WEEKLY ANALYSIS

NUMBER 818, MAY 8, 2023

ECB eased the pace of interest rate hikes

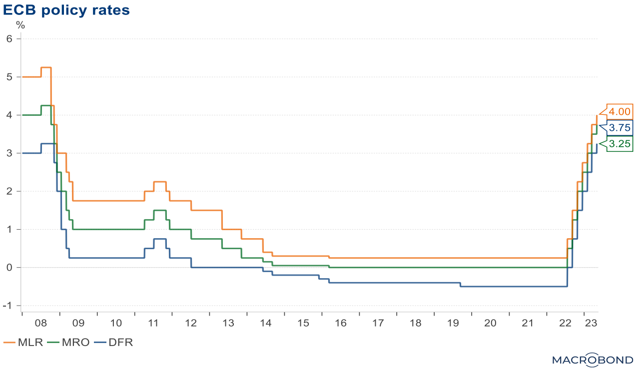
ECB raised interest rates by 25 b. p.

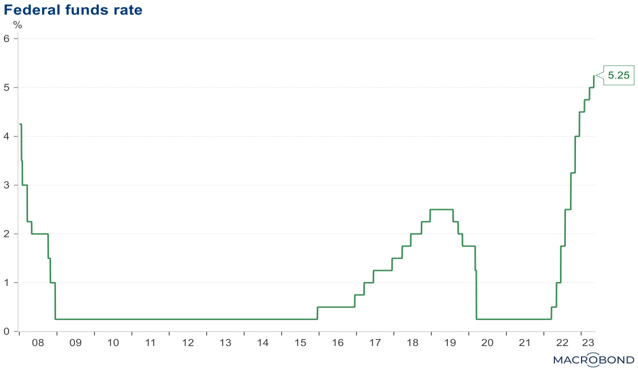
- Last two weeks were marked by the release of a series of data that indicate the resilience of the eurozone economy, but also continued strong inflationary pressures. After a decline of 0.1% in the last quarter of 2022, in the first quarter GDP grew by 0.1% q-o-q (1.3% y-o-y), thus avoiding a technical recession, and according to the mainly survey indicators available so far, growth continues in the second quarter. According to the flash estimate, the annual HICP inflation rose slightly to 7.0% in April, and the core inflation rate (rate without food and energy) marginally decreased to 5.6%. However, what is worrisome is that the prices of services continue to grow fuelled by a strong labour market; the unemployment rate was as low as 6.5% in March. In such an environment, the European Central Bank, at its meeting on May 4, decided to ease the pace of key interest rate hikes and raised them by 25 b. p., in line with our expectations. As of May 10, interest rate on deposits (DFR) will amount to 3.25%, on main refinancing operations (MRO) 3.75%, and on overnight loans (MLR) 4.00%. Indications of further movements in interest rates were again absent. As in March, the ECB states that in further decisions it would be guided by the assessment of the inflation outlook based on the incoming economic and financial data, dynamics of underlying inflation and strength of monetary policy transmission. This meeting did not present new GDP and inflation projections that will be updated for the June meeting. Change has been announced in the asset purchase programme and, after reducing the reinvestment of principal payments from maturing securities (€15bn per month until the end of June), they will no longer be reinvested from July.
- At the press conference, Lagarde stated that further decisions are aimed at ensuring that interest rates were raised to a sufficiently restrictive level. Therefore, at the June meeting we expect another increase of 25 b. p. followed by a raise by a further 50 b. p. until the end of September, which would bring the deposit interest rate to a peak of 4.00%.

Fed also raised the interest rate by 25 b. p.

- The Fed has adopted a decision on increasing the fed funds rate target range by 25 b. p. to 5.00-5.25%. Although inflation has weakened since the middle of last year, approaching 4%, it is still far above the 2% target, so it will take time to lower it to that level. Its head Powell at the press conference stated that conditions in the banking system have improved since March and that it is healthy and resilient, and the Fed will improve supervisory practices to make it even stronger.

The U.S. economy has slowed and in the coming period, activity will be pressed by adverse financing conditions that could be further tightened due to problems with some banks. Powell said, however, that he thought the U.S. would likely avoid a recession, and a strong labour market and excess demand would press prices for some time to come. In such an environment, further monetary policy moves will depend on developments, but so far there is no sign of further tightening of monetary policy. Our expectation is that the Fed will keep the interest rate at this level and that there will be no cuts to it this year.

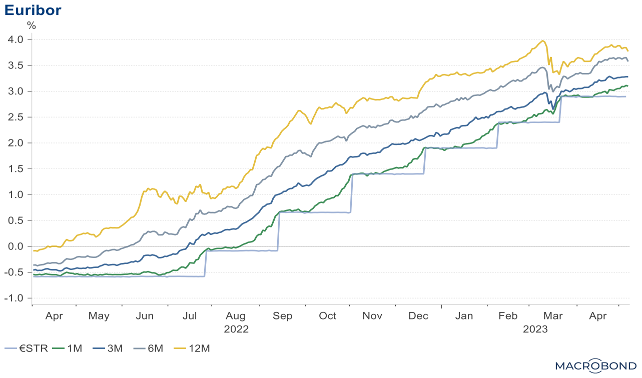




- The CBS's flash estimate indicates that the annual inflation rate slowed to 8.8% in April, mainly in line with expectations, given that the monthly inflation rate was 0.9% at the same time (the same as in March). The CBS notes that on a monthly basis there was an increase in prices of non-food industrial products without energy by 1.5%, food products by 0.9% and services by 1.0%, while at the same time in energy there was a decrease in prices by 0.4%. Simultaneously, Eurostat announced that the comparable annual rate of harmonised inflation in Croatia was (equivalent) 8.8%, identical to that in Italy, i.e., slightly below the inflation in Slovenia (9.2%) and above Germany's inflation (7.6%) and the eurozone average (7.0%).

Annual inflation rate slows to 8.8% in April

- The dollar weakened against the euro following the Fed and ECB meeting. On Friday, the exchange rate was $1.1014 for the euro, up by 0.3% w-o-w.
- Euribor stagnated w-o-w for shorter maturities and rose by up to 10 b. p. for longer ones, so 3M stood at 3.3% on Friday and 6M 3.6%. The MF issued 110 million of six-month and 811 million of one-year T-bills with interest rates higher by 70 and 20 p.p. respectively (3.2 and 3.5%). This week €16 million is due, but there will be no auction.
- Crobex closed the week up by 0.4% w-o-w (2,239.0 points) due to the growth of the most important sectoral indices (CROBEXindustry +0.2% to 1,419.0, CROBEXnutris +1.6% to 783.1, CROBEXtourist +2.0% to 4,118.9). Crobis stagnated at 94.5 points.



LEGAL DISCLAIMER

This publication is issued by PRIVREDNA BANKA ZAGREB-DIONIČKO DRUŠTVO, Zagreb, Radnička 50 (hereinafter: PBZ) and aimed at clients of the PBZ Group. This publication is intended for information purposes only and may not in any way be considered an offer or invitation to purchase any property or rights mentioned in it. The informative nature of this publication means that it may not serve as a substitute for the personal judgment and assessment of any reader or anyone who receives this publication. The information, opinions, analyses, conclusions, forecasts and projections given here are founded on publicly available data whose accuracy PBZ relies on but cannot guarantee. Accordingly, all the opinions, attitudes, conclusions, forecasts and projections given in this publication are subject to changes, which depend on changes to the data as published by the source used. PBZ allows further utilization of the data given in this publication on the condition that the publication is indicated as the source. All the property mentioned in this publication and whose movement is the subject of comment may from time to time be the subject of trade or positions taken by PBZ.

ECONOMIC RESEARCH

Ivana Jović

Ana Lokin

TRANSLATION

Ana Biloš

Jelena Marinović

www.pbz.hr