

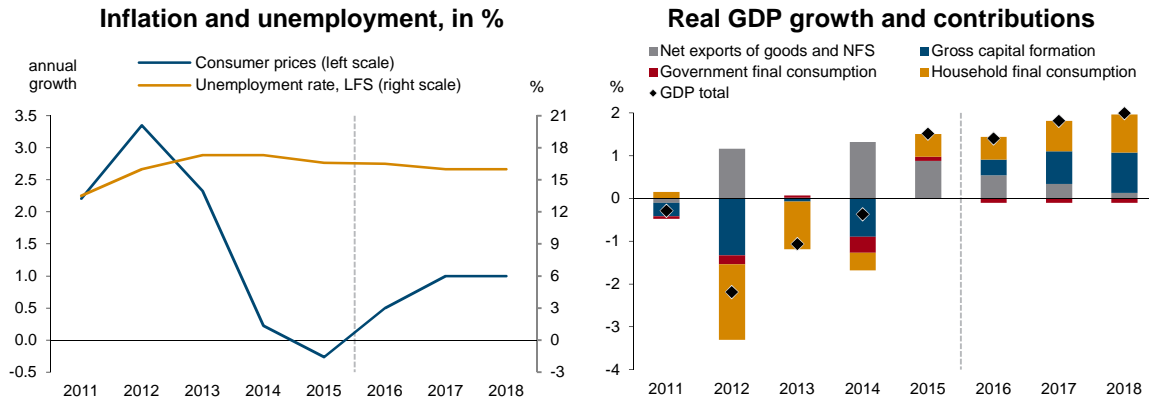


CROATIA: Slow return to growth

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Croatia's economy has returned to a mild growth path in 2015. The turnaround was backed by a rise in external demand and a modest recovery in household consumption and investments. EU-funded investments and the continuation of private consumption recovery should help to stimulate GDP growth, which, however, will remain relatively weak, 1.7% on average, over the period 2016-2018. Fiscal consolidation coupled with high public debt will remain the main impediments to sustainable growth.

Figure 40 / Croatia: main macroeconomic indicators



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

After six years of recession, Croatia's economy returned to growth in 2015. The 1.5% GDP growth was backed both by foreign and domestic demand. Household consumption grew for the first time since 2011 owing to a mild recovery in the labour market, real wage increases and a reduction of personal income tax introduced at the beginning of the year. Thanks to an improved absorption of EU funds, gross fixed capital formation rose for the first time since 2009 (the only exception being a temporary increase in 2013), but was not strong enough to put a brake on the protracted decline in construction activities. The rise in investments⁴¹ is mainly associated with public sector activities, but there are also some signs of recovery in private sector investment. Growth of industrial production took off in the course of the year and increased by 2.7%, with a further rise in labour productivity due to continued layoffs. Though improving somewhat, the unemployment rate remained high (16.6%) compared with other EU countries,

⁴¹ Croatian National Bank, Bulletin 220, December 2015, p. 10.

ranking third after Greece and Spain. Also youth unemployment is still among the highest in the EU, at 44% in December 2015. In terms of employment, Pension Insurance data report a 0.5% rise during the first nine months of the year, while Labour Force Survey data indicate an increase by 1.6%. Both real gross and net wages increased, by 1.7% and 3.5% respectively, in 2015.

Foreign trade performed dynamically in 2015 with goods exports (up 9%) rising ahead of imports (up 6.7%, both in nominal euro terms). The trade deficit increased slightly against 2014. Trade with EU countries performed above average, while deliveries to CEFTA countries decreased slightly, primarily on account of a remarkable export decline in trade with Bosnia and Herzegovina, Croatia's major trading partner in the region. Trade with Russia shrank significantly both in terms of exports (by 30%) and imports (by 48%). After years of restructuring-related declines, exports of the shipbuilding industry were 2.5 times higher in 2015 than a year earlier; exports of car parts, pharmaceutical and leather products reported far above average growth rates. The strong growth of the current account surplus to 4.6% of GDP is mainly due to the conversion effect of Swiss franc loans on the declining deficit in the primary income, the growing surplus in services trade and the transfer of EU funds.

Following the parliamentary elections held on 8 November 2015, a new government came into office on 25 January 2016 after protracted and difficult coalition negotiations. The government consists of a coalition between the Croatian Democratic Union (HDZ) and Most, a new party of municipal politicians and independents formed prior to the elections. It is headed by Tihomir Orešković, holding Croatian and Canadian citizenship and serving formerly as chief financial officer of the Teva pharmaceutical company. In his first speech to the parliament the new prime minister stressed that, in order to achieve sustainable economic growth (over 3%) and a sound fiscal position (budget deficit below 3% in 2017 and public debt lower than 80% of the GDP by 2020), five major areas have to be tackled: efficiency of the public sector, business competitiveness, investments and EU funds, public debt management and the reform of the educational and health systems. Considering the fragile coalition, it remains to be seen whether these announcements will be put into practice or remain lip service as has frequently happened in the past.

The analysis of the fiscal stance in 2015 is impeded by methodological changes. Available data for the central government budget for the whole year indicate that the general government deficit may have decreased to an estimated 4.2% of the GDP and public debt has increased less dramatically than originally expected. This was mainly made possible by higher than expected revenues owing to stronger GDP growth. The budget for 2016 is still under preparation due to the change in government. According to the prime minister, the major objective will remain the further reduction of the budget deficit. Initial information indicates that programmes worth about EUR 500 million should be activated to stimulate growth of small and medium-sized enterprises, and also EU funding should support GDP growth. Investments in tourist facilities should continue, e.g. in the airport Mali Lošinj, Hotel Park Rovinj or the Costabella Resort in Rijeka.⁴² Investments are also envisaged in strategic public companies such as the electric power provider HEP. The reduction of the number of (currently 20) counties, which has been considered by experts as an important prerequisite for the efficient use of EU funds, is according to the prime minister not a priority, while the minister of economy announced a 'public debate about the right model' on how to (re)organise regions. There are also diverging views among the members of the government on the introduction of a property tax, e.g. to tax unused property or to abolish other taxes or

⁴² The government envisages investing EUR 2.2 billion in tourist infrastructure (mostly in hotels) up to 2020; in 2016 alone investments in tourism will account for EUR 670 million.

<https://vlada.gov.hr/news/prime-minister-oreskovic-expects-further-increase-in-interest-in-tourism-investment/18396>

contributions instead. The 2016 budget, which will be presented on 10 March, might be seen as a first indicator of the policy direction of the new government. Overall, it seems that there is not much room to manoeuvre since the government will have to comply with the recommendations under the excessive deficit procedure.

Improving credit ratings is another important goal of the new government. Only in January 2016, Standard & Poor's affirmed Croatia's long-term and short-term credit ratings at 'BB' and 'B', respectively. The outlook on the ratings remains negative. The main reasons behind are weak GDP growth, poor public finances and delayed reform planning due to the long-lasting coalition talks. This rating was also confirmed by Fitch.

First results regarding the conversion of Swiss franc loans into euro-denominated loans – the legislation of which was adopted in September 2015 – show that the differences between the annuities for these two types of loans turned out to be relatively small due to the effects of previous interventions, such as the one-year freezing of the exchange rate for these loans at 6.39 kuna per Swiss franc in January 2015 and the setting of a maximum interest rate at 3.23% effective from the beginning of 2014⁴³. At the end of January 2016, six out of eight banks providing Swiss franc loans in the past decided to stick to the fixed exchange rate for clients who have agreed to convert their loans. Recently, some irregularities in the calculation of conversions have been reported.

Regarding the economic prospects for the coming years, Croatia will continue to experience moderate GDP growth (at 1.7% p.a.) over the period 2016-2018; that growth will become more robust and will be backed by (public) investments supported by EU funds and a gradual recovery of private sector investments. Sustained recovery of household consumption should also help to initiate a new period of growth. GDP growth is expected to translate into a steady rise of employment and decreasing unemployment. Assuming slightly lower growth of both exports and imports of goods and services, the current account is expected to remain in surplus over the period 2016-2018. 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 demonstrate its commitment to fiscal consolidation and related reforms.

⁴³ EIZ, Croatian Economic Outlook, December 2015, p. 9.

Table 9 / Croatia: selected economic indicators

	2011	2012	2013	2014	2015 ¹⁾	2016	2017 Forecast	2018
Population, th pers., average	4,283	4,269	4,254	4,236	4,220	4,220	4,220	4,220
Gross domestic product, HRK mn, nom.	332,587	330,456	329,571	328,431	334,000	340,400	350,000	360,600
annual change in % (real)	-0.3	-2.2	-1.1	-0.4	1.5	1.4	1.8	2.0
GDP/capita (EUR at exchange rate)	10,400	10,300	10,200	10,200	10,400	10,500	10,800	11,100
GDP/capita (EUR at PPP)	15,500	15,900	15,800	16,100	16,900	.	.	.
Consumption of households, HRK mn, nom.	195,325	195,623	195,623	193,524	195,700	.	.	.
annual change in % (real)	0.3	-3.0	-1.9	-0.7	0.9	0.9	1.2	1.5
Gross fixed capital form., HRK mn, nom.	67,471	64,820	65,257	62,639	63,300	.	.	.
annual change in % (real)	-2.7	-3.3	1.4	-3.6	0.9	2.0	4.0	5.0
Gross industrial production ²⁾								
annual change in % (real)	-1.2	-5.5	-1.8	1.2	2.7	2.8	2.8	3.0
Gross agricultural production								
annual change in % (real)	-4.7	-9.4	4.2	-7.0	-0.2	.	.	.
Construction output ²⁾								
annual change in % (real)	-11.3	-12.7	-4.7	-7.2	-0.5	.	.	.
Employed persons, LFS, th, average ³⁾	1,493	1,566	1,524	1,566	1,590	1,610	1,630	1,650
annual change in %	-3.2	-3.6	-2.7	2.7	1.6	1.5	1.5	1.5
Unemployed persons, LFS, th, average ³⁾	232	297	318	327	315	320	310	310
Unemployment rate, LFS, in %, average ³⁾	13.5	16.0	17.3	17.3	16.6	16.5	16.0	16.0
Reg. unemployment rate, in %, end of period	18.7	21.1	21.6	19.6	17.9	.	.	.
Average monthly gross wages, HRK	7,796	7,875	7,939	7,953	8,054	8,200	8,400	8,700
annual change in % (real, gross)	-0.8	-2.3	-1.4	0.4	1.8	1.8	2.0	2.0
Average monthly net wages, HRK	5,441	5,478	5,515	5,533	5,710	5,900	6,100	6,300
annual change in % (real, net)	-0.4	-2.6	-1.5	0.5	3.7	2.5	2.5	2.5
Consumer prices (HICP), % p.a.	2.2	3.4	2.3	0.2	-0.3	0.5	1.0	1.0
Producer prices in industry, % p.a.	7.0	5.1	-0.4	-2.7	-3.9	-2.0	1.0	1.0
General governm. budget, EU-def., % of GDP								
Revenues	41.0	41.7	42.5	42.6	43.4	43.4	43.8	44.0
Expenditures	48.8	47.1	47.8	48.2	47.6	47.4	47.3	47.0
Net lending (+) / net borrowing (-)	-7.8	-5.3	-5.4	-5.6	-4.2	-4.0	-3.5	-3.0
Public debt, EU-def., % of GDP	63.7	69.2	80.8	85.1	86.0	88.0	89.0	90.0
Central bank policy rate, % p.a., end of period ⁴⁾	7.0	7.0	7.0	7.0	3.0	3.0	3.0	3.0
Current account, EUR mn	-316	-21	443	364	2,000	1,500	1,000	900
Current account, % of GDP	-0.7	0.0	1.0	0.8	4.6	3.4	2.2	1.9
Exports of goods, BOP, EUR mn	8,742	8,673	8,924	9,761	10,650	11,400	12,200	13,200
annual change in %	8.5	-0.8	2.9	9.4	9.1	7.0	7.0	8.0
Imports of goods, BOP, EUR mn	15,124	14,969	15,511	16,116	17,200	18,200	19,100	20,200
annual change in %	8.2	-1.0	3.6	3.9	6.7	6.0	5.0	6.0
Exports of services, BOP, EUR mn	9,367	9,641	9,839	10,268	10,700	11,100	11,500	12,000
annual change in %	4.7	2.9	2.1	4.4	4.2	4.0	4.0	4.0
Imports of services, BOP, EUR mn	3,172	3,127	3,061	3,029	3,290	3,500	3,700	3,900
annual change in %	-0.1	-1.4	-2.1	-1.1	8.6	5.0	5.5	5.5
FDI liabilities (inflow), EUR mn	1,018	1,136	710	2,896	1,000	.	.	.
FDI assets (outflow), EUR mn	-169	-64	-118	1,586	400	.	.	.
Gross reserves of NB excl. gold, EUR mn	11,195	11,236	12,908	12,688	13,707	.	.	.
Gross external debt, EUR mn	46,397	45,297	45,958	46,664	47,500	48,500	49,500	50,500
Gross external debt, % of GDP	103.7	103.0	105.6	108.4	108.2	109.0	108.5	107.5
Average exchange rate HRK/EUR	7.4342	7.5173	7.5735	7.6300	7.6096	7.65	7.67	7.67
Purchasing power parity HRK/EUR	5.0066	4.8716	4.8939	4.8133	4.6913	.	.	.

1) Preliminary and wiiw estimates. - 2) Enterprises with 20 and more employees. - 3) From 2012 according to census April 2011. - 4) Discount rate of NB.

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