# CROATIA

| Table 1 | 2017 |
|---|---|
| Population, million | 4.1 |
| GDP, current US$ billion | 54.9 |
| GDP per capita, current US$ | 13297 |
| Lower middle-income poverty rate ($3.2)[a] | 1.3 |
| Upper middle-income poverty rate ($5.5)[a] | 5.8 |
| Gini coefficient[a] | 30.8 |
| School enrollment, primary (% gross)[b] | 98.0 |
| Life expectancy at birth, years[b] | 77.3 |

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2015), 2011 PPPs.
(b) Most recent WDI value (2015).

*Economic growth decelerated to 2.8 percent in 2017 due to a slowdown in government investment and a rebound in imports. The poverty rate is projected to have declined to 5.1 percent as disposable incomes have increased. Strong fiscal consolidation continued in 2017, leading to a further fall in the debt ratio. However, the reform momentum has faltered and, without addressing substantial economic and institutional weaknesses, prospects for reinitiating real convergence and promoting inclusive growth are weak.*

## Recent developments

GDP growth slowed from 3.2 percent in 2016 to 2.8 percent in 2017. Exports of goods and services was the main driver of growth in 2017. Tourism recorded exceptional performance with foreign tourist nights rising by over 11 percent, and strong growth of merchandise export continued. Private consumption also made a positive contribution to growth, supported by favorable labor market developments and personal income tax rate cuts. However, the share of imported durable goods in consumption increased. On balance, the effect of net exports on growth turned negative. In addition, growth slowed down because investment growth decelerated markedly. This was mainly due to a weaker absorption of EU funds, which led to a sharp fall in government investments.

Following deflationary pressures in 2016, prices increased by 1.1 percent y-o-y in 2017 on the back of the recovery of international oil and food prices. With inflation still subdued, the Croatian National Bank (CNB) continued to pursue an expansionary monetary policy throughout 2017.

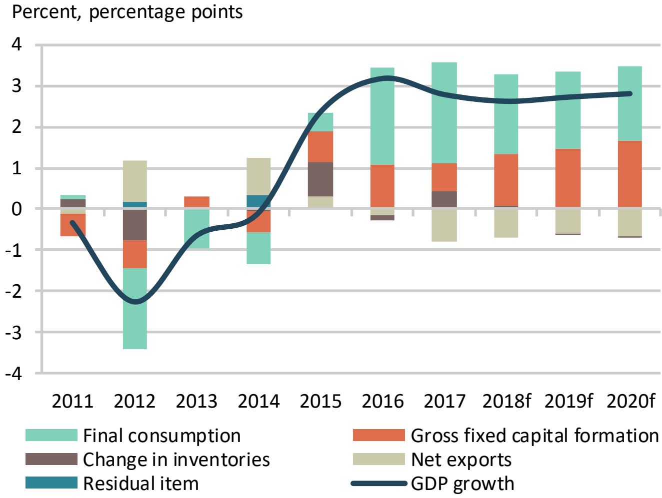
Fiscal consolidation also continued in 2017, with the budget surplus estimated at 0.1 percent of GDP, down from a deficit of 0.9 percent in 2016. The surplus was achieved by buoyant tax collection and constrained growth in expenditures in line with the November 2017 budget revision. The combination of a significant primary surplus and a small debt reducing interest-rate growth differential resulted in a stronger than expected fall in the government's debt ratio to 80 percent of GDP in 2017, down from 82.7 in 2016.

External imbalances narrowed further as the current account surplus increased to 3.7 percent of GDP in September 2017 (on a four-quarter basis). This rise is expected to be only temporary, as it reflects a fall in banks' profits resulting from their exposures to Agrokor Group. External debt (of the public and private sectors) declined to 84.2 percent of GDP in November 2017, 5.6 percent lower than 2016, as banks and the private corporate sector continued to deleverage.

Employment rose across the board, with manufacturing, tourism and construction accounting for more than a half of the increase. Together with negative migration flows, this led to a marked decline of the survey-based unemployment rate to an estimated 11 percent in 2017, down from 13.1 percent in 2016. Real net wages increased by 4.2 percent y-o-y in December. The positive wage trends are due the recovery of firms' profitability, labor shortages in some sectors, a 6-percent rise in public sector wages and cuts in the personal income tax rate.

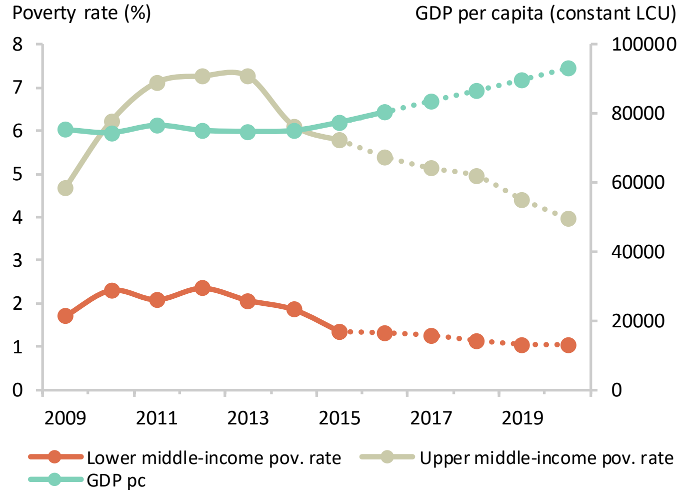
Economic recovery and labor market improvements are now starting to reduce absolute poverty, after increasing during six subsequent years of economic recession. The poverty rate measured at the upper middle-income class poverty line of $5.5 at 2011 PPP per capita fell from 7.3 percent in 2013 to 5.8 percent in 2015, which is still higher than the pre-crisis rate. The poverty rate for 2017 is projected at 5.1 percent, suggesting that

**FIGURE 1 Croatia** / Real GDP growth and contributions to real GDP growth




Sources: CROSTAT, World Bank.

**FIGURE 2 Croatia** / Actual and projected poverty rates and real GDP per capita




Sources: World Bank (see notes to Table 2).

the reduction in poverty is slowing down. While real per capita income has returned to its 2008 level, output is still about 4 percent lower than in 2008. Therefore, the rebound in per capita income reflects the impact of demographic trends.

## Outlook

Growth is expected to slow further to 2.6 percent in 2018, due to a slowdown in private consumption as the favorable effects of the tax reform on real wages start to fade. Furthermore, exports of tourist services are expected to slow in 2018, due to capacity constraints. On the other hand, better absorption of EU funds will give a boost to investment spending. These trends suggest an average economic growth of 2.8 percent for 2019 and 2020.

The government balance is expected to stay in surplus and may reach 1 percent by 2020, leading to a further decline in public debt to below 70 percent of GDP. However, the overall fiscal stance will become moderately pro-cyclical, as the structural budget balance is expected to worsen.

Positive labor market developments are expected to support the growth of disposable income for all segments of the welfare distribution. The continued decline in the share of long-term unemployed and NEETs will reduce the absolute poverty rate further to 4.0 percent in 2020.

## Risks and challenges

Risks are slightly skewed to the downside. As the operational restructuring of Agrokor Group unfolds in 2018, the negative effects on investment activity and private consumption might be greater than currently envisaged. In addition, although the positive contribution of exports of goods to GDP growth is expected to stay high, it is exposed to the risk of a slowdown in external demand from the EU. Furthermore, the still high level of public debt makes Croatia vulnerable to interest rate shocks and worsening external financing conditions. Finally, the cyclical upturn and the sounder fiscal position may foster continued complacency. The lack of reforms would have an adverse effect on growth over the medium term.

Croatia's prospects for improving higher and more inclusive growth remain weak. Currently low potential growth calls for a strong structural reform agenda. Substantial economic, social and institutional weaknesses should be addressed to boost private sector productivity and competitiveness, raise the quality of human and physical capital and modernize public services. This would lead to increasing economic activity and employment, which are crucial for a further reduction in poverty.

**TABLE 2 Croatia** / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

| | 2015 | 2016 | 2017 e | 2018 f | 2019 f | 2020 f |
|---|---|---|---|---|---|---|
| **Real GDP growth, at constant market prices** | 2.3 | 3.2 | 2.8 | 2.6 | 2.7 | 2.8 |
| Private Consumption | 1.1 | 3.5 | 3.6 | 3.0 | 2.8 | 2.6 |
| Government Consumption | -0.9 | 1.9 | 2.0 | 1.5 | 1.5 | 1.6 |
| Gross Fixed Capital Investment | 3.8 | 5.3 | 3.4 | 6.4 | 6.9 | 7.4 |
| Exports, Goods and Services | 9.4 | 5.6 | 6.1 | 5.8 | 5.0 | 5.0 |
| Imports, Goods and Services | 9.2 | 6.2 | 8.1 | 7.4 | 6.3 | 6.4 |
| **Real GDP growth, at constant factor prices** | 2.3 | 2.8 | 2.8 | 2.6 | 2.7 | 2.8 |
| Agriculture | 1.3 | 0.6 | -2.2 | 2.2 | 2.2 | 2.2 |
| Industry | 2.6 | 4.4 | 1.3 | 3.6 | 2.8 | 2.8 |
| Services | 2.3 | 2.3 | 3.6 | 2.3 | 2.7 | 2.8 |
| **Inflation (Consumer Price Index)** | -0.5 | -1.0 | 1.5 | 1.4 | 1.4 | 1.5 |
| **Current Account Balance (% of GDP)** | 4.5 | 2.6 | 3.6 | 2.6 | 1.7 | 1.0 |
| **Financial and Capital Account (% of GDP)** | -3.5 | -1.7 | -3.2 | -1.5 | -0.6 | 0.0 |
| Net Foreign Direct Investment (% of GDP) | 0.5 | 4.0 | 1.3 | 2.6 | 2.6 | 2.8 |
| **Fiscal Balance (% of GDP)** | -3.3 | -0.9 | 0.1 | 0.5 | 0.6 | 1.0 |
| **Debt (% of GDP)** | 85.4 | 82.7 | 80.1 | 76.0 | 72.1 | 67.7 |
| **Primary Balance (% of GDP)** | 0.2 | 2.3 | 3.1 | 3.2 | 3.2 | 3.5 |
| **Lower middle-income poverty rate ($3.2 in 2011 PPP)**[a,b] | 1.3 | 1.3 | 1.3 | 1.1 | 1.0 | 1.0 |
| **Upper middle-income poverty rate ($5.5 in 2011 PPP)**[a,b] | 5.8 | 5.4 | 5.1 | 5.0 | 4.4 | 4.0 |

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on EU-SILC harmonization, using 2015-EU-SILC. Actual data: 2015. Nowcast: 2016 - 2017. Forecast are from 2018 to 2020.
(b) Projection using neutral distribution (2015) with pass-through = 0.87 based on GDP per capita in constant LCU.