

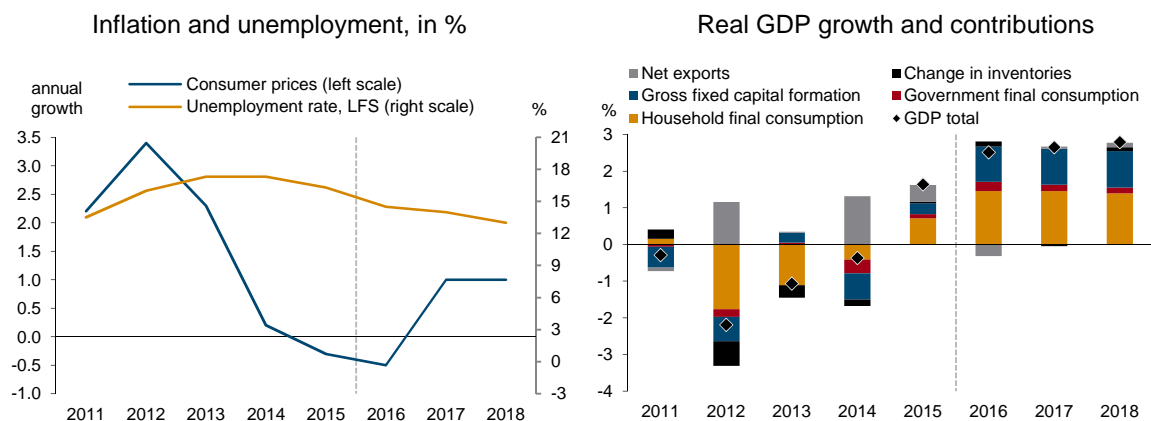


## CROATIA: Economy back on a more stable growth path

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Croatia's economy continues on its path of recovery, with GDP up by an estimated 2.5% in 2016. Growth is backed by a rise in domestic demand, both household consumption and investments. Investments fuelled by EU-funding and continued private consumption recovery should help to stimulate more robust GDP growth over the biennium 2017-2018. Fiscal consolidation coupled with high public debt will remain the main challenges to sustainable growth.

Figure 27 / Croatia: Main macroeconomic indicators



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

Having shown first signs of recovery last year, after six years of contraction, GDP continued to grow in the first half of 2016. Domestic demand, both household consumption and rising investments, were the driving forces behind the 2.7% rise in GDP; foreign demand contributed negatively to this expansion. Private consumption growth gained momentum owing to a recovery in the labour market combined with real wage increases and increased earnings from tourism. Gross fixed capital formation continued its growth path starting from the second quarter of 2015 and translated, among other things, into an increase in construction activities – which had declined for the past seven years. Industrial production continued to grow, but at a slower pace than at the beginning of the year. During the first eight months industrial output was up by 5%, with the highest growth reported for the manufacture of chemicals and of electrical equipment, while the output of shipbuilding contracted again.

The situation in the labour market continued to improve: according to Pension Insurance data, employment rose by almost 2% in the first half of the year; Labour Force Survey data report an increase by 1%, with the unemployment rate falling strongly to 14.1%, from 16.9% in the first six months of 2015. Apart from rising employment, especially outward migration has contributed to the positive labour market outcome: since the country's accession to the EU in July 2013, the number of Croatian workers in Germany has increased by 57,500 and in Austria by about 6,000. Both real gross and net wages rose, by 3.6% and 3.1% respectively, in the first half of 2016.

Over the same period, external trade in goods performed less dynamically than a year earlier, with exports and imports both growing at about 4.7% in euro terms. The trade deficit was about EUR 160 million higher, while the surplus in the services trade went up, thanks to increased earnings from tourism. Revenues from tourism are expected to reach a record level in 2016, likely benefiting inter alia from political turbulence in Turkey. Assuming that the surplus in services trade will go on increasing, the current account is expected to report a surplus again in 2016 as a whole.

The consolidated general government deficit continued to narrow in 2016, mostly on account of higher than expected (tax) revenues coupled with lower expenditures, particularly on subsidies, intermediary consumption as well as spending on employees. The expenditure cut is partly due to provisional budget financing in the first quarter of the year, limiting state expenditures. According to a recent statement by the Minister of Finance, reducing the deficit as planned to 2.6% of GDP seems to be feasible this year.

In mid-June 2016, the Croatian parliament dismissed Prime Minister Tihomir Orešković in a notion of no confidence. As this action marked also the end of the coalition government between the Croatian Democratic Union (HDZ) and its junior partner Most, the Croatian deputies decided on the dissolution of the parliament (which had been elected only in late January 2016). Contrary to opinion polls predicting a victory of the Social Democratic Party, HDZ won the snap elections held on 11 September, although it fell short of the absolute majority. As expected, HDZ formed again a coalition with its former partner Most and representatives of smaller parties including the representatives of minorities. The new government is led by Andrej Plenković, the newly elected head of HDZ and former Member of the European Parliament.

With respect to the country's economy the new government has very ambitious goals: accordingly, GDP growth should accelerate to 5% in 2020 and the employment rate increase to 68%, i.e. creating 180,000 new jobs. The economic policy will have five main pillars: (1) simplification of the tax system; (2) investment in growth drivers such as agriculture, tourism and industry; (3) efficiency of institutions; (4) sustainability of public finances; and (5) reform of the educational system. Fiscal stability – apart from economic growth – is considered key to achieve a better credit ranking and a more favourable position in the international financial market. In 2017 Croatia will have to repay almost EUR 4 billion of maturing bonds and interest. Even if the new government manages to absorb EU funds more efficiently than was the case in the past, there will be the need for adequate national co-financing which might lead to a trade-off between meeting fiscal consolidation targets and stimulating economic growth by an expansion of government spending.

wiiw expects the Croatian GDP to grow by 2.5% in 2016, which is one percentage point higher than the forecast made in spring. The upward revision is mainly due to rising domestic demand and the earlier than expected revival of investment. Economic growth will become more robust over the forecasting

period 2017-2018 backed by (public) investments supported by EU funds and a further recovery of private sector investments. Also the sustained recovery of household consumption should contribute to GDP growth, which is expected to translate into a steady improvement in the labour market. The current account is expected to remain in surplus over the period 2016-2018, but that surplus will be declining (the high surplus in 2015 was mainly due to one-off effects related to the conversion of Swiss franc loans). The downside risks to the outlook are: long-lasting fiscal consolidation coupled with high public debt. In addition, the new Croatian government will need to prove its commitment to fiscal consolidation and related reforms. Demographic challenges (ageing of the population coupled with increased migration) are becoming increasingly apparent as well.

**Table 10 / Croatia: Selected economic indicators**

	2012	2013	2014	2015 <sup>1)</sup>	2015 January-June	2016	2016 2017 Forecast	2018	
Population, th pers., average	4,269	4,254	4,236	4,208	.	.	4,190	4,190	4,190
Gross domestic product, HRK mn, nom.	330,456	329,571	328,431	334,219	158,580	162,521	340,900	353,600	367,100
annual change in % (real)	-2.2	-1.1	-0.4	1.6	0.8	2.7	2.5	2.7	2.8
GDP/capita (EUR at exchange rate)	10,300	10,200	10,200	10,400	.	.	10,700	11,100	11,500
GDP/capita (EUR at PPP)	15,900	15,800	16,100	16,700	.	.	.	.	.
Consumption of households, HRK mn, nom.	195,623	195,623	193,524	194,878	96,321	97,675	.	.	.
annual change in % (real)	-3.0	-1.9	-0.7	1.2	0.5	3.1	2.5	2.5	2.4
Gross fixed capital form., HRK mn, nom.	64,820	65,257	62,639	63,888	31,231	32,731	.	.	.
annual change in % (real)	-3.3	1.4	-3.6	1.6	0.2	5.4	5.0	5.1	5.2
Gross industrial production <sup>2)</sup>									
annual change in % (real)	-5.6	-1.8	1.2	2.7	1.2	6.4	4.9	4.0	4.0
Gross agricultural production									
annual change in % (real)	-9.4	4.2	-7.0	-0.2	.	.	.	.	.
Construction output <sup>2)</sup>									
annual change in % (real)	-12.6	-4.6	-7.3	-0.6	-0.7	4.0	.	.	.
Employed persons, LFS, th, average	1,566	1,524	1,566	1,589	1,572	1,587	1,610	1,630	1,650
annual change in %	-3.6	-2.7	2.7	1.5	2.2	0.9	1.0	1.5	1.5
Unemployed persons, LFS, th, average	297	318	327	309	317	260	270	270	250
Unemployment rate, LFS, in %, average	16.0	17.3	17.3	16.3	16.9	14.1	14.5	14.0	13.0
Reg. unemployment rate, in %, end of period	21.1	21.6	19.6	17.9	16.1	13.6	.	.	.
Average monthly gross wages, HRK <sup>3)</sup>	7,875	7,939	7,953	8,055	7,597	7,751	7,800	8,000	8,200
annual change in % (real, gross)	-2.3	-1.4	0.4	1.8	.	3.6	3.5	2.0	2.0
Average monthly net wages, HRK <sup>3)</sup>	5,478	5,515	5,533	5,711	5,582	5,674	5,700	5,900	6,100
annual change in % (real, net)	-2.6	-1.5	0.5	3.7	.	3.1	3.0	2.5	2.5
Consumer prices (HICP), % p.a.	3.4	2.3	0.2	-0.3	-0.2	-0.8	-0.5	1.0	1.0
Producer prices in industry, % p.a.	5.0	-0.4	-2.7	-3.9	-3.6	-5.4	-2.0	1.0	1.0
General government budget, EU-def., % of GDP									
Revenues	41.7	42.5	42.6	43.7	.	.	44.1	44.3	44.0
Expenditures	47.0	47.8	48.1	46.9	.	.	46.8	46.6	46.0
Net lending (+) / net borrowing (-)	-5.3	-5.3	-5.5	-3.2	.	.	-2.7	-2.3	-2.0
Public debt, EU-def., % of GDP	70.7	82.2	86.5	86.7	.	.	87.6	87.3	87.0
Central bank policy rate, % p.a., end of period <sup>4)</sup>	7.0	7.0	7.0	3.0	7.0	3.0	3.0	3.0	3.0
Current account, EUR mn	-23	441	901	2,237	-1,227	-1,428	1,700	900	740
Current account, % of GDP	-0.1	1.0	2.1	5.1	-5.9	-6.6	3.8	1.9	1.5
Exports of goods, BOP, EUR mn	8,673	8,924	9,761	10,698	5,067	5,305	11,200	11,800	12,400
annual change in %	-0.8	2.9	9.4	9.6	10.3	4.7	4.5	5.0	5.5
Imports of goods, BOP, EUR mn	14,969	15,511	16,116	17,357	8,515	8,909	18,100	19,000	20,100
annual change in %	-1.0	3.6	3.9	7.7	6.3	4.6	4.4	5.0	6.0
Exports of services, BOP, EUR mn	9,642	9,840	10,221	11,255	3,810	3,939	11,600	12,100	12,600
annual change in %	2.9	2.1	3.9	10.1	13.1	3.4	3.0	4.0	4.0
Imports of services, BOP, EUR mn	3,127	3,062	2,989	3,348	1,564	1,613	3,400	3,600	3,800
annual change in %	-1.4	-2.1	-2.4	12.0	11.5	3.1	3.0	4.5	5.5
FDI liabilities (inflow), EUR mn	1,145	710	2,393	170	508	606	300	.	.
FDI assets (outflow), EUR mn	-87	-111	1,596	-27	227	-108	-100	.	.
Gross reserves of NB excl. gold, EUR mn	11,236	12,908	12,688	13,707	13,734	12,937	.	.	.
Gross external debt, EUR mn	45,297	45,958	46,664	45,534	48,793	43,432	49,100	50,500	51,900
Gross external debt, % of GDP	103.1	105.7	108.5	103.7	111.2	96.4	109.0	108.5	107.5
Average exchange rate HRK/EUR	7.5217	7.5786	7.6344	7.6137	7.6278	7.5610	7.57	7.60	7.60
Purchasing power parity HRK/EUR	4.8716	4.8938	4.8134	4.7447	.	.	.	.	.

1) Preliminary. - 2) Enterprises with 20 and more employees. - 3) Half-year data for 2016 according to new data sources. - 4) Discount rate of NB.

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