

Hermine Vidovic

Croatia: widening external imbalances

Croatia's GDP grew by about 4.5% in 2006, at a slightly higher rate than in the year before. The main driver of growth was rising domestic demand, supported by strong household and enterprise lending. Investment spending increased significantly, up by nearly 12% in the first three quarters of the year; this was also reflected in the strong recovery of construction activities. Household consumption grew at almost the same rate as in 2005 (3%), while government consumption was up only 1.4%. Conversely, foreign trade contributed negatively to GDP growth. Average annual consumer price inflation remained almost unchanged, at 3.2%, as compared to a year earlier.

Industrial output grew significantly in the first quarter of the year (6.1%), slowed down thereafter and rebounded somewhat towards the end of the year. In the whole year 2006 industrial production increased by 4.5%. Output of capital goods developed quite well, expanding by 14.5%. Manufacturing grew in line with overall industrial production; the most outstanding results were achieved in the manufacture of radio, television and communication equipment, machinery and equipment, and tanning and dressing of leather. Output contracted in eleven out of 23 reporting branches, of which most pronouncedly in the chemical and clothing industries.

According to Labour Force Survey data both employment and unemployment fell in the first half of the year; the unemployment rate stood at 11.8% and reached its lowest value since the late 1990s. The relative success in reducing unemployment is, however, tempered by the fact that at the same time activity and employment rates declined as well, indicating that a growing number of people have exited from the labour market.

Despite exports rising faster than imports, the trade deficit reached a record high of about EUR 8.8 billion in 2006, some EUR 1 billion more than a year earlier. A regional breakdown of trade derived from customs statistics reveals that exports to the EU-25, particularly those to the new EU member states, developed above average, but also exports to Sweden and the UK showed a strong dynamism (ship deliveries). Exports to the successor states of the former Yugoslavia performed less favourable than in earlier years; a considerable export expansion was reported only in trade with Serbia. In the year as a whole the current account ended up with an estimated EUR 3 billion deficit or more than 8% of the GDP. As in previous years the widening trade deficit was only partly offset by rising earnings from services. In addition, the deficit of the income balance deteriorated and the transfer balance was negative for the first time. As for FDI inflows, 2006 turned out to be the most successful year so far. Already in the first three quarters of the year the FDI inflow reached EUR 1.76 billion, more than in the whole year 2005. This amount does not yet include the inflow due to the sale of the pharmaceutical company Pliva to the US-based

company Barr (recorded value of about USD 2 billion) as well as the sale of further stakes of the oil company INA.

Croatia's foreign debt continued to rise despite several attempts of the National Bank to curb credit growth. Having repeatedly increased the marginal reserve requirement on new bank borrowing from abroad, the National Bank has imposed a credit growth limit of 12% a year on commercial banks in 2007. Banks whose lending exceeds this limit will have to buy low-yield central bank securities. However, as experience has shown, this step may further restrict banks' external borrowing but will not have any decisive impact on enterprise borrowing, which reports the strongest growth. By the end of 2006 foreign debt stood at close to EUR 29 billion or 85.5% of the GDP. Since December last year the external debt structure by debtors has changed considerably: the portion of government and banks' debt has been declining while the share of 'other sectors' (mainly enterprises) has been on the rise. The contraction of the government's foreign debt is mainly caused by the shift of budget financing from external to domestic sources.

Thanks to higher than anticipated revenues a downward revision of the general government deficit from the originally planned 3.2% to 3% of the expected GDP was made possible in July last year. According to the Ministry of Finance, this was due to an improvement in the collection of revenues coupled with the establishment of a Financial Police at the beginning of 2006. The 2007 budget adopted in December last year anticipates a further reduction of the fiscal deficit to 2.8%, down from 3% in 2006, and is based on the assumption of 4.6% GDP growth and an inflation rate of 3.2%. The main priorities of the new (election-year) budget include a balanced regional development, education and science, infrastructure, the promotion of entrepreneurship and assistance for disadvantaged persons.

In November 2006 the Croatian government submitted its (third) Pre-accession Economic Programme for the period 2007-2009 to the EU. Apart from further fiscal consolidation and reducing external imbalances it focuses on structural reforms, such as the further restructuring and privatization of Croatian companies, e.g. in the shipbuilding sector (to be completed by 2010), steel and aluminium industries and the restructuring of the Croatian railways.

The prospects of entering the EU have decisively improved Croatia's international standing, which is reflected in the country's rating improvements by the most important rating agencies. In general, economic prospects remain positive provided that Croatia does not slip into a severe debt crisis. Driven primarily by domestic demand, GDP growth may be sustained at the current level in the period 2007-2009. This supports a gradual increase in employment and a further reduction of the unemployment rate. The current account deficit will remain substantial in the years to come, implying a further increase in foreign debt.

Table HR

Croatia: Selected Economic Indicators

	2000	2001	2002	2003	2004	2005	2006 ¹⁾	2007	2008
	forecast								
Population, th pers., mid-year	4437	4437	4443	4442	4439	4442	4442	.	.
Gross domestic product, HRK mn, nom.	152519	165640	181231	198422	212826	229031	247000	265900	286200
annual change in % (real)	2.9	4.4	5.6	5.3	3.8	4.3	4.5	4.4	4.4
GDP/capita (EUR at exchange rate)	4502	4998	5507	5906	6397	6968	.	.	.
GDP/capita (EUR at PPP - wiiw)	8100	8630	9380	9930	10570	11270	.	.	.
Gross industrial production ²⁾									
annual change in % (real)	1.7	6.0	5.4	4.1	3.7	5.1	4.5	4.4	4.5
Gross agricultural production									
annual change in % (real)	-10.0	8.5	7.7	-15.9	11.9	-8.7	.	.	.
Construction industry, hours worked ²⁾									
annual change in % (real)	-9.1	3.6	12.8	22.8	2.0	-0.8	9.9 ^{I-XI}	.	.
Consumption of households, HRK mn, nom.	89637	98054	108027	115081	122100	130576	139201	.	.
annual change in % (real)	4.2	4.5	7.7	4.6	3.9	3.4	3.3	3	3
Gross fixed capital form., HRK mn, nom.	33281	36984	44105	56662	60866	65391	74907	.	.
annual change in % (real)	-3.8	7.1	13.9	24.7	4.4	4.8	11	9	9
LFS - employed persons, th, avg. ³⁾	1553	1469	1528	1537	1563	1573	1548 ^{I-VI}	.	.
annual change in %	4.1	-5.4	.	0.6	1.7	0.7	-1.1 ^{I-VI}	.	.
Reg. employees in industry, th pers., avg.	291.9	287.2	281.0	282.6	281.7	278.9	276.1	.	.
annual change in %	-2.5	-1.6	-2.2	0.6	-0.3	-1.0	-1.0	.	.
LFS - unemployed persons, average ³⁾	298.0	277.0	266.0	256.0	249.5	229.0	208.0	.	.
LFS - unemployment rate in %, average ³⁾	16.1	15.9	14.8	14.3	13.8	12.7	11.5	11	10.5
Reg. unemployment rate in %, end of period	22.3	23.1	21.3	18.7	18.5	17.8	17.0	16.5	16
Average gross monthly wages, HRK	4869	5061	5366	5623	5985	6248	6613 ^{I-XI}	.	.
annual change in % (real, net)	3.4	1.6	3.1	3.8	3.7	1.6	1.8 ^{I-XI}	.	.
Consumer prices, % p.a. ⁴⁾	6.2	4.9	1.7	1.8	2.1	3.3	3.2	3	2.9
Producer prices in industry, % p.a.	9.7	3.6	-0.4	1.9	3.5	3.0	2.9	2.5	2.4
General governm. budget, IMF-def., % GDP									
Revenues	46.2	44.0	46.3	45.1	45.4	44.9	.	.	.
Expenditures	52.7	50.7	51.4	51.3	50.2	49.0	.	.	.
Deficit (-) / surplus (+), % GDP	-6.5	-6.7	-5.0	-6.2	-4.8	-4.1	-3	-3	-2.5
Public debt in % of GDP% ⁵⁾	48.9	50.3	50.7	51.2	52.0	52.7	52	53	54
Discount rate % p.a., end of period	5.9	5.9	4.5	4.5	4.5	4.5	4.5	.	.
Current account, EUR mn	-477.9	-817.6	-2095.3	-1865.7	-1404.2	-1994.5	-3000	-2900	-2800
Current account in % of GDP	-2.4	-3.7	-8.6	-7.1	-4.9	-6.4	-8.9	-8.1	-7.3
Gross reserves of NB excl. gold, EUR mn	3783.2	5333.6	5651.3	6554.1	6436.2	7438.4	8983.7 ^{XI}	.	.
Gross external debt, EUR mn	12109.3	13458.3	15054.8	19810.6	22780.7	25540.8	29000	.	.
Gross external debt in % of GDP	60.6	60.7	61.5	75.5	80.2	82.5	86	.	.
FDI inflow, EUR mn	1138.5	1502.5	1196.8	1784.5	990.4	1421.1	2000	.	.
FDI outflow, EUR mn	0.2	173.3	601.3	106.1	281.9	191.9	100	.	.
Exports of goods, BOP, EUR mn	4969.3	5318.8	5293.1	5571.7	6603.1	7216.6	8400	9300	10500
annual growth rate in %	20.2	7.0	-0.5	5.3	18.5	9.3	16	11	13
Imports of goods, BOP, EUR mn	8468.7	9922.6	11253.4	12545.9	13330.9	14738.3	16900	18900	21100
annual growth rate in %	17.0	17.2	13.4	11.5	6.3	10.6	15	12	12
Exports of services, BOP, EUR mn	4442.0	5481.3	5832.3	7565.9	7636.7	8052.6	8500	.	.
annual growth rate in %	26.6	23.4	6.4	29.7	0.9	5.4	6	.	.
Imports of services, BOP, EUR mn	1971.5	2178.5	2547.5	2632.9	2867.8	2734.9	3000	.	.
annual growth rate in %	0.3	10.5	16.9	3.4	8.9	-4.6	10	.	.
Average exchange rate HRK/USD	8.28	8.34	7.86	6.70	6.04	5.95	5.84	.	.
Average exchange rate HRK/EUR (ECU)	7.63	7.47	7.41	7.56	7.50	7.40	7.32	7.4	7.4
Purchasing power parity HRK/USD	3.73	3.77	3.75	3.81	3.82	3.84	3.83	.	.
Purchasing power parity HRK/EUR	4.24	4.33	4.35	4.50	4.54	4.58	4.62	.	.

Note: The term 'industry' refers to NACE classification C+D+E.

1) Preliminary. - 2) Enterprises with more than 20 employees. - 3) From 2002 according to census March 2001. - 4) Until 2001 retail prices. - 5) Including guarantees.

Source: wiiw Database incorporating national statistics; IMF; wiiw forecasts.