

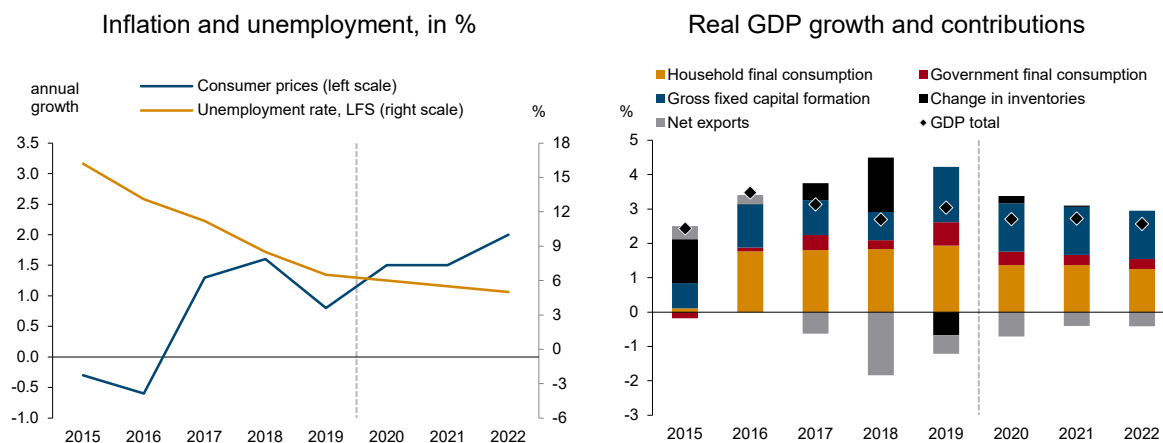


CROATIA: Solid growth

HERMINE VIDOVIC

Croatia's economy performed well in 2019. GDP growth will slow somewhat over the forecast period, but will remain at a relatively high level (2.7% p.a.) thanks to the country's strong tourism sector. Private consumption and investments supported by EU transfers will remain the main drivers of growth. In its quest to adopt the euro as soon as possible, the Croatian government will seek to keep the budget in balance or in surplus, and to further reduce public debt.

Figure 6.5 / Croatia: Main macroeconomic indicators



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

Croatia's real GDP growth is estimated to have reached 3% in 2019, which was higher than a year earlier. Domestic demand was the main driver behind this growth, and the rise in both consumption and gross fixed capital formation was the highest since 2007/2008. Private consumption was pushed up by rising disposable income – rising employment, growing real wages and remittances. Also construction output, which relies heavily on EU funding, reported its highest growth (9%) since the onset of the crisis. Net exports made a negative contribution to GDP growth. After a drop in 2019, industrial output grew by a mere 0.5% in 2019; only food production, the production of chemicals and pharmaceuticals, and the manufacturing of furniture showed notable output growth, while the majority of industrial branches reported declines in production. Output fell most for coke and refined petroleum products (by 24%), manufacturing of machinery and equipment (by 11%) and – most notably – shipbuilding (by a third): indeed, the Uljanik shipyard, which has tried (and failed) for some time to find a strategic investor will finally go into liquidation. Given the low competitiveness of Croatian industry, no significant improvement is expected in the near future.

Labour market outcomes continued to improve in 2019. Based on pension insurance data, employment increased by 2.3%, while Labour Force Survey data indicate a smaller increase of 1.3%. The unemployment rate fell to 6.5%, and youth unemployment to 16.1% – 2 percentage points higher than the EU average. While part of this improvement is due to rising domestic employment, continued outward migration played an important role in the reduction in unemployment: some 15,000 people are leaving annually, according to the prime minister. The persistent shortage of labour in tourism, construction, transport, the metal and food industries and agriculture has been countered primarily by hiring foreign workers, particularly from Bosnia and Herzegovina. Over the past few years, the quotas for foreign workers have steadily been increased (the quota for 2020 is set at 78,470). Croatia, in common with other EU countries, wants to abandon the quota system and make the employment of third-country nationals dependent on applications from employers for the recruitment of foreigners. A draft law to this effect was recently presented to parliament. Real net wages continued to increase and were up by 2.9% in 2019, owing to public-sector wage increases and labour shortages. Consumer price inflation averaged 0.8% in 2019: this is mainly the result of a fall in the average annual growth rate of energy and food prices, and a cut in the VAT rate on some food products early in the year.

Given the deteriorating external conditions, trade in goods and services performed relatively well in 2019. Goods exports and imports increased by an estimated 6% and 7%, respectively. Trade in services was largely driven by tourism, reaching new heights in earnings – a somewhat unexpected development after a temporary slowdown in July. The current account surplus amounted to an estimated 2% of GDP, which is a slight improvement over the previous year.

Croatia has likely achieved a surplus in the general government budget for the third year in a row. The general government budget closed in 2019 with probably a small surplus (0.3% of GDP), mostly on account of an increase in revenue – due partly to rising tax revenues (VAT in particular). Expenditure rose as well on, for instance, employee compensation (following an increase in social benefits), subsidies and grants and other such expenditure. By contrast, expenditure on interest payments decreased. Public debt is estimated to have declined to 72.2% of GDP in 2019, from almost 74.4% in 2018. For 2020, the Ministry of Finance expects the general government to run a surplus of 0.2% of the projected GDP growth of 2.5%; this should increase further to 0.4% in 2021 and 0.8% in 2022 (based on 2.4% GDP growth in each year). In June 2019, the government issued a foreign bond worth EUR 1.5 billion to refinance a 15-year international bond that matured in November 2019. In addition, in November 2019 it issued two domestic bonds worth HRK 11 billion (EUR 1.4 billion). Both the foreign and the domestic bonds were issued at historically low interest rates.

There is an ongoing process of meeting the criteria that Croatia committed to when it applied to enter the ERM II and join the banking union. These commitments relate to the macro-prudential framework, the anti-money laundering framework, the collection, production and dissemination of statistics, public sector governance, and the reduction of the financial and administrative burden. Asset quality reviews and stress testing in systemically important Croatian banks are currently under way. The whole process is being closely monitored by the ECB and the European Commission. Once they have provided a positive assessment, a decision will be taken on the formal application by the Croatian authorities for ERM II participation. The results of the assessment are expected by late June or July, which would mean that Croatia could join the ERM II as soon as early 2021.

Parliamentary elections will be held in autumn 2020. Following the defeat of the incumbent president, Kolinda Grabar-Kitarovic, by the former social democratic prime minister, Zoran Milanovic, in January 2020, the parliamentary elections in autumn will be an acid test for the ruling Croatian Democratic Union (HDZ), which supported Ms Grabar-Kitarovic in her election campaign. According to the most recent opinion polls, the social democrats are in the lead, followed by the HDZ and the party of Miroslav Skoro, a right-wing populist who also ran for the presidency.

GDP growth will slow somewhat over the forecast period, but will remain at a relatively high level (2.7% p.a.) due to Croatia's strong tourism sector. Domestic demand will remain the main driver of growth. Household consumption should benefit from a further improvement in the labour market, rising wages and continued lending, which is also confirmed by the last consumer confidence and expectations index, which recorded a further increase. Wages will increase particularly for employees in the government sector and for teachers, following agreements between the government and the respective trade unions. The services trade surplus, by contrast, may remain at an elevated level due to high (but probably not rising) earnings from tourism. Thus, the current account will remain in positive territory, but is expected to dwindle in line with higher trade deficits. Downside risks stem from weaker demand from Croatia's main trading partners. In its quest to adopt the euro as soon as possible, the Croatian government will seek to keep the general government budget in balance or in surplus, and to further reduce public debt. The shrinkage of the working-age population due to population ageing and continued outward migration will be among the major future challenges.

Table 6.5 / Croatia: Selected economic indicators

	2015	2016	2017	2018	2019 ¹⁾	2020	2021 Forecast	2022
Population, th pers., average	4,208	4,172	4,130	4,091	4,050	3,980	3,980	3,980
Gross domestic product, HRK bn, nom.	339.7	351.2	366.4	383.0	398.0	415	433	453
annual change in % (real)	2.4	3.5	3.1	2.7	3.0	2.7	2.7	2.6
GDP/capita (EUR at PPP)	17,300	17,800	18,600	19,500	20,600	.	.	.
Consumption of households, HRK bn, nom.	196.5	200.2	208.4	218.2	230.0	.	.	.
annual change in % (real)	0.2	3.1	3.2	3.2	3.4	2.4	2.4	2.2
Gross fixed capital form., HRK bn, nom.	66.4	70.4	73.3	76.7	80.0	.	.	.
annual change in % (real)	3.8	6.5	5.1	4.1	8.0	7.0	7.0	7.0
Gross industrial production ²⁾								
annual change in % (real)	2.7	5.3	1.4	-1.0	0.6	2.0	2.0	2.0
Gross agricultural production								
annual change in % (real)	2.9	6.9	-4.9	6.4	-2.6	.	.	.
Construction output ²⁾								
annual change in % (real)	-0.5	3.3	1.7	4.9	8.0	.	.	.
Employed persons, LFS, th, average	1,585	1,590	1,625	1,655	1,675	1,690	1,700	1,710
annual change in %	1.3	0.3	2.2	1.8	1.2	1.0	0.5	0.5
Unemployed persons, LFS, th, average	306	240	205	152	120	110	100	90
Unemployment rate, LFS, in %, average	16.2	13.1	11.2	8.5	6.5	6.0	5.5	5.0
Reg. unemployment rate, in %, eop ³⁾	17.6	14.1	11.2	8.9	7.9	.	.	.
Average monthly gross wages, HRK ⁴⁾	8,055	7,752	8,055	8,448	8,766	9,100	9,500	9,900
annual change in % (real, gross)	1.8	3.0	2.8	3.3	3.0	2.8	2.5	2.5
Average monthly net wages, HRK ⁴⁾	5,711	5,685	5,985	6,242	6,457	6,700	7,000	7,300
annual change in % (real, net)	3.7	2.7	4.1	2.8	2.7	2.3	2.3	2.2
Consumer prices (HICP), % p.a.	-0.3	-0.6	1.3	1.6	0.8	1.5	1.5	2.0
Producer prices in industry, % p.a.	-3.8	-4.3	2.0	2.2	0.8	1.8	1.9	2.0
General governm.budget, EU-def., % of GDP								
Revenues	45.3	46.5	46.2	46.3	47.0	46.7	46.3	46.0
Expenditures	48.6	47.6	45.4	46.0	46.7	46.6	46.1	45.8
Net lending (+) / net borrowing (-)	-3.3	-1.1	0.8	0.3	0.3	0.1	0.2	0.2
General gov.gross debt, EU def., % of GDP	84.4	81.0	78.0	74.7	71.3	68.0	66.5	64.0
Stock of loans of non-fin.private sector, % p.a.	-3.1	-4.3	-0.1	2.3	3.9	.	.	.
Non-performing loans (NPL), in %, eop ⁵⁾	16.7	12.2	8.8	7.6	6.0	.	.	.
Central bank policy rate, % p.a., eop ⁶⁾	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Current account, EUR mn	1,436	983	1,660	970	1,410	1,200	1,200	1,150
Current account, % of GDP	3.2	2.1	3.4	1.9	2.6	2.1	2.1	1.9
Exports of goods, BOP, EUR mn	10,197	10,512	11,707	12,240	12,830	13,500	14,200	15,100
annual change in %	8.1	3.1	11.4	4.6	4.8	5.0	5.0	6.0
Imports of goods, BOP, EUR mn	17,319	18,119	20,152	21,882	22,870	24,400	26,100	27,900
annual change in %	7.9	4.6	11.2	8.6	4.5	6.5	7.0	7.0
Exports of services, BOP, EUR mn	10,523	11,725	12,885	13,848	14,750	15,900	17,100	18,400
annual change in %	12.3	11.4	9.9	7.5	6.5	7.5	7.5	7.5
Imports of services, BOP, EUR mn	3,282	3,562	4,109	4,634	5,000	5,400	5,800	6,300
annual change in %	13.1	8.5	15.4	12.8	7.9	7.8	8.0	8.5
FDI liabilities, EUR mn	33	356	462	995	600	1,000	.	.
FDI assets, EUR mn	-189	-1,631	-679	264	120	200	.	.
Gross reserves of NB excl. gold, EUR mn	13,707	13,514	15,706	17,438	18,560	.	.	.
Gross external debt, EUR mn	48,230	44,714	43,683	42,710	43,500	44,900	45,600	45,900
Gross external debt, % of GDP	108.1	95.9	89.0	82.7	81.1	80.0	78.0	75.0
Average exchange rate HRK/EUR	7.6137	7.5333	7.4637	7.4182	7.4180	7.4	7.4	7.4

1) Preliminary and wiiw estimates. - 2) Enterprises with 20 and more employees. - 3) From 2016 new source for labour force. - 4) From 2016 data are based on tax administration data, survey data before. - 5) Loans more than 90 days overdue, and from 2016 also including loans unlikely to be paid. - 6) Discount rate of NB.

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