

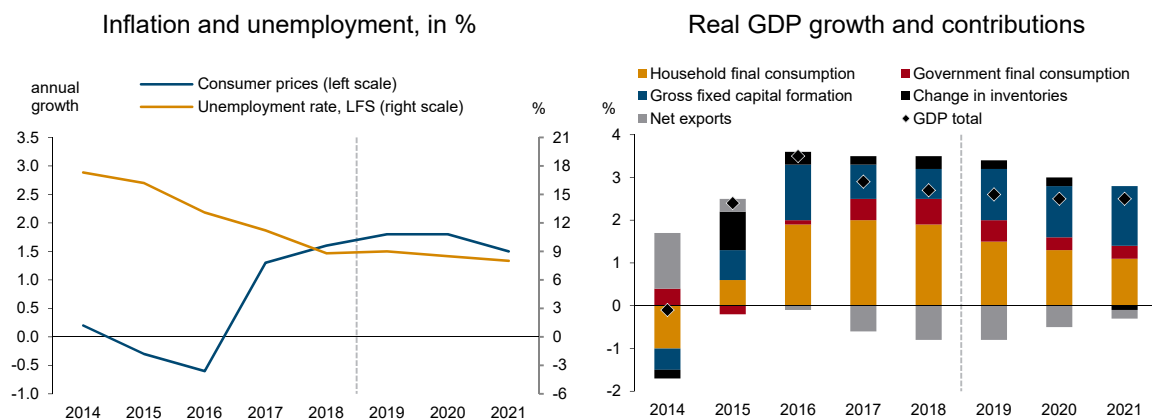


## CROATIA: Weaker growth momentum

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Croatia's GDP growth will continue to moderate to 2.5% in the 2019-2021 period. The main support to growth will come from private consumption and tourism. A more effective use of EU funds would be key to stimulating investments and growth. Continued emigration of young people together with the ageing of the population is becoming a growth limiting factor. Joining the euro area is high on the political agenda.

Figure 6.5 / Croatia: Main macroeconomic indicators



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

**Croatia's real GDP is estimated to have reached 2.7% in 2018 driven by private consumption and tourism.** Consumption was pushed up by rising disposable income - growing real wages as well as increasing remittances from abroad. The increase in gross fixed capital formation remained below expectations, indicating still low absorption of EU funds. Hence, the output growth in construction was only modest, at 4.5%. Net exports made a negative contribution to GDP growth. Industrial production dropped by 1% in 2018, with the most pronounced output declines in the production of fabricated metal products, chemicals and chemical products and shipbuilding in particular. As for the latter, still no solution could be found for the ailing Uljanik shipyard, and wages have not been paid for months. The weaknesses in the chemical industry are partly related to the difficulties of Petrokemija, a company producing agricultural fertilisers and animal feed supplements, which has been in troubles for years. Only in November the oil and gas company INA, together with the natural gas provider PPD (Prvo Plinarsko Društvo), became the largest shareholders of the state-owned company, while the share of the state was reduced to 20%.

**Labour market conditions continued to improve in 2018.** Employment based on Pension Insurance data increased by 2.3%, while Labour Force Survey data indicate a 1.5% increase. The unemployment rate fell to 8.8% and youth unemployment to about 23%, which is still 10 p.p. higher than the EU average. While part of this improvement is due to rising domestic employment, continued outward migration played an important role for the reduction in unemployment. Despite still high unemployment, labour shortages have already become a concern for companies in some sectors (e.g. construction, tourism, IT), which are considered as a limiting factor for production. Real net wages continued to increase and were up by 3% in 2018, owing to minimum and public sector wage increases and to tax changes. The minimum wage for 2019 was raised by 9% to HRK 3000 (EUR 405) or 45% of the average wage – which was the highest one-off increase since 2008. About 37,000 workers are earning a minimum wage, mostly in the textile, timber, leather and metal industries. Consumer price inflation averaged 1.6% in 2018, mostly driven by higher energy prices in the first half of the year.

**After a strong upturn in external trade in 2017, export and import growth subsided in 2018.** Goods exports and imports increased by 5% and 6% respectively. Trade with EU countries developed favourably, whereas exports to CEFTA countries remained stagnant, but declined significantly to Russia and Turkey. The overall trade deficit was about EUR 600 million higher than in 2017, while the surplus in services trade – tourism in particular – increased by an estimated EUR 300 million. Hence, the current account remained in surplus in 2018, at an estimated 2.7% of GDP. The inflow of FDI was lower than in 2017, at about EUR 1.1 billion.

**The upswing in tourism is likely to weaken.** Having achieved record earnings from tourism in the past couple of years not least because of political uncertainties in Turkey and Northern Africa, Croatia's tourism is increasingly facing competition particularly from Turkey, which is considered safe again. Also the economic weakening in tourists' main countries of origin, e.g. Germany and Italy, could have a dampening effect on Croatia's tourism. In addition, labour shortages – so far mainly offset by workers from abroad – may have an impact on wages and prices, so that Croatia might become too expensive and tourists may opt for Turkey or Greece instead.

**Croatia reported a surplus in the general government budget for the second year in a row.** The general government budget closed likely with a small surplus in 2018, mostly on account of an increase in revenues which was partly due to rising tax revenues (VAT in particular). Expenditures went up as well, e.g. for employee compensations due to an increase in the number of civil servants and government employees, as well as expenditures on social benefits. By contrast, expenditures, e.g. on subsidies and interest payments decreased. The budget surplus would have been even higher if the Ministry of Finance had not had to pay HRK 2.5 billion (EUR 330 million) in guarantees for the Uljanik shipyard; additional payments are expected in 2019. Public debt is estimated to have declined to 73.3% of GDP in 2018, from almost 78% in 2017. For 2019 the Ministry of Finance expects the general government to run a deficit of 0.5% of the GDP.

**The absorption of EU funds remains low.** Being a driver of investment and growth in a number of new EU Member States, EU funding still does not play an import role in Croatia. Though the causes of low absorption, such as limited administrative capacity, lack of strategic planning, lack of human resources particularly at the local level, or insufficient information of potential recipients, have been identified and calls for improvement repeated for years, there are no visible solutions on the horizon. Up to now commitments worth 58% within the current financial perspective worth EUR 12.7 billion (of which

EUR 10.7 billion ESIF funding) were made, but actual payments amount to only 15%, for the European Social Fund (ESF) only 6%.

**The adoption of the euro is in the mutual interest of the government and the National Bank.** In May 2018 the government adopted a 'Strategy for the Introduction of the Euro in the Republic of Croatia', analysing the costs and benefits of euro adoption and presenting policies to be undertaken in order to introduce the euro as well as policy options after the adoption of the new currency. Croatia's economy is highly euroised – about 75% of domestic savings and two thirds of total debt liabilities are linked to the euro. According to the governor of the Croatian National Bank, a letter of intent for the entry into the ERM II will be submitted probably in the second quarter of this year, which would allow joining the ERM II in 2020. So far, there are no objections by euro countries against the euro introduction in Croatia, as was reported in the case of Bulgaria. Only recently, Prime Minister Andrej Plenković stated that Croatia aims to become a member of the eurozone by the end of the next Croatian government mandate, in 2024. Results of a recent survey conducted by the National Bank show that more than half of the Croatian population is in favour of the introduction of the euro, 37% are against and 12% are undecided.

**GDP growth will slow down in the forecast period mainly due to weaker foreign conditions.** In 2019 GDP should grow by 2.5% but will slightly decelerate in the following years. Household consumption should benefit from a further improvement in the labour market and rising wages, while an intensification of investments remains questionable considering the low absorption of EU funds. Assuming a further strengthening of domestic demand, imports will rise and consequently result in higher trade deficits. The services trade surplus, by contrast, may remain at high levels due to earnings from tourism, but competition from Northern Africa and Turkey will be growing in the coming years. Thus, the current account will remain in positive territory, but is expected to dwindle in line with higher trade deficits. Downside risks stem from weaker demand from Croatia's main trading partners, Italy in particular. Public debt is expected to continue its downward path as a share of GDP in the coming two to three years, but downside risks are related to further guarantees provided to the Uljanik shipyard or payments of health care arrears. The shrinkage of the working-age population and continued emigration of young people might become more of a growth limiting factor in the future.

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

	2014	2015	2016	2017	2018 <sup>1)</sup>	2019	2020	2021
						Forecast		
Population, th pers., average	4,236	4,208	4,172	4,130	4,100	4,050	4,000	4,000
Gross domestic product, HRK bn, nom.	331.6	339.6	351.3	365.6	381.7	399	416	433
annual change in % (real)	-0.1	2.4	3.5	2.9	2.7	2.6	2.5	2.5
GDP/capita (EUR at PPP)	16,300	17,300	17,900	18,500	19,400	.	.	.
Consumption of households, HRK bn, nom.	191.4	192.3	196.4	205.5	220.0	.	.	.
annual change in % (real)	-1.6	1.0	3.4	3.6	3.4	2.6	2.4	2.0
Gross fixed capital form., HRK bn, nom.	63.8	66.4	70.4	73.3	80.0	.	.	.
annual change in % (real)	-2.8	3.8	6.5	3.8	3.4	6.0	6.0	7.0
Gross industrial production <sup>2)</sup>								
annual change in % (real)	1.2	2.7	5.3	1.4	-1.0	2.5	2.0	2.0
Gross agricultural production								
annual change in % (real)	-6.9	2.9	6.9	-4.9	-0.8	.	.	.
Construction output <sup>2)</sup>								
annual change in % (real)	-6.9	-0.5	3.3	1.7	4.5	.	.	.
Employed persons, LFS, th, average	1,566	1,585	1,590	1,625	1,650	1,670	1,690	1,710
annual change in %	2.7	1.3	0.3	2.2	1.5	1.0	1.0	1.0
Unemployed persons, LFS, th, average	327	306	240	205	160	170	160	150
Unemployment rate, LFS, in %, average	17.3	16.2	13.1	11.2	8.8	9.0	8.5	8.0
Reg. unemployment rate, in %, eop	19.4	17.6	14.7	12.2	9.6	.	.	.
Average monthly gross wages, HRK <sup>3)</sup>	7,953	8,055	7,752	8,055	8,448	8,860	9,300	9,700
annual change in % (real, gross)	0.4	1.8	3.0	2.8	3.3	3.0	3.0	2.5
Average monthly net wages, HRK <sup>3)</sup>	5,533	5,711	5,685	5,985	6,242	6,540	6,800	7,100
annual change in % (real, net)	0.5	3.7	2.7	4.1	2.8	3.0	2.5	2.5
Consumer prices (HICP), % p.a.	0.2	-0.3	-0.6	1.3	1.6	1.8	1.8	1.5
Producer prices in industry, % p.a.	-2.7	-3.8	-4.3	2.0	2.2	2.0	2.0	2.0
General governm.budget, EU-def., % of GDP								
Revenues	42.9	44.8	46.0	45.8	45.7	44.4	43.9	43.9
Expenditures	48.1	48.3	46.9	45.0	45.4	44.0	43.8	43.9
Net lending (+) / net borrowing (-)	-5.1	-3.4	-0.9	0.9	0.3	0.4	0.1	0.0
General gov.gross debt, EU def., % of GDP	84.0	83.7	80.2	77.5	73.3	70.1	68.0	66.5
Stock of loans of non-fin.private sector, % p.a.	-2.0	-3.1	-4.3	-0.1	2.3	.	.	.
Non-performing loans (NPL), in %, eop	17.1	16.7	13.8	11.4	10.3	.	.	.
Central bank policy rate, % p.a., eop <sup>4)</sup>	7.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Current account, EUR mn	858	2,019	1,207	1,984	1,400	1,300	1,200	600
Current account, % of GDP	2.0	4.5	2.6	4.0	2.7	2.4	2.1	1.0
Exports of goods, BOP, EUR mn	9,440	10,193	10,511	11,712	12,310	12,900	13,600	14,300
annual change in %	5.8	8.0	3.1	11.4	5.1	4.5	5.5	5.0
Imports of goods, BOP, EUR mn	15,952	17,168	17,896	19,966	21,200	22,800	24,300	25,900
annual change in %	2.8	7.6	4.2	11.6	6.2	7.5	6.5	6.5
Exports of services, BOP, EUR mn	10,237	11,280	12,274	13,417	14,200	15,100	16,000	17,000
annual change in %	4.0	10.2	8.8	9.3	5.8	6.0	6.0	6.0
Imports of services, BOP, EUR mn	2,903	3,280	3,566	4,100	4,630	5,100	5,600	6,200
annual change in %	-6.0	13.0	8.7	15.0	12.9	11.0	10.0	10.0
FDI liabilities, EUR mn	2,299	191	1,764	1,787	1,100	.	.	.
FDI assets, EUR mn	1,608	-42	-176	584	400	.	.	.
Gross reserves of NB excl. gold, EUR mn	12,688	13,707	13,514	15,706	17,438	.	.	.
Gross external debt, EUR mn	46,416	45,384	41,668	40,069	39,100	39,300	39,900	39,800
Gross external debt, % of GDP	106.9	101.7	89.3	81.8	76.0	73.0	71.0	68.0
Average exchange rate HRK/EUR	7.6344	7.6137	7.5333	7.4637	7.4182	7.4	7.4	7.4

1) Preliminary and wiiw estimates. - 2) Enterprises with 20 and more employees. - 3) From 2016 data are based on tax records (survey JOPPD); prior to that data are based on a monthly survey covering 70% of persons in employment. - 4) Discount rate of NB.

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