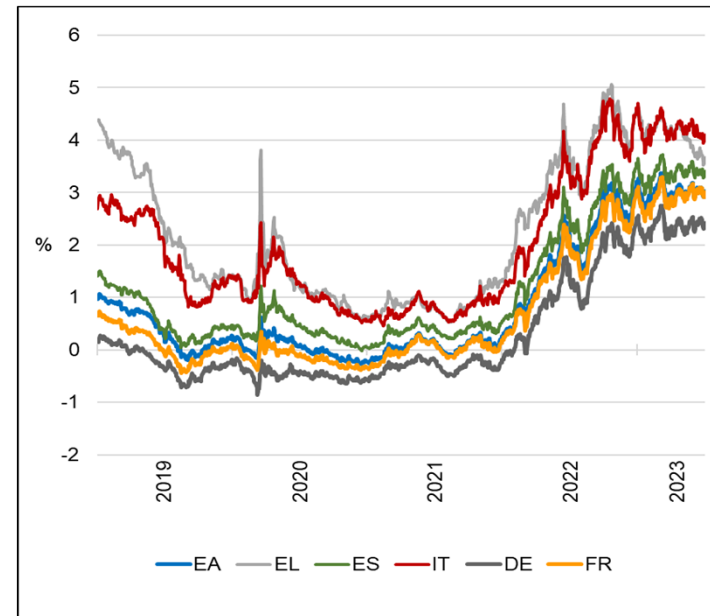
Key money market interest rates



Source: ECB; Bloomberg

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10-year government bond yields

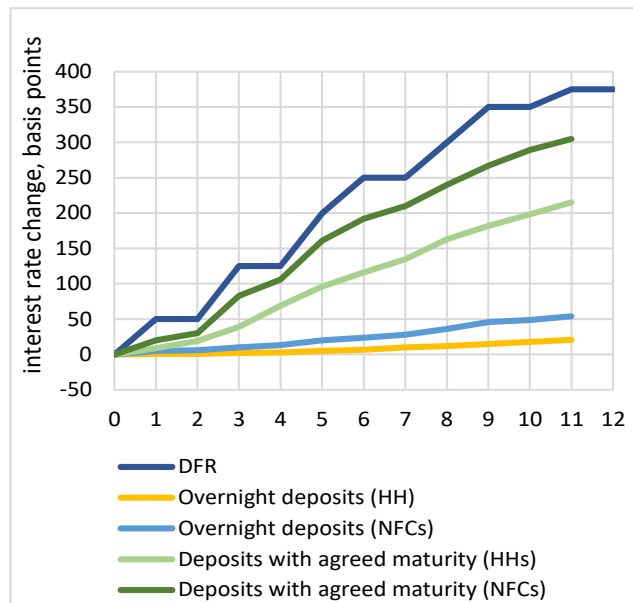


Note: Yields for the euro area are weighted by the share in GDP of the countries involved. The euro area does not include data for EE, LV, LU and MT; data up to end-June 2023.

Source: Bloomberg

Transmission of monetary policy on lending rates is effective but...

Interest rate pass through to deposits



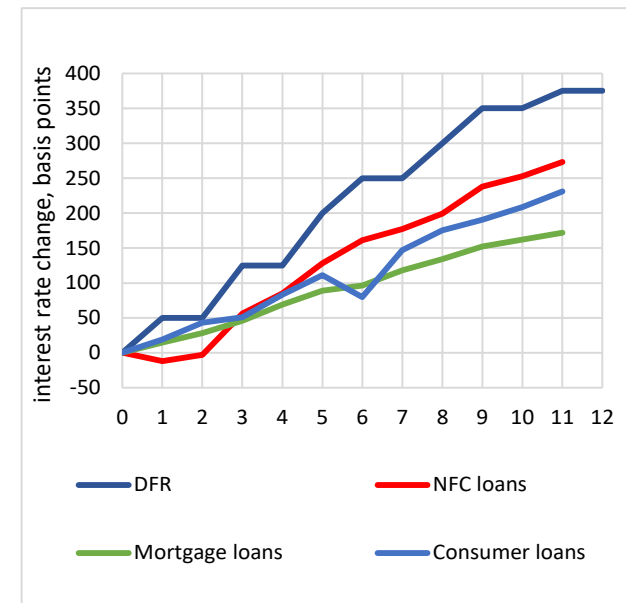
Note: X axis refers to number of months since the start of the hiking cycle; 0 is June 2022.

Source: ECB; CNB calculations

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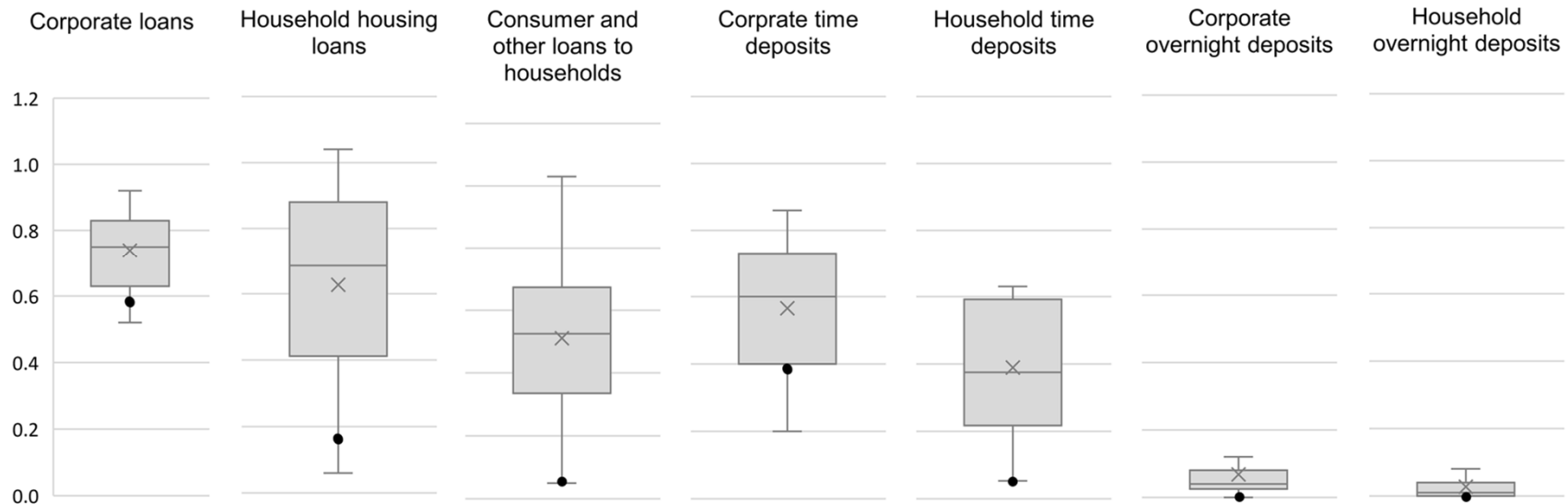
Interest rate pass through to loans



Note: X axis refers to number of months since the start of the hiking cycle; 0 is June 2022.

Source: ECB; CNB calculations

... there is a significant heterogeneity across products and across jurisdictions



Note: January 2022 to March 2023; horizontal lines depict minimum and maximum values, values for 25th percentile, median and 75th percentile, while x's represent average values for all euro area Member States and black dots depict average values for Croatia; on average, 74% of the increase in the three-month EURIBOR over the last year has been transmitted to corporate lending rates in the euro area, while transmission to housing (consumer) loans to households has been slightly weaker, totalling 63% (51%). Lower sensitivity has been registered in interest rates on corporate and household time deposits (57% and 39%, and especially in overnight deposits (7% and 3%).

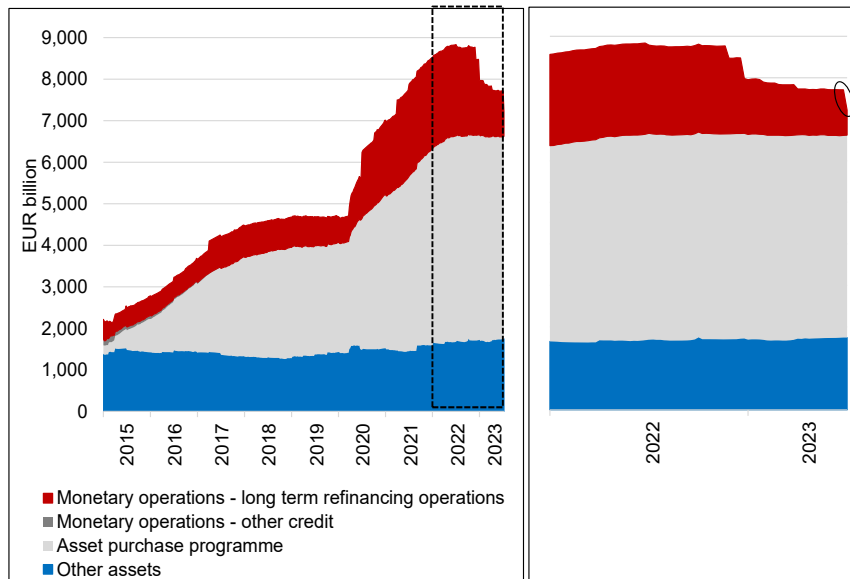
Source: ECB and CNB calculations

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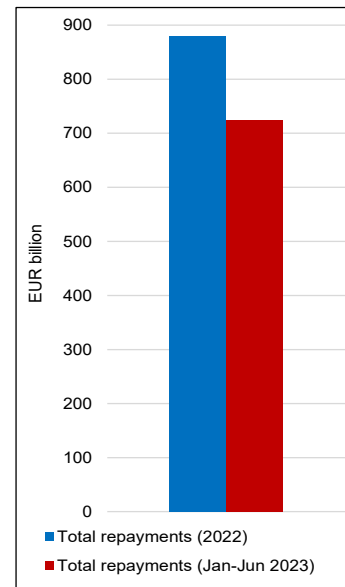
TLTRO repayments went smooth, with only a small recourse to the ECB lending facilities

Eurosystem balance sheet



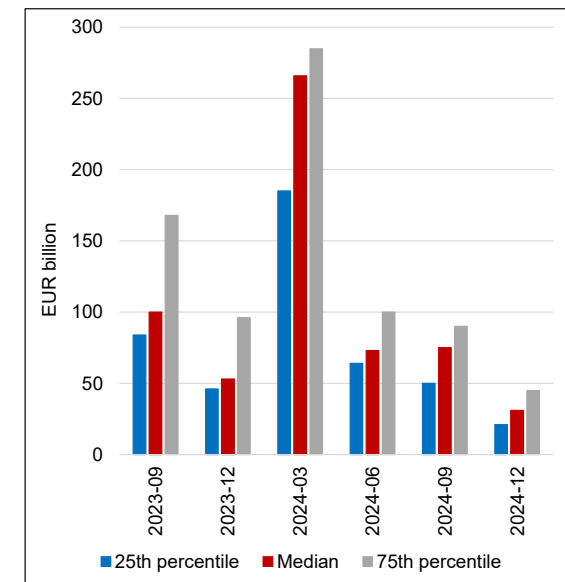
Note: Data up to July 2, 2023.
Source: ECB; CNB calculations

Total repayments under LTRO



Source: ECB; CNB calculations

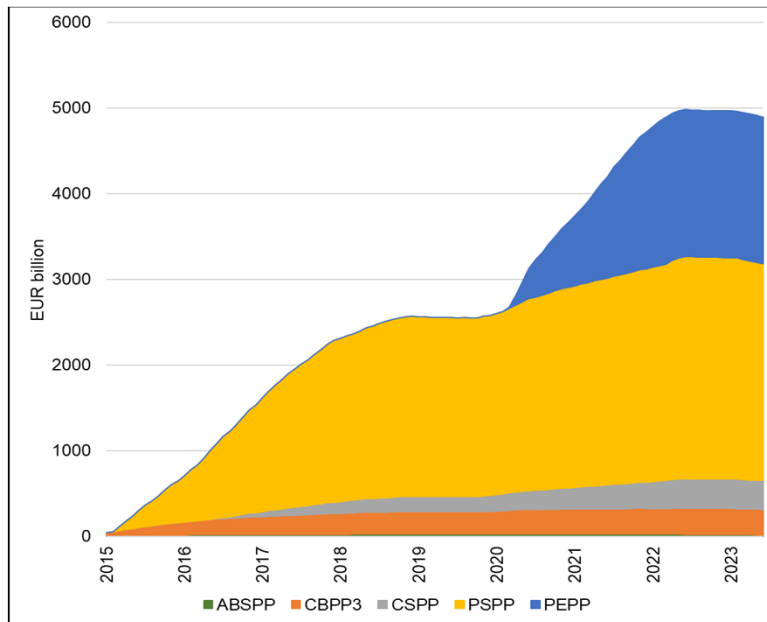
Expected repayments under TLTRO III



Source: Survey of Monetary Analysts (SMA); June 2023.

Squeezing of the balance sheet gradual

APP discontinued from July



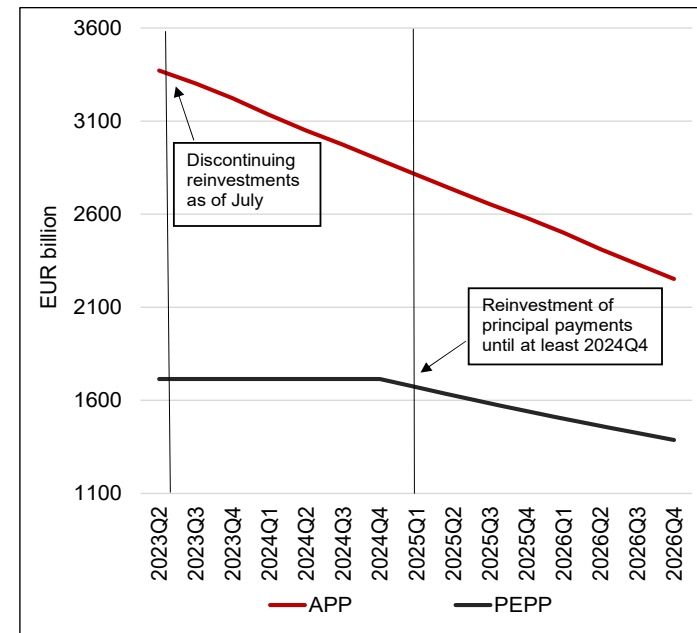
Note: Data refers to APP holdings (end-of-month book value at amortised cost); up to June 2023.

Source: ECB

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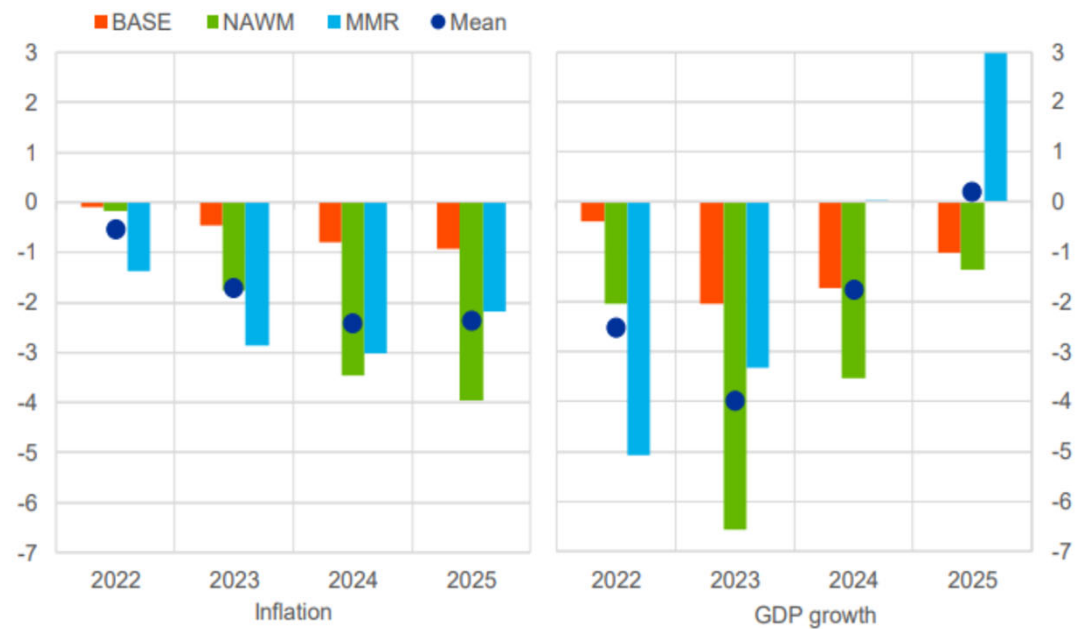
Expectations for the Eurosystem stock of bonds under the APP and PEPP



Note: Median expectations are shown

Source: Survey of Monetary Analysts (SMA); June 2023

Effects of monetary tightening so far according to ECB model estimates

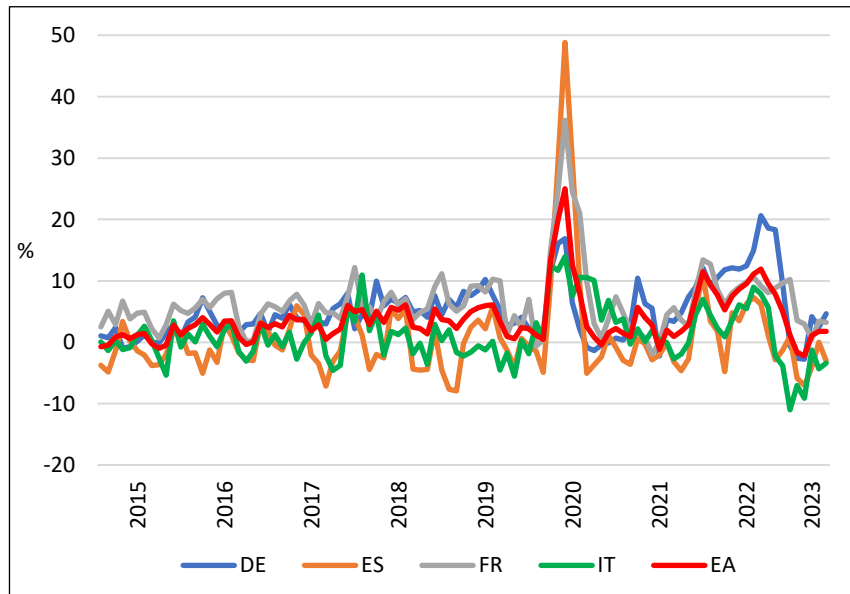


Note: Year-on-year percentage changes

Source: ECB, speech by Luis de Guindos: The inflation outlook and monetary policy in the euro area (Keynote Speech, King's College London, July 2023)

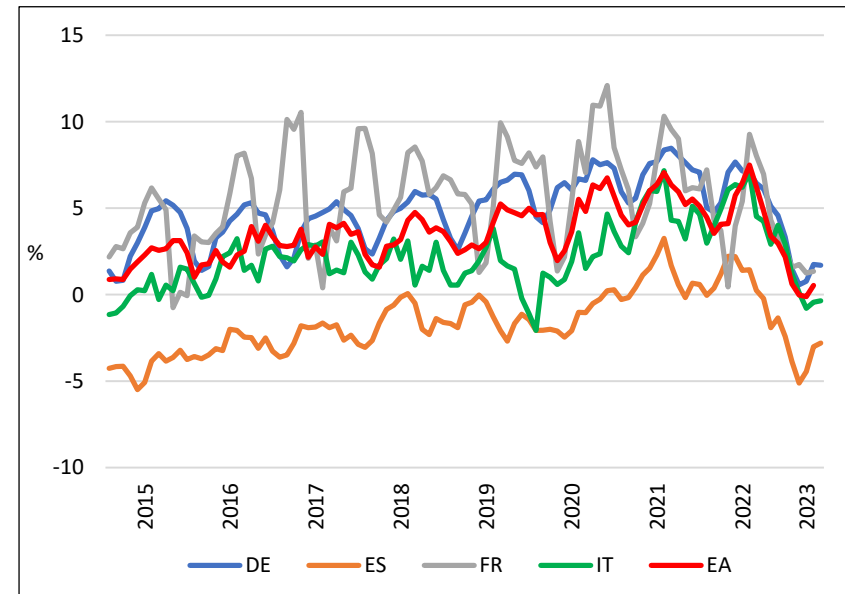
Bank lending activity has slowed down, but largely due to one-off factors

Loan momentum (NFCs)



Note: Data up to May 2023.
Source: ECB; CNB calculations

Loan momentum (HHs)



Note: Data up to May 2023. Refers to loans to households for house purchase
Source: ECB; CNB calculations

Final remarks

- ❖ Overall, risks to both GDP and inflation outlook are still elevated but more balanced
- ❖ Underlying price pressures remain strong, particularly in the service sector, with labour markets holding tight
- ❖ So far our key policy rates have been raised by 400 basis points since July last year making fastest tightening on record, but we are most probably not done yet
- ❖ Monetary policy transmission to money market rates is smooth, while government bond yields stay still
- ❖ Transmission to deposit and lending rates effective, but with significant heterogeneity across products and jurisdictions
- ❖ Tighter financing conditions are gradually having an impact on the real economy



HNB

Thank you for your attention!

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