

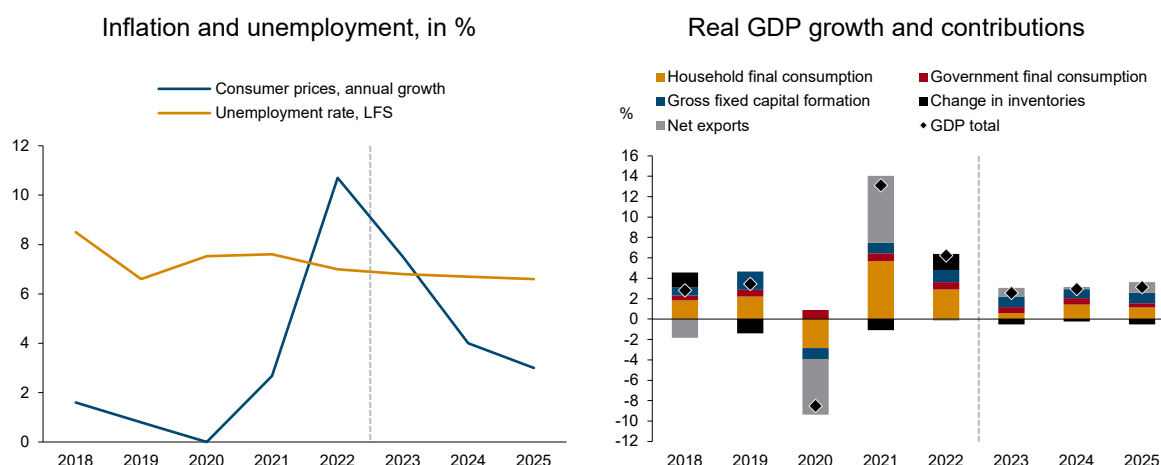


CROATIA: Tourism to keep economy afloat

BERND CHRISTOPH STRÖHM

Croatia's accession to the euro area and the EU's border-free Schengen zone boosted tourism in 2023. The country's full EU integration will also provide a fillip to trade and investment in the long term. EU-related funds were already supporting investment activity in the country in 2022, and have continued to do so this year. Nevertheless, persistently high levels of inflation have put real incomes, external demand and investment sentiment under pressure, which is why we have maintained our growth forecast for 2023 of 2.5%.

Figure 6.5 / Croatia: Main macroeconomic indicators



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

Croatia's economy displayed stable performance in H1 2023, despite the ongoing cost-of-living crisis. GDP expanded by 2.7% year on year in Q2 2023, following a 2.8% surge the previous quarter. Economic growth was driven by strong investments and public consumption. In addition, private consumption supported domestic demand by accelerating to 2.3% year on year in Q2 2023; investment activity also grew at a similar pace in Q2, surging to 3.2% year on year. Lastly, net exports likewise made a positive contribution to growth – exports of goods and services fell by only 1.6% year on year in Q2, compared to imports, which saw a 3.6% decline year on year.

The country's accession to the euro area and the EU's border-free Schengen zone boosted tourism in 2023. Despite the current circumstances – not least the impact of global inflation and the ongoing conflict in Ukraine – Croatia's tourist season performed very well, thanks to the introduction of the euro as the country's currency and its accession to the Schengen area in January 2023 (about 80% of tourists come from the Schengen area and some 60% from the euro area). From January to the end

of August 2023, Croatia saw 16.2m arrivals and 88.5m overnight stays – up 8% and 2%, respectively, against the same period of 2022. According to the Croatian Tourism Ministry, tourist numbers this year will likely surpass the record set in 2019.

The declining trend in inflation, observed since the November 2022 peak of 13.5%, went into reverse in August, as inflation surged to 7.8%. The main drivers of inflation in August were still food, beverages and tobacco (+10.1% year on year). In addition, the introduction of the euro in January led to an immediate surge in the price of certain goods (in particular coffee and baked goods) during the two-week transition period when both the kuna and the euro were in circulation. Alongside some supply-chain normalisation, the government support package helped ease the pressure of prices for housing and utilities in H1 2023. Nevertheless, food prices continued to rise, even though the government reduced the VAT on certain food products to 5% and is actively monitoring movements in the price of foodstuffs (to little significant effect). Given the August figure, we have revised our average inflation forecast for this year upward, from 6.5% to 7.5%. As for the coming years, we forecast that inflation will gradually fall – to 4% in 2024 and 3% in 2025.

Overall, the government is planning to allocate EUR 3.4bn (5% of GDP) in 2023 to investments in energy-efficiency measures and to mitigating the cost-of-living crisis. This includes the fifth state aid package presented in September (worth EUR 1.7bn). We have thus maintained our previous forecast that the budget deficit in 2023 will remain at 2.4% of GDP and will continue at around 2% in 2024. The high level of inflation meant that the public debt declined to 68.8% of GDP in 2022 (from 79.3% in 2021). We project that this downward trend will continue in the coming period, and that public debt will fall to 63% in 2023.

Croatia's unemployment rate will decline to pre-Covid-19 levels. According to the national statistical office, there were 103,774 unemployed persons registered with the Employment Service in July 2023 – 5.3% lower than in the same month of 2022. We expect the unemployment rate to fall to 6.8% on average this year, thus reaching its pre-Covid-19 levels. Despite this relatively high rate of unemployment, the country is still facing labour shortages in certain professions and sectors, due to mass emigration to other EU countries. Croatia also faces a declining demography – the country's population contracted by some 10% (roughly 400,000 people) from 2011 to 2021. According to an estimate by the Croatian State Bureau of Statistics, the population of the country in mid-2022 was 3,855,641.

The inflow of funds from the EU's Recovery and Resilience Facility (RRF) is supporting growth dynamics in 2023. In 2021, the European Commission approved a grant of EUR 6.3bn (12.8% of Croatia's 2020 GDP) from the RRF for the period 2021-2026. In June 2023, Croatia managed to fully absorb allocations from the EU Solidarity Fund to deal with the aftermath of the Zagreb and Petrinja earthquakes to the tune of EUR1.03bn. Total EU funding for 2023 is capped at some EUR 4bn. Implementation of the RRF-financed projects, including the reconstruction of earthquake-damaged infrastructure in the Zagreb, Krapina-Zagorje, Sisak-Moslavina and Karlovac counties, will contribute 1.5 percentage points to headline GDP growth in 2023 and 2.5 percentage points in 2024 and 2025 (according to the European Commission). In September, the government asked the European Commission to alter the country's RRF and add EUR 4.4bn in loans to reflect the fact that Croatia's economic performance in 2020 and 2021 had been better than originally envisaged by the government.

Croatia's economy is projected to grow by 2.5% in 2023, unchanged from our previous forecast.

The high inflation, coupled with the deteriorating funding conditions and uncertainty, will depress real wages and hamper investor sentiment. Household consumption will also remain subdued for the remainder of 2023. The allocation of EU funds means that public investment will act as the main driver of this year's economic growth, while tourism will likely fall by the wayside in Q4. In 2024, external demand will bring more uncertainty, due to the poor outlook for growth in the EU and particularly Germany. There are also downside risks from the war in Ukraine dragging on. This will result in a slowdown in the global economy, which could have an unfavourable effect on the Croatian tourism sector. Consequently, GDP growth in both 2024 and 2025 will likely stay at the 3% mark.

Table 6.5 / Croatia: Selected economic indicators

	2020	2021	2022 ¹⁾	2022 January-June	2023	2023 Forecast	2024 Forecast	2025
Population, th pers., average ²⁾	4,047	3,949	3,857	.	.	3,853	3,850	3,849
Gross domestic product, EUR-HRK m, nom.	50,477	58,244	66,943	31,283	35,511	74,000	79,000	84,000
annual change in % (real)	-8.5	13.1	6.2	8.2	2.7	2.5	2.9	3.1
GDP/capita (EUR at PPP)	19,460	22,570	25,730	.	.	.	.	.
Consumption of households, EUR-HRK m, nom.	29,092	32,726	38,128	18,133	20,263	.	.	.
annual change in % (real)	-5.1	9.9	5.2	7.1	1.9	1.0	2.5	2.0
Gross fixed capital form., EUR-HRK m, nom.	11,217	12,068	13,839	6,803.3	7,783	.	.	.
annual change in % (real)	-5.0	4.7	5.8	3.0	3.5	5.0	4.3	5.0
Gross industrial production ³⁾								
annual change in % (real)	-2.7	6.3	1.2	2.8	-0.8	-0.5	2.3	2.5
Gross agricultural production								
annual change in % (real)	1.1	-3.4	-6.5	.	.	.	.	.
Construction output ³⁾								
annual change in % (real)	4.4	9.3	4.0	4.5	3.2	.	.	.
Employed persons, LFS, th, average ⁴⁾	1,657	1,678	1,707	1,700	1,596	1,710	1,740	1,770
annual change in %	-1.3	1.3	1.7	2.5	.	1.9	1.5	1.5
Unemployed persons, LFS, th, average ⁴⁾	135	138	128	132	110	120	120	130
Unemployment rate, LFS, in %, average ⁴⁾	7.5	7.6	7.0	7.3	6.5	6.8	6.7	6.6
Reg. unemployment rate, in %, eop	9.3	7.3	6.7	6.1	5.6	.	.	.
Average monthly gross wages, EUR-HRK	1,223	1,274	1,380	1,363	1,546	1,500	1,600	1,700
annual change in % (real, gross)	2.4	1.6	-2.3	-0.9	3.3	3.0	2.5	2.3
Average monthly net wages, EUR-HRK	898	946	1,016	1,004	1,123	1,100	1,200	1,300
annual change in % (real, net)	2.6	2.7	-3.1	-1.7	1.8	2.0	2.3	2.5
Consumer prices (HICP), % p.a.	0.0	2.7	10.7	8.6	10.0	7.5	4.0	3.0
Producer prices in industry, % p.a.	-3.2	11.6	25.5	28.8	4.0	10.0	4.0	2.2
General governm. budget, EU def., % of GDP								
Revenues	46.8	46.2	45.5	.	.	47.0	46.3	47.0
Expenditures	54.1	48.7	45.1	.	.	49.4	48.3	48.8
Net lending (+) / net borrowing (-)	-7.3	-2.5	0.4	.	.	-2.4	-2.0	-1.8
General gov. gross debt, EU def., % of GDP	86.9	78.3	68.8	.	.	63.0	62.0	60.0
Stock of loans of non-fin. private sector, % p.a.	3.5	2.3	11.2	8.0	9.2	.	.	.
Non-performing loans (NPL), in %, eop ⁵⁾	5.4	4.3	3.0	3.8	3.0	.	.	.
Central bank policy rate, % p.a., eop ⁶⁾	3.0	3.0	3.0	3.0	4.0	.	.	.
Current account, EUR m	-267	1,022	-1,061	.	.	-330	130	1,420
Current account, % of GDP	-0.5	1.8	-1.6	.	.	-0.4	0.2	1.7
Exports of goods, BOP, EUR m	12,028	14,803	20,439	.	.	22,070	23,680	25,220
annual change in %	-6.2	23.1	38.1	.	.	8.0	7.3	6.5
Imports of goods, BOP, EUR m	20,882	26,205	38,419	.	.	43,100	47,000	51,200
annual change in %	-10.4	25.5	46.6	.	.	12.2	9.0	9.0
Exports of services, BOP, EUR m	8,928	14,315	19,871	.	.	24,500	27,300	31,200
annual change in %	-41.9	60.3	38.8	.	.	23.5	11.5	14.3
Imports of services, BOP, EUR m	3,622	4,494	5,692	.	.	6,000	6,200	6,400
annual change in %	-28.8	24.1	26.7	.	.	4.9	2.5	2.5
FDI liabilities, EUR m	1,111	3,903	3,488	.	.	3,590	.	.
FDI assets, EUR m	406	1,105	-260	.	.	1,200	.	.
Gross reserves of CB excl. gold, EUR m ⁷⁾	18,943	25,022	27,771	25,243	2,890	.	.	.
Gross external debt, EUR m	41,285	47,213	49,554	.	.	57,700	58,500	61,300
Gross external debt, % of GDP	81.8	81.0	74.0	.	.	78.0	74.0	73.0
Average exchange rate EUR-HRK/EUR	1.0005	0.9992	1.0001	1.0009	1.0000	1.0	1.0	1.0

Note: Croatia has introduced the Euro from 1 January 2023. Up to and including 2022 all time series in HRK as well as the exchange rates have been divided for statistical purposes by the conversion factor 7.5345 (HRK per EUR) to achieve euro-fixed series (EUR-HRK).

1) Preliminary. - 2) From 2021 based on census 2021. - 3) Enterprises with 20 and more employees. - 4) From 2023 according to census 2021. From 2021 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (IESS). - 5) Loans more than 90 days overdue and those unlikely to be paid. - 6) Discount rate of CB. - 7) From January 2023 (Euro introduction) only foreign currency reserves denominated in non-euro currencies.

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