



CROATIA: Hope for a reversal of the negative growth trend

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In Croatia GDP fell for the sixth consecutive year; however, the country is likely to return to a slightly positive growth path in 2015. Household consumption remains subdued owing to high and persistent unemployment and continued deleveraging. Economic recovery will hinge primarily on external demand, and a revival in investment activities following increased absorption of EU funds. Fiscal consolidation and an overly indebted enterprise sector are the key obstacles to more robust growth.

Croatia's economy continued to shrink for the sixth consecutive year, with GDP contracting by 0.6% in 2014. Gross fixed capital formation and private consumption declined further and government consumption, after showing an upward trend in 2013, fell again in 2014. Only foreign demand contributed positively to GDP growth. The continued drop in investment has been felt particularly in construction, also reporting a decline for the sixth year in a row. After five years of contraction, industrial production showed first signs of recovery, up by 1.2%. Manufacturing grew by 3%, with above-average output growth registered, among others, for the production of leather, wearing apparel, pharmaceuticals and rubber and plastic products. Labour productivity in industry continued to increase due to further layoffs.

The labour market situation remained weak with employment declining by 2% in the first three quarters of 2014 according to the Pension Insurance Institute. In December registered unemployment stood at 19.6%, 3 percentage points lower than in 2013. The reason behind this was mainly of an administrative nature: a high number of persons were deleted from the registers because of non-compliance with the legal provisions. In November the LFS-based unemployment rate stood at close to 17%, youth unemployment at a disastrous 46%, representing the third highest rate in the EU after Spain and Greece. After years of decline both real gross and net wages grew only modestly in 2014.

Since Croatia's accession to the EU in July 2013, trade data have been subject to several revisions following the adoption of the Eurostat methodology in data compilation.¹ Based on customs statistics, goods exports and imports measured in euro terms increased by 8% and 4%, respectively, in the first eleven months of 2014. As a result, the trade deficit declined by EUR 450 million compared to the same period in 2013. Sales expanded both to the EU and CEFTA countries, by about 11% each. A breakdown

¹ Since Croatia's accession to the EU, data on foreign trade in goods are acquired from two different sources: Intrastat for the trade in goods between EU Member States, and the Single Administrative Document for trade in goods with non-EU countries (Extrastat).

by commodity groups shows that wearing apparel, textiles, motor vehicles, and rubber and plastic products reported the strongest growth while exports of ships shrank by almost half. Data on services trade available for the first three quarters of 2014 indicate a modest export increase (tourism and transport in particular) and a contraction of imports, leading to a rise in the services trade surplus compared to a year earlier. For 2014 as a whole wiiw expects the current account to end up with a surplus (EUR 200 million), slightly lower than in 2013. As regards FDI, both inflows and outflows were exceptionally high in the first three quarters of 2014, suggesting that the large transactions were actually round-tripping (a Croatian company sending FDI funds to its subsidiary abroad and then channelling it back).

The general government deficit reached an estimated 5% of GDP in 2014. Revenues performed better than anticipated mainly due to an increased inflow of excises and VAT, while expenditures remained stagnant. The general government debt is estimated to have reached about 81% of the GDP. The 2015 budget is based on an (optimistic) 0.5% GDP growth and envisages the general government deficit to narrow to 3.8% of the GDP, mainly through expenditure cuts. As of 1 January 2015, the Croatian Health Fund has been excluded from the state budget (though some expenses remain in the budget), making comparisons with previous years difficult. Given that 2015 is an election year, there is a high uncertainty on whether fiscal discipline can be maintained.² In February 2015 a new Eurobond issue of at least EUR 1 billion will be launched for the financing of a EUR 700 million euro-linked T-bill.

Croatian households are heavily affected by the decision of the Swiss National Bank to abandon the peg of the franc to the euro. About 60,000 persons have loans in Swiss francs, primarily for housing (38% of the total amount of such loans). The stock of Swiss franc loans amounts to about HRK 27 billion or EUR 3.9 billion. In response to the decision of the Swiss National Bank the Croatian parliament decided to fix the exchange rate of the franc for the next 12 months at 6.39 kuna, corresponding to the level prior to the lifting of the cap on the franc. The costs of this decision will have to be borne by the banks. The government announced that talks with the National Bank and commercial banks should follow to find longer-term solutions. Prime Minister Milanovic has also announced the possibility of converting the loans into local currency following the Hungarian example. The Croatian National Bank warned that a conversion of all currency-indexed housing loans to kuna would imply a reduction of the foreign exchange reserves by EUR 7.8 billion; excluding debts denominated in euro, the reserves would drop by EUR 3.2 billion.

At the beginning of February 2015 the Croatian government announced an agreement with municipalities, banks, telecommunication providers and public and private companies to write off debts of the country's poorest citizens. To qualify for the write-off, the applicants' debts must not exceed HRK 35,000 (EUR 4,800), the monthly income of a single person must be less than HRK 1,250 (EUR 170) over the last three months and the banking account must have been blocked for more than 12 months. Applicants are not allowed to have any property or savings.

At the end of September 2014 the ratio of non-performing loans to total loans was at 17.2% (up from 15.7% in December 2013). Out of the loans provided to the corporate sector (in particular construction and real estate), 30% were categorised as non-performing; the share of non-performing loans in total household loans was 12%.

² The European Commission, in its Winter Forecast 2015, expects the general government deficit to stand at 5.5% in 2015.

In January 2015 Kolinda Grabar Kitarovic, the candidate of the main opposition party HDZ, was elected new president of Croatia, replacing incumbent president Ivo Josipovic. This result may also be interpreted as a signal for the upcoming parliamentary elections to be held by the end of 2015 or at the beginning of 2016.

As for the years to come, wiiw has slightly revised upwards the forecast for Croatia's GDP growth for 2015 from stagnation to a 0.3% increase which should be primarily backed by exports. More pronounced growth of more than 1% is expected in 2016 and 2017, driven by external demand as well as by investments fuelled by increased absorption of EU funds. Household consumption will remain suppressed due to high and persistent unemployment and continued private sector deleveraging. Uncertainties remain on whether fiscal discipline can be maintained given that 2015 is an election year.

Table 1 / Croatia: Selected Economic Indicators

	2010	2011	2012	2013	2014 ¹⁾	2015	2016	2017
						Forecast		
Population, th pers., average ²⁾	4,296	4,283	4,269	4,254	4,250	4,250	4,250	4,250
Gross domestic product, HRK mn, nom. ³⁾	328,041	332,587	330,456	330,135	328,890	331,200	336,500	345,000
annual change in % (real) ³⁾	-1.7	-0.3	-2.2	-0.9	-0.6	0.3	1.1	1.5
GDP/capita (EUR at exchange rate)	10,500	10,400	10,300	10,200	10,100	10,100	10,200	10,300
GDP/capita (EUR at PPP)	14,900	15,400	15,700	15,800	15,800	.	.	.
Consumption of households, HRK mn, nom. ³⁾	190,237	195,325	195,623	196,885	196,140	.	.	.
annual change in % (real) ³⁾	-1.5	0.3	-3.0	-1.3	-0.6	-0.3	0.5	0.6
Gross fixed capital form., HRK mn, nom. ³⁾	69,784	67,471	64,820	63,732	61,320	.	.	.
annual change in % (real) ³⁾	-15.2	-2.7	-3.3	-1.0	-4.0	1.0	3.0	4.0
Gross industrial production ⁴⁾								
annual change in % (real)	-1.4	-1.2	-5.5	-1.8	1.2	2.0	2.5	2.5
Gross agricultural production								
annual change in % (real)	-8.2	-1.0	-9.9	5.2	0.8	.	.	.
Construction output ⁴⁾								
annual change in % (real)	-15.8	-8.5	-11.1	-4.1	-7.0	.	.	.
Employed persons, LFS, th, average ⁵⁾	1,541	1,493	1,446	1,390	1,550	1,550	1,560	1,570
annual change in %	-4.0	-3.2	-3.1	-3.9	.	0.0	0.5	0.5
Unemployed persons, LFS, th, average ⁵⁾	206	232	272	288	325	.	.	.
Unemployment rate, LFS, in %, average ⁵⁾	11.8	13.5	15.9	17.2	17.3	17.5	16.5	16.0
Unemployment rate, reg., in %, end of period	18.8	18.7	21.1	21.6	19.6	19.0	18.0	17.0
Average monthly gross wages, HRK	7,679	7,796	7,875	7,939	7,945	.	.	.
annual change in % (real, gross)	-1.5	-0.8	-2.3	-1.4	0.3	.	.	.
Average monthly net wages, HRK	5,343	5,441	5,478	5,515	5,520	.	.	.
annual change in % (real, net)	-0.5	-0.4	-2.6	-1.5	0.3	.	.	.
Consumer prices (HICP), % p.a.	1.1	2.2	3.4	2.3	0.2	0.4	0.5	1.0
Producer prices in industry, % p.a. ⁶⁾	4.3	7.0	5.4	-0.2	-2.6	0.0	1.0	1.0
General governm.budget, EU-def., % of GDP								
Revenues	40.8	40.6	41.3	41.8	42.5	.	.	.
Expenditures	46.8	48.2	46.9	47.0	47.5	.	.	.
Net lending (+) / net borrowing (-)	-6.0	-7.7	-5.6	-5.2	-5.0	-5.5	-5.6	-4.0
Public debt, EU-def., % of GDP	52.8	59.9	64.4	75.7	81.0	84.0	87.0	89.0
Central bank policy rate, % p.a., end of period ⁷⁾	9.0	7.0	7.0	7.0	7.0	.	.	.
Current account, EUR mn ⁸⁾	-503	-360	-61	341	200	100	50	0
Current account, % of GDP	-1.1	-0.8	-0.1	0.8	0.5	0.2	0.1	0.0
Exports of goods, BOP, EUR mn ⁸⁾	8,058	8,742	8,673	8,923	9,900	10,600	11,300	12,100
annual change in %	22.2	8.5	-0.8	2.9	10.9	7.0	7.0	7.0
Imports of goods, BOP, EUR mn ⁸⁾	13,980	15,124	14,970	15,512	16,180	16,800	17,500	18,400
annual change in %	-0.5	8.2	-1.0	3.6	4.3	4.0	4.0	5.0
Exports of services, BOP, EUR mn ⁸⁾	8,928	9,358	9,636	9,824	10,020	10,200	10,400	10,700
annual change in %	-0.6	4.8	3.0	2.0	2.0	2.0	2.0	2.5
Imports of services, BOP, EUR mn ⁸⁾	3,167	3,169	3,120	3,032	2,970	3,000	3,100	3,200
annual change in %	-0.6	0.1	-1.5	-2.8	-2.0	2.0	3.0	3.0
FDI inflow (liabilities), EUR mn ⁸⁾	1,069	1,036	1,134	741	2,700	.	.	.
FDI outflow (assets), EUR mn ⁸⁾	125	-169	-63	-118	1,900	.	.	.
Gross reserves of NB excl. gold, EUR mn	10,660	11,195	11,236	12,908	12,687	.	.	.
Gross external debt, EUR mn ⁸⁾	46,908	46,397	45,276	45,920	46,500	.	.	.
Gross external debt, % of GDP	104.2	103.7	103.0	105.3	107.9	.	.	.
Average exchange rate HRK/EUR	7.2862	7.4342	7.5173	7.5735	7.6300	7.73	7.79	7.86
Purchasing power parity HRK/EUR	5.1340	5.0537	4.9167	4.9168	4.8984	.	.	.

1) Preliminary and wiiw estimates. - 2) According to census April 2011. - 3) According to ESA'10. - 4) Enterprises with 20 and more employees. - 5) From 2014 according to census April 2011. - 6) 2010 domestic output prices. - 7) Discount rate of NB. - 8) BOP 6th edition. Source: wiiw Databases incorporating national statistics. Forecasts by