

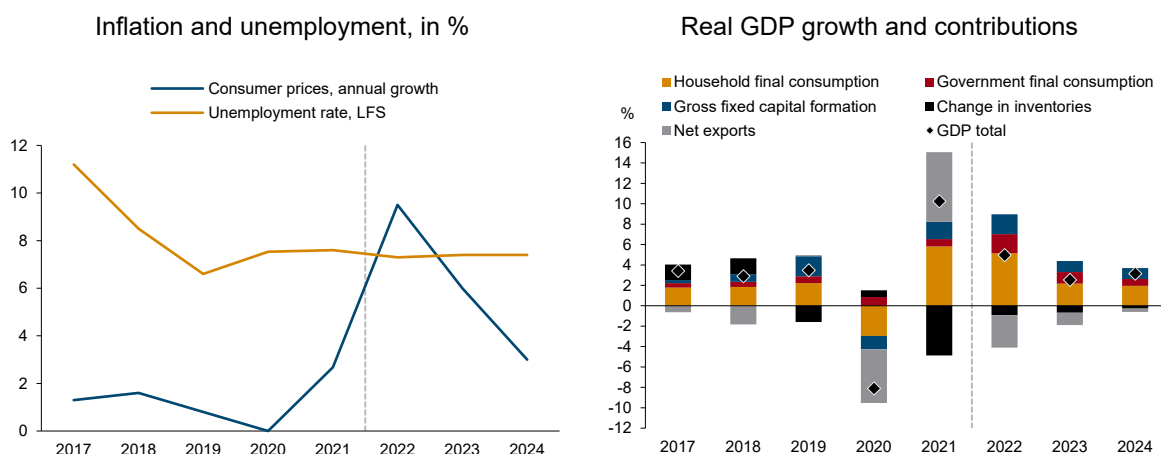


## CROATIA: Within a whisker of adopting the euro

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Croatia's economy grew strongly in the first half of 2022, thanks to robust household consumption. In addition, the summer tourist season was very solid. As a result, we have revised this year's GDP forecast up from 3.3% to 5%. Despite record levels of inflation, the European Commission has also confirmed that Croatia is set to join the euro area next year. Nevertheless, the high inflation and the war in Ukraine still promise much uncertainty for 2023.

Figure 6.5 / Croatia: Main macroeconomic indicators



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

**The Croatian economy continued to grow strongly in the first half of 2022.** The country's GDP increased by 7.3% in real terms in the first six months, thanks to improved turnover in catering services, transport services and the retail trade. Household consumption helped with the growth by surging 7% year on year in the same period. In addition, exports of goods and services in Q2 increased by 41.9% year on year in the wake of a solid tourist season that led to a robust 65.7% year-on-year increase in the service side. The government's energy subsidies also supported household spending in the service sector.

**Tourism has performed strongly.** During the first eight months of 2022, 15m tourists arrived in Croatia and there were 86.6m overnight stays. That meant 40% more arrivals and 27% more overnight stays than in the same period of 2021: the number of overnight stays was thus only 4% below the same period of pre-pandemic 2019. The largest number of overnight stays was achieved by arrivals from Germany, Slovenia and Austria. Thanks to the bountiful tourist season, we have revised this year's GDP forecast up from 3.3% to 5%.

**Growth has also been supported by the strong inflows of EU funds.** Investment projects have been facilitated by allocations from the EU's Reconstruction and Resilience Facility (EUR 6.3bn).

Nevertheless, investment projects have been hampered by surging energy prices and supply bottlenecks that have affected building materials, and this has slowed the reconstruction of earthquake-damaged infrastructure in the Zagreb, Krapina-Zagorje, Sisak-Moslavina and Karlovac counties. In September, the government finally signed a partnership agreement with the European Commission, aimed at allowing Croatia to receive EUR 9bn in EU Cohesion Policy grants for the financing period 2021-2027. Those funds should promote the economic, social and territorial cohesion of Croatia's regions and facilitate the country's green and digital transition.

**The war in Ukraine will bring a high degree of uncertainty in 2023, mainly because of the fear of recession among Croatia's main trading partners.** Even though Croatia's direct economic exposure to Russia is fairly low, we expect the Russo-Ukrainian war to dampen Croatia's economic growth prospects in 2023, mainly via the impact of a deteriorating EU-area economy – especially in Italy and Germany, which both face the prospect of recession next year. Because of this, we have revised Croatia's GDP growth forecast for 2023 down to 2.5%, from 3.5% previously.

**At the same time, energy shortages are much less of an issue in Croatia than in some other CESEE countries.** The government announced in August 2022 that it was to invest EUR 180m to expand the annual capacity of the Omišalj liquefied natural gas (LNG) terminal on the island of Krk (built in 2020) from 2.9bn to 6.1bn cubic metres in 2024-2025, and to build a new gas pipeline in a bid to diversify supplies. The Krk terminal could theoretically supply natural gas to neighbouring countries, such as Slovenia or Bosnia and Herzegovina. Slovenia has already expressed interest in importing natural gas from the LNG terminal from October 2022.

**Inflation picked up to 12.3% year on year in July and August – the highest level since the hyperinflationary days of the early 1990s.** August was the fourth straight month with double-digit inflation. Persistent global supply-chain disruptions and higher energy prices will continue to exert upward pressure on prices, which is why double-digit inflation will persist in Q4 2022, despite the government's price-cap measures. For the year as a whole, inflation is expected to average some 9.5%.

**To support households and businesses in the face of surging inflation, the government drafted a new set of measures in September, worth some EUR 2.8bn (4.8% of GDP).** It introduced price caps on foodstuffs, including sunflower oil, milk, flour, white sugar, whole chickens, pork and minced meat. The government also introduced a cap on electricity prices for local businesses and households from 1 October 2022 to 31 March 2023. In addition to the relief for energy consumers, the government plans to allocate subsidies to the tune of EUR 252m for local companies, in a bid to encourage the introduction of energy-saving technology. The extra expenditure means that this year's budget deficit will rise to 3% of GDP. The government has managed to contain the increase in the public debt, though, thanks to the country's stellar economic recovery in 2021. The public debt-to-GDP ratio will fall to around 76% by the end of 2022.

**Croatia will introduce the euro in January 2023.** Despite record levels of inflation, the European Commission confirmed in June that Croatia had fulfilled all the economic criteria for it to join the euro area in January 2023. The kuna will be converted to the euro at an exchange rate of EUR/HRK 7.53 – the current central rate in the European Exchange Rate Mechanism (ERM II). Stores already began to

display prices in both HRK and EUR in September. The government had managed to keep the budget deficit below the Maastricht Treaty's 3% criterion in 2021 and has kept the exchange rate stable against the euro for at least two years. However, the European Commission has been obliged to turn a blind eye to Croatia's public finance situation: despite a marked reduction, public debt still stood at almost 80% of GDP in 2021 – well above the 60% condition notionally required by the EU.

**The government is struggling to counter emigration and the brain drain.** Croatia's labour market is characterised by labour shortages in some occupations, partly on account of emigration to other EU member states. According to calculations by the Croatian National Bank, an average of 2% of Croatia's population migrated annually in the first three years after Croatia joined the EU. The results of the 2021 population census show that Croatia's population has contracted by over 400,000 (nearly 10% of the country's population) over the past 10 years. The census also reveals that one Croat in five is aged 65 or over, making Croatia among the 'oldest' countries in the EU.

**Table 6.5 / Croatia: Selected economic indicators**

	2019	2020	2021 <sup>1)</sup>	2021 January-June	2022	2022 Forecast	2023 Forecast	2024
Population, th pers., average <sup>2)</sup>	4,067	4,047	3,958	.	.	3,885	3,883	3,880
Gross domestic product, HRK bn, nom.	412.2	378.3	430.6	199.0	231.2	495	538	572
annual change in % (real)	3.5	-8.1	10.2	7.7	7.4	5.0	2.5	3.1
GDP/capita (EUR at PPP)	20,770	19,230	22,580	.	.	.	.	.
Consumption of households, HRK bn, nom.	229.6	218.2	246.6	117.5	136.5	.	.	.
annual change in % (real)	4.0	-5.3	10.1	8.5	7.0	9.0	3.8	3.4
Gross fixed capital form., HRK bn, nom.	88.7	84.4	93.0	46.0	52.9	.	.	.
annual change in % (real)	9.8	-6.1	7.6	11.3	6.4	9.0	5.0	5.0
Gross industrial production <sup>3)</sup>								
annual change in % (real)	0.6	-2.7	6.3	9.0	2.8	2.0	2.8	2.5
Gross agricultural production								
annual change in % (real)	-1.2	1.1	-6.0	.	.	.	.	.
Construction output <sup>3)</sup>								
annual change in % (real)	8.3	4.4	9.3	12.0	4.4	.	.	.
Employed persons, LFS, th, average <sup>4)</sup>	1,680	1,657	1,678	1,658	1,699	1,700	1,720	1,740
annual change in %	1.5	-1.3	1.3	-0.1	2.5	1.5	1.3	1.3
Unemployed persons, LFS, th, average <sup>4)</sup>	119	135	138	162	132	130	140	140
Unemployment rate, LFS, in %, average <sup>4)</sup>	6.6	7.5	7.6	9.0	7.3	7.3	7.4	7.4
Reg. unemployment rate, in %, eop	7.8	9.3	7.3	7.4	6.1	.	.	.
Average monthly gross wages, HRK <sup>5)</sup>	8,766	9,216	9,599	9,532	10,266	10,800	11,700	12,400
annual change in % (real, gross)	3.0	2.4	1.6	2.6	-0.9	2.3	2.5	2.5
Average monthly net wages, HRK <sup>5)</sup>	6,457	6,763	7,129	7,086	7,564	8,000	8,700	9,200
annual change in % (real, net)	2.6	2.6	2.7	4.1	-1.7	2.5	2.5	2.5
Consumer prices (HICP), % p.a.	0.8	0.0	2.7	1.5	8.6	9.5	6.0	3.0
Producer prices in industry, % p.a.	0.8	-3.2	11.6	4.3	28.8	5.0	3.0	2.2
General governm. budget, EU def., % of GDP								
Revenues	46.3	47.2	46.4	.	.	49.0	45.8	46.0
Expenditures	46.1	54.5	49.2	.	.	52.0	48.7	48.5
Net lending (+) / net borrowing (-)	0.2	-7.3	-2.9	.	.	-3.0	-2.9	-2.5
General gov.gross debt, EU def., % of GDP	71.1	87.3	79.8			76.0	72.5	71.0
Stock of loans of non-fin. private sector, % p.a.	3.9	3.5	2.3	1.6	8.0	.	.	.
Non-performing loans (NPL), in %, eop <sup>6)</sup>	5.5	5.4	4.3	5.1	3.8	.	.	.
Central bank policy rate, % p.a., eop <sup>7)</sup>	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Current account, EUR m	1,578	-267	1,807	-2,123	-3,785	-1,310	-1,720	-2,050
Current account, % of GDP	2.8	-0.5	3.2	-8.1	-12.3	-2.0	-2.4	-2.7
Exports of goods, BOP, EUR m	12,819	12,028	15,611	6,947	9,708	17,440	19,530	20,800
annual change in %	5.1	-6.2	29.8	23.8	39.7	11.7	12.0	6.5
Imports of goods, BOP, EUR m	23,313	20,883	26,256	12,172	18,153	31,800	35,300	38,200
annual change in %	6.6	-10.4	25.7	20.3	49.1	21.0	10.9	8.3
Exports of services, BOP, EUR m	15,375	8,927	14,314	3,670	5,927	15,800	16,900	18,300
annual change in %	10.8	-41.9	60.3	30.0	61.5	10.5	7.0	8.4
Imports of services, BOP, EUR m	5,087	3,622	4,494	1,899	2,473	4,600	4,700	4,800
annual change in %	9.4	-28.8	24.1	9.1	30.2	3.0	3.0	3.0
FDI liabilities, EUR m	3,508	1,109	3,930	1,785	1,716	2,300	.	.
FDI assets, EUR m	82	408	1,150	830	-13	-500	.	.
Gross reserves of CB excl. gold, EUR m	18,560	18,943	25,022	21,540	25,243	.	.	.
Gross external debt, EUR m	40,330	40,124	44,802	44,416	46,730	46,500	48,900	51,200
Gross external debt, % of GDP	72.6	79.9	78.3	77.7	71.4	71.0	69.0	68.0
Average exchange rate HRK/EUR	7.4180	7.5384	7.5284	7.5508	7.5414	7.6	7.6	7.6

1) Preliminary. - 2) From 2021 based on Census 2021. - 3) Enterprises with 20 and more employees. - 4) From 2021 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (I ESS). - 5) From 2020 employees expressed in full-time equivalents (FTE). - 6) Loans more than 90 days overdue and those unlikely to be paid. - 7) Discount rate of CB.

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