

## **Croatia: strong growth, weak external position**

The main economic indicators point to a dynamic development during the first months of the year 2003. Driven primarily by domestic demand, most of all by strong (public) investment activities (up 16%), GDP grew by 4.9% in the first quarter. Industrial production rose by 5.8% in the period January-May, of which non-durable consumer goods were up 8.8% whereas the production of capital goods remained almost stagnant. Within manufacturing, with 5.5% output growth on average, publishing and printing, manufacture of fabricated metal products, non-metallic mineral products and radio, television and communication equipment grew faster than average. Substantial output declines were reported for manufacture of chemicals, other transport equipment and wood products.

Retail trade, though soaring by 7.6% in the first four months of the year, performed less dynamically than a year earlier when the turnover jumped by 13% in real terms. This is also reflected in the slower growth of corporate and household borrowing during the first quarter of 2003 as compared to the extraordinarily high growth rates observed in 2002. Thus, banks seem to have adjusted to credit restrictions imposed by the central bank at the beginning of the year. The construction industry has continued its upward trend in 2003 primarily related to the construction of the Zagreb-Split motorway and other infrastructure projects.

Following the introduction of stricter registration rules, the number of unemployed is falling. By the end of April, the unemployment rate stood at 20.4%, down from 23.2% in April last year. At the same time, employment slightly exceeded the previous year's level. A new labour law aiming at the liberalization of the labour market has entered the parliament procedure against strong opposition on the part of the trade unions.

Thanks to the shipbuilding industry, foreign trade developed dynamically during the first quarter of the year. Measured in current US dollar terms, exports expanded by almost 40%; imports grew slightly less, by 37%. The trade deficit was about one third higher than during the first three months of 2002 and the current account deficit increased from USD 875 million to USD 1 billion. Trade figures expressed in euro terms (eliminating the dollar depreciation against the euro and the kuna) present a different picture: accordingly, total exports expanded by 15.4%, while imports grew by 12.4%, resulting in a trade deficit of EUR 1.4 billion (10% higher than in the same 2002 period).

In the first quarter of 2003, foreign debt increased by USD 1.7 billion as against December 2002 and reached nearly USD 17 billion. According to the central bank, part of this increase (USD 330 million) is due to currency adjustments (most of the country's debt is

denominated in euro) whereas the actual rise of the debt is given as USD 1.36 billion. Until the end of the year, debt is expected to grow by a further USD 2.5 billion, thus reaching USD 19.5 billion. Looking at different debt indicators, we obtain an inconsistent picture. The debt to GDP ratio – about 87% of the (2002) GDP – is alarming, while the ratio of debt to exports of goods and services is not. The burden of the debt service is similarly ambiguous. Total debt service as a share to exports of goods and services is approaching the threshold of high indebtedness, while the burden of interest payments is still not worrisome. From the overview of these indicators it follows that Croatia is not facing immediate problems concerning its foreign debt. The medium-term assessment, however, has to be more cautious, especially in 2004 and 2005, when debt servicing (principal and interest payments) will amount to approximately USD 2.8 billion per year.

Fiscal developments are still lacking transparency and comparisons with previous years are next to impossible. During the first quarter of 2003 the consolidated central government budget closed with a HRK 2.6 billion deficit, similar to that in the same 2002 period. The deficit was almost exclusively financed via foreign sources (eurobond issue). According to the standby arrangement agreed upon with the IMF in February 2003, the general government deficit should not exceed 5% in 2003, a challenging task in view of the elections to be held in autumn. Contrary to news according to which the privatizations of the INA oil company and the biggest insurer might be delayed, the Croatian government has announced in an Addendum to the Letter of Intent submitted to the IMF in mid-June that the partial sale of INA may materialize by the end of the month and a 25% plus one share of Croatia Osiguranje will be offered to the catholic church and other investors (instead of selling 30% of the company at the Zagreb Stock Exchange as stated earlier).

In February 2003 Croatia submitted its application for EU membership, aspiring to enter the Union together with Bulgaria and Romania, who intend to accede in 2007. However, in a recent statement EU enlargement commissioner Verheugen declared that it was too early to say whether Croatia could catch up with the two countries. The EU Commission will have to prepare an opinion, which may take some time, as it requires an examination of the entire legislation and the political system of the country.

The outlook for 2003 is still positive and wiiw adheres to its forecast made earlier. Owing to a slowdown of private consumption as a consequence of the credit squeeze, GDP growth will be somewhat lower than in 2002 but with a 4% increase still satisfactory. Strong investment activities will continue due to motorway construction and other infrastructure projects. The current account and trade deficits will continue to grow.

Table HR

## Croatia: Selected Economic Indicators

	1998	1999	2000	2001	2002 <sup>1)</sup>	2002 1st quarter	2003	2003 forecast	2004
Population, th pers., mid-year <sup>2)</sup>	4501	4554	4437	4437	.	.	.	.	.
Gross domestic product, HRK mn, nom.	137604	141579	152519	162909	176429	40456	43492	187200	196100
annual change in % (real)	2.5	-0.9	2.9	3.8	5.2	4.3	4.9	4	3.7
GDP/capita (USD at exchange rate)	4805	4371	4153	4403	5065	.	.	.	.
GDP/capita (USD at PPP - wiiw)	8240	8180	8820	9380	9990	.	.	.	.
Gross industrial production <sup>3)</sup>									
annual change in % (real)	3.7	-1.4	1.7	6.0	5.4	1.9	4.6	5.5	5
Gross agricultural production									
annual change in % (real)	10.2	-3.5	-10.0	8.4	.	.	.	.	.
Goods transport, public, mn t-kms <sup>4)</sup>	170107	146302	146852	142440	139417	30656	30236	.	.
annual change in %	-16.4	-14.0	.	-1.0	-2.1	-2.2	-1.4	.	.
Gross fixed capital form., HRK mn, nom.	32065.6	33025.0	33281.0	37252.0	43674.0	9810.0	11691.0	.	.
annual change in % (real)	2.5	-3.9	-3.8	9.7	10.1	9.4	16.2	12	8
Construction industry, hours worked <sup>3)</sup>									
annual change in % (real)	0.7	-7.7	-9.1	3.6	12.8	10.6	19.2	.	.
Dwellings completed, units	12557	12175	12187	18088	.	.	.	.	.
annual change in %	0.3	-3.0	0.1	48.4	.	.	.	.	.
Employment total, th pers., average <sup>5)</sup>	1384.8	1364.5	1341.0	1348.3	1340.8	1337.9	1339.7	.	.
annual change in % <sup>5)</sup>	0.4	-1.5	-1.7	0.5	-0.6	0.9	0.1	.	.
Employees in industry, th pers., average	308.9	299.5	291.9	287.2	277.2	280.6	274.3	.	.
annual change in %	-3.4	-3.0	-2.5	-1.6	-3.5	-2.0	2.2	.	.
Reg. unemployed, th pers, end of period	302.7	341.7	378.5	395.1	366.2	415.4	355.8	.	.
Reg. unemployment rate in %, end of period	18.1	20.4	22.3	23.1	21.5	23.8	21.0	20	18
LFS - unemployment rate in %, average	11.4	13.6	16.1	15.9	14.8	.	.	14.5	14
Average gross monthly wages, HRK	4131	4551	4869	5061	5366	5133	5459	.	.
annual change in % (real, net)	6.0	10.1	3.4	1.6	3.1	-0.9	5.7	.	.
Retail trade turnover, HRK mn	.	.	.	.	.	.	.	.	.
annual change in % (real)	0.1	-3.5	10.0	10.0	12.5	13.0	7.6	.	.
Retail prices, % p.a.	5.7	4.2	6.2	4.9	2.2	3.2	1.7	2	1
Producer prices in industry, % p.a.	-1.2	2.6	9.7	3.6	-0.4	-2.6	3.4	.	.
Central government budget, HRK mn <sup>6)</sup>									
Revenues	43809	46356	44636	53504	70929	14611	17028	.	.
Expenditures	42552	48879	50744	57813	74940	17225	19668	.	.
Deficit (-) / surplus (+)	1257	-2523	-6108	-4309	-4010	-2614	-2640	.	.
Deficit (-) / surplus (+), % GDP	0.9	-1.8	-4.0	-2.7	-2.3	-6.5	-6.1	.	.
Money supply, HRK mn, end of period									
M1, Money	13531	13859	18030	23704	30870	24375	29512	.	.
Broad money	57340	56659	73061	106071	116142	106245	118791	.	.
Discount rate % p.a., end of period	5.9	7.9	5.9	5.9	4.5	5.9	4.5	.	.
Current account, USD mn	-1452.8	-1397.8	-438.9	-616.8	-1546.7	-867.0	-1006.0	-1800	-1200
Current account in % of GDP	-6.7	-7.0	-2.4	-3.2	-6.9	-18.2	-16.4	-6.6	-4.2
Gross reserves of NB excl. gold, USD mn	2815.7	3025.0	3524.8	4704.2	5885.8	4885.5	6208.0	.	.
Gross external debt, USD mn	9683.3	9977.9	11054.8	11316.6	15241.7	11388.9	16996.0	.	.
Exports total, fob, EUR mn <sup>7)</sup>	4046.2	4027.3	4818.0	5210.4	5182.5	1180.6	1362.3	5400	5500
annual growth rate in %	10.4	-0.5	18.9	8.1	-0.5	-0.3	15.4	4	2
Imports total, cif, EUR mn <sup>7)</sup>	7476.9	7324.1	8588.5	10232.4	11316.3	2447.2	2751.5	12600	12900
annual growth rate in %	-7.2	-2.0	16.8	19.1	10.6	12.0	12.4	11	2
Average exchange rate HRK/USD	6.36	7.11	8.28	8.34	7.86	8.51	7.07	6.9	6.9
Average exchange rate HRK/EUR (ECU)	7.14	7.58	7.63	7.47	7.41	7.46	7.58	7.5	7.5
Purchasing power parity HRK/USD, wiiw	3.71	3.80	3.90	3.92	3.99	.	.	.	.
Purchasing power parity HRK/EUR, wiiw	4.04	4.14	4.27	4.29	4.31	.	.	.	.

Notes: 1) Preliminary. - 2) From 2000 according to census March 2001. - 3) Enterprises with more than 19 employees. - 4) From 2001 new methodology. - 5) Including persons employed at the Ministry of Defence and Ministry of Internal Affairs. - 6) Methodological changes in June 2001 and January 2002 with respect to the stepwise inclusion of extrabudgetary funds. - 7) From 2000 new method of statistical processing. Converted from the national currency to EUR at the official exchange rate.

Source: wiiw Database incorporating national statistics; wiiw forecasts.