

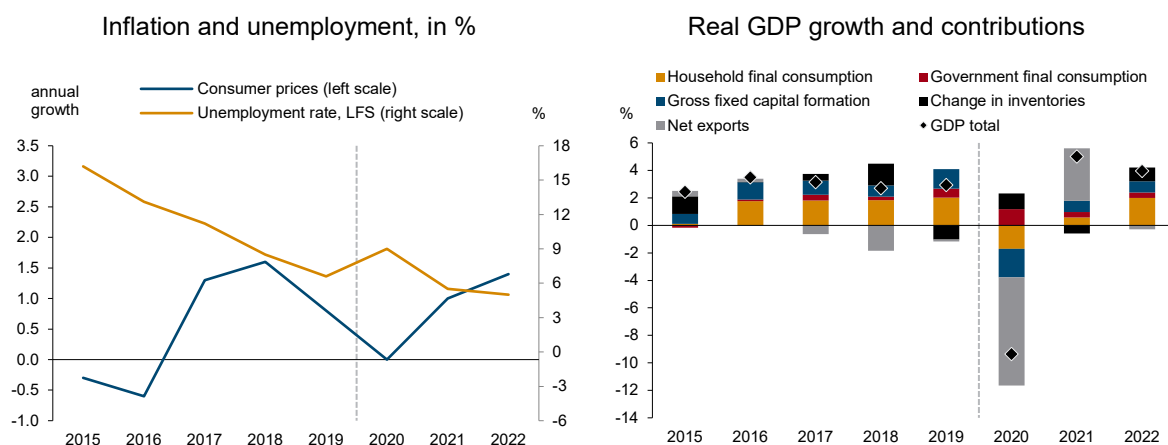


## CROATIA: In the eye of the storm

BERND CHRISTOPH STRÖHM

The economy's heavy reliance on tourism means that Croatia will suffer one of the biggest contractions in CESEE in 2020, with real GDP projected to decline by 9.4%. Unemployment will rise, and inflation will average 0% for the year as a whole. To mitigate the economic downturn caused by COVID-19, the government initiated a support package worth about 9% of GDP. The tourism sector should stage at least a partial recovery next year, which will underpin growth of around 5%.

Figure 4.5 / Croatia: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

**The Croatian economy will suffer a severe setback in 2020, since COVID-19 has caused domestic and international demand to shrink dramatically.** The consequences of the pandemic will be felt much more keenly in Croatia than in most other CESEE countries, with GDP contracting by an estimated 9.4% in 2020. The reason for this sharp decline is the country's reliance on its tourism sector, which accounts for between 20% and 25% of Croatia's GDP (directly and indirectly). On top of the disruptions generated by COVID-19, Croatia has had to cope with the impact of a powerful earthquake that struck the capital Zagreb and its surroundings on 22 March, causing damage in the region of EUR 5.7 billion. Nevertheless, due to the anticipated recovery of tourism earnings, as well as an increase in private consumption and foreign demand, it can be expected that the country's GDP will bounce back to 5% in 2021.

**The tourism industry has suffered a severe blow due to COVID-19.** In the first seven months of 2020, Croatia recorded 58.9% fewer tourist nights, compared to the same period in 2019. The most severe drop in tourism arrivals was in Q2 2020, when stringent international restrictions on travel were in

place; since these were lifted at the end of June, the situation has improved moderately. Monthly data show that the tourism sector bounced back somewhat in July, recording a total of 2.2 million tourist arrivals and 14.7 million tourist nights. It is likely that the moderate recovery continued in August. Croatia seems to have benefited from being within driving distance of key sources of tourism, especially Germany. However, the July data still revealed a sharp fall in tourist arrivals, compared to the same period in 2019: tourist arrivals were 48.1% down and 42.5% fewer tourist nights were recorded.

**The pandemic resulted in a significant deterioration in Croatia's public finance situation, compared to 2019.** In 2019, the state budget was on a path of consolidation. The government had recorded a budget surplus of about 0.4%, with public debt falling to 73.2% of GDP. However, this positive trend changed dramatically with the arrival of COVID-19. The pandemic resulted in Croatia's public finance situation deteriorating significantly, mainly due to the country's heavy dependence on tourism. In order to mitigate the effects of the pandemic on the country's economy, the government launched a support package worth about 9% of GDP. The support measures included wage subsidies, tax deferrals or tax exemptions, access to financing and the establishment of a short-time working (*Kurzarbeit*) scheme. The government's fiscal measures are additionally supported by the World Bank, which announced on 26 June that it had approved USD 300 million to provide emergency support to the Croatian authorities. In light of those measures, it can be expected that Croatia will record a budget deficit of about 8% and a rise in public debt to about 86% of GDP in 2020.

**The COVID-19 pandemic has already had a negative impact on investment, and this is likely to remain the case for some time.** Due to the uncertainty caused by COVID-19, foreign investments are also affected, particularly in the country's aviation industry, including the planned construction of a factory for lightweight components for commercial aircraft passenger cabins by the Austrian company FACC. This is why gross fixed capital formation in Croatia saw a noticeable decrease from EUR 2.6 billion in the first quarter of 2020 to EUR 2.4 billion in the second. Nevertheless, overall investments facilitated by the government, especially in infrastructure projects co-financed by the EU, will go ahead in spite of COVID-19. Public investment is also supported by a USD 200 million loan facilitated by the World Bank and aimed at rebuilding Zagreb's infrastructure after the March 2020 earthquake.

**Inflation has decelerated due to lower energy prices and a slump in consumer demand caused by COVID-19; only a moderate pick-up is projected for 2021.** The average annual consumer price inflation rate will likely fall from 0.8% in 2019 to 0% in 2020, largely due to the decrease in energy prices; this will also lead to a 4% drop in the Producer Price Index. The expected slowdown in inflation in 2020 is also a result of lower demand in the context of the pandemic, particularly in tourism-related services, recreational and cultural services, and semi-durable and durable consumer goods. As the economy recovers in 2021, price pressure should firm somewhat, but inflation next year will average just 1%.

**The COVID-19 pandemic and the measures put in place to contain the spread of the infection are likely to result in a decline in the number of people employed, especially in the tourism sector.** Negative economic consequences will also be felt in sectors such as transport (e.g. the port of Rijeka), retail trade and the export-oriented manufacturing sectors. The rise in unemployment will likely hit the country's younger population, since seasonal workers – especially those providing services and in the country's dominant tourism sector – tend mostly to consist of younger people. Nevertheless, thanks to the government's coronavirus support measures (which have been extended until the end of 2020 in the most severely affected sectors), the rise in unemployment has so far been mitigated. To head off further

unemployment, in August the government set before parliament a bill of amendments to the Law on Foreigners; this would require employers to request a test of the labour market by the Croatian Employment Service prior to employing a foreigner. It can be expected that unemployment will likely rise to 9% in 2020.

**Net exports of services are expected to fall sharply in 2020.** The substantial slump in tourism earnings, most notably in Q2 2020, will severely affect the country's current account in 2020. However, tourist consumption by Croatian nationals abroad and imports of other services are also expected to fall, which will mitigate the strong impact of the decline in revenue from tourism on the country's current account balance. Nevertheless, due to the country's dependence on the tourism sector (creating a surplus in Croatia's current account at an average of about 2.2% of GDP over the past six years) and its traditional deficit in trade in goods, Croatia's current account may be expected to switch to a deficit of 3.9% in 2020. With the anticipated recovery of tourism earnings next year, this deficit will likely narrow to 0.6% in 2021.

**Table 4.5 / Croatia: Selected economic indicators**

	2017	2018	2019 <sup>1)</sup>	2020 1Q	2020 2Q	2020 1-2Q	2020 Forecast	2021 Forecast	2022
Population, th pers., average	4,130	4,091	4,067	.	.	.	3,980	3,980	3,980
Gross domestic product, HRK bn, nom.	366.4	383.0	400.1	90	84.7	174.9	363	385	406
annual change in % (real)	3.1	2.7	2.9	0.4	-15.1	-7.8	-9.4	5.0	4.0
GDP/capita (EUR at PPP)	18,220	19,120	20,080	.	.	.	.	.	.
Consumption of households, HRK bn, nom.	208.4	218.2	227.9	55	49.4	104.5	.	.	.
annual change in % (real)	3.2	3.2	3.6	0.7	-14.0	-6.8	-3.0	1.0	3.5
Gross fixed capital form., HRK bn, nom.	73.3	76.7	82.7	20	19.0	39.4	.	.	.
annual change in % (real)	5.1	4.1	7.1	3.1	-14.7	-6.3	-10.0	4.0	4.0
Gross industrial production <sup>2)</sup>									
annual change in % (real)	1.4	-1.0	0.6	-2.8	-8.6	-5.7	-5.0	3.0	2.0
Gross agricultural production									
annual change in % (real)	-4.9	6.4	-0.2	.	.	.	.	.	.
Construction output <sup>2)</sup>									
annual change in % (real)	1.7	4.9	8.3	6.1	0.2	3.1	.	.	.
Employed persons, LFS, th, average	1,625	1,655	1,680	1,649	1,668	1,659	1,670	1,680	1,690
annual change in %	2.2	1.8	1.5	-0.7	-0.6	-0.6	-0.5	0.5	0.5
Unemployed persons, LFS, th, average	205	152	119	123	115	119	170	100	90
Unemployment rate, LFS, in %, average	11.2	8.5	6.6	7.0	6.5	6.8	9.0	5.5	5.0
Reg. unemployment rate, in %, eop	11.2	8.9	7.8	8.6	9.1	9.1	.	.	.
Average monthly gross wages, HRK	8,055	8,448	8,766	9,240	9,124	9,182	8,900	9,200	9,600
annual change in % (real, gross)	2.8	3.3	3.0	1.9	1.3	1.6	1.5	2.0	2.5
Average monthly net wages, HRK	5,985	6,242	6,457	6,766	6,684	6,725	6,600	6,800	7,000
annual change in % (real, net)	4.1	2.8	2.7	1.8	1.5	1.7	1.5	2.1	2.2
Consumer prices (HICP), % p.a.	1.3	1.6	0.8	1.2	-0.4	0.4	0.0	1.0	1.4
Producer prices in industry, % p.a.	2.0	2.2	0.8	-0.1	-5.4	-2.8	-4.0	1.9	2.0
General governm.budget, EU-def., % of GDP									
Revenues	46.1	46.5	47.5	.	.	.	42.0	45.5	46.0
Expenditures	45.3	46.3	47.1	.	.	.	50.0	49.0	48.5
Net lending (+) / net borrowing (-)	0.8	0.2	0.4	.	.	.	-8.0	-3.5	-2.5
General gov.gross debt, EU def., % of GDP	77.8	74.7	73.2	.	.	.	86.0	84.0	82.0
Stock of loans of non-fin.private sector, % p.a.	-0.1	2.3	3.9	6.0	4.1	4.1	.	.	.
Non-performing loans (NPL), in %, eop <sup>3)</sup>	8.8	7.6	5.5	5.4	5.5	5.5	.	.	.
Central bank policy rate, % p.a., eop <sup>4)</sup>	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Current account, EUR mn	1,681	932	1,478	-1,424	-669	-2,093	-1,900	-300	-650
Current account, % of GDP	3.4	1.8	2.7	-11.8	-6.0	-9.0	-3.9	-0.6	-1.2
Exports of goods, BOP, EUR mn	11,707	12,240	12,861	3,018	2,596	5,614	10,500	11,400	12,200
annual change in %	11.4	4.6	5.1	-0.1	-17.5	-9.0	-18.0	9.0	7.0
Imports of goods, BOP, EUR mn	20,152	21,882	23,305	5,523	4,503	10,026	19,900	20,600	22,600
annual change in %	11.2	8.6	6.5	-1.4	-27.0	-14.8	-14.5	3.5	9.5
Exports of services, BOP, EUR mn	12,881	13,847	15,341	1,350	1,182	2,531	10,700	12,300	13,300
annual change in %	9.9	7.5	10.8	-7.1	-67.1	-49.8	-30.0	15.0	8.0
Imports of services, BOP, EUR mn	4,108	4,639	5,013	946	710	1,655	4,800	5,200	5,400
annual change in %	15.3	12.9	8.1	-22.7	-42.5	-32.6	-5.0	8.0	3.0
FDI liabilities, EUR mn	445	1,074	1,278	435	237	671	1,000	.	.
FDI assets, EUR mn	-673	231	175	99	52	151	200	.	.
Gross reserves of NB excl. gold, EUR mn	15,706	17,438	18,560	16,512	17,311	17,311	.	.	.
Gross external debt, EUR mn	43,683	42,710	40,877	40,447	41,251	41,251	41,100	40,500	40,100
Gross external debt, % of GDP	89.0	82.7	75.8	83.6	85.2	85.2	85.0	80.0	75.0
Average exchange rate HRK/EUR	7.4637	7.4182	7.4180	7.4893	7.5786	7.5340	7.5	7.6	7.6

1) Preliminary. - 2) Enterprises with 20 and more employees. - 3) Loans more than 90 days overdue and those unlikely to be paid. - 4) Discount rate of NB.

Source: wiiw Databases incorporating Eurostat and national statistics. Forecasts by wiiw.