

CROATIA

Key conditions and challenges

Table 1 2020

Population, million	4.0
GDP, current US\$ billion	56.8
GDP per capita, current US\$	14101.4
International poverty rate (\$ 19) ^a	0.5
Lower middle-income poverty rate (\$3.2) ^a	0.8
Upper middle-income poverty rate (\$5.5) ^a	2.4
Gini index ^a	29.8
School enrollment, primary (% gross) ^b	94.6
Life expectancy at birth, years ^b	78.1

Source: WDI, Macro Poverty Outlook, and official data.

Notes:

(a) Most recent value (2018), 2011 PPPs.

(b) Most recent WDI value (2018).

As for most countries in Europe, the end of 2020 saw a surge of COVID-19 infections and the reintroduction of social distancing restrictions in Croatia. The country also suffered from a second devastating earthquake in December last year. Progress on vaccination should allow for reopening policies, resulting in a gradual recovery of the Croatian economy led by the tourism sector. GDP is projected to increase by 4.7 percent in 2021, enabling poverty to return to a downward trend.

The large reliance on tourism has made Croatia highly vulnerable to adverse external shocks such as the current pandemic. GDP contraction in Croatia in 2020, at -8.4 percent, was one of the largest in the EU. The country also suffered from two devastating earthquakes, in March and December 2020. Going forward, generous EU funding through various initiatives should play a key role in supporting the country's economic recovery. However, Croatia will need to use such funds appropriately for both reforms and investment, to maximize the benefits of such financing. While the vaccination program has started, the situation remains highly uncertain because of vaccine supply bottlenecks, its effectiveness on new virus variants, and uptake levels among the population.

At 65.2 percent of the EU27 GDP per capita in 2019 (PPP), Croatia still lags behind EU peers. Strengthening long-term growth is critical to accelerate the income convergence. This will require a diversification of the economy towards more knowledge-based sectors and addressing the economy's structural issues, including public sector governance, education outcomes and the efficiency of the judiciary. On the fiscal front, the surge in public debt in 2020, reflecting the economic downturn and a large fiscal stimulus package, calls for fiscal prudence and efforts to increase the effectiveness and

efficiency of public spending over the coming years.

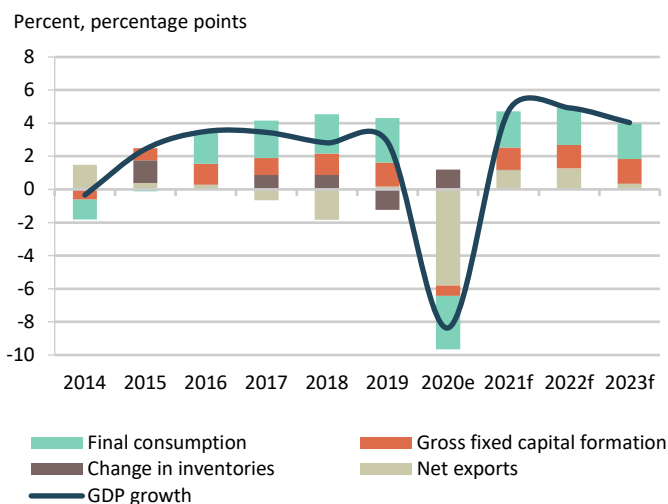
Recent developments

Economic activity continued to recover at the end of the last year from a drop experienced during the first half of 2020. However, the pace of recovery was much slower compared to the summer months due to the reintroduction of social distancing measures. Overall, Croatia's real GDP is estimated to have contracted by 8.4 percent in 2020. The tourism sector bore the brunt of the impact, which was reflected in a sharp drop in export of services. Decline in exports of goods was, on the other hand, relatively moderate following recovery towards the end of the year. Private consumption and investment also strengthened in the second half of 2020, which further helped in cushioning the annual decline in the manufacturing sector, while construction activity continued to increase in 2020.

Due to a sharp deterioration in the trade deficit, the current account balance is estimated to have fallen to -1.3 percent of GDP in 2020, after six years of surpluses.

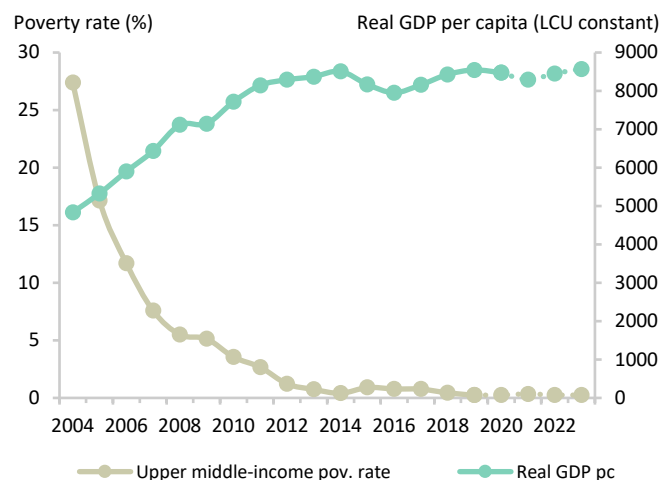
As a result of the fiscal stimulus, the decline in employment was relatively modest, and administrative unemployment averaged 9 percent, 1.3 percentage points higher than in 2019. Fiscal support measures together with decline in economic activity led to a surge in public debt, estimated at 87.2 percent of GDP in 2020.

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



Source: World Bank. Notes: see notes to Table 2.

The degree of expansionary monetary policy increased, and the liquidity of the banking sector reached historical highs. Also, the NPLs ratio remained stable. This, however, can be partly explained by regulatory relief and agreed moratorium on credit obligations and should therefore be monitored closely.

Results from the second round of the Rapid Household Assessment conducted in December indicate low-wage earners continue to be more affected by the crisis than those in the top income brackets. Also, nearly 30 percent of Croatian households reported an annual reduction in overall income in 2020 and approximately 80 percent of households indicate inadequate savings to weather the shock from the prolonged pandemic. The situation is more challenging for poor and rural households. Poverty is estimated to have increased to 2.6 percent in 2020 – or approximately 14,000 additional Croatian living on less than \$5.5 a day at 2011 PPP prices.

Outlook

Economic activity in Croatia is projected to gradually recover from the downturn experienced in 2020 growing at the average

annual rate of 4.5 percent in the 2021-2023 period. Implementation of the vaccination strategy and epidemiological measures in Croatia and Europe are expected to put the pandemic under control by the summer of 2021 allowing countries to partially lift travel restrictions. For Croatia this would result in an increase in tourist arrivals, and together with the recovery of its trading partners, would lead to strong growth of exports of goods and services. Investments are projected to be supported by EU funds, including for earthquake reconstruction. Although a pick-up in inflation that could reach 1.8 percent by 2023 will weigh in on real incomes, improved household sentiment and gradual labor market recovery could result in strengthening of personal consumption. The economic situation in Croatia is likely to continue improving till the end of the forecast horizon as the pandemic abates, and with increased uptake of EU funds. The current account balance is projected to return to surplus (estimated at 2.2 percent of GDP in 2023), following trade deficit improvements. Continued increase in economic activity and phasing-out of the fiscal support measures should reduce the fiscal deficit and bring public debt below 80 percent of GDP by 2023.

The gradual rebound of the economy is expected to reduce poverty. However,

the compounded impacts of the crisis and the low savings rate among working poor households could mean a longer recovery process for this vulnerable group compared to others. Poverty is estimated to return to the pre-crisis level of 2.2 percent by 2021 and fall further to 2.0 percent by 2023.

The risks for the forecast are tilted to the downside reflecting possible prolongation of the pandemic and related travel restrictions as well as phasing out the fiscal support measures that could lead to a rise in unemployment. This would weaken the recovery and slow down the fall in the poverty.

TABLE 2 Croatia / Macro poverty outlook indicators

(annual percent change unless indicated otherwise)

	2018	2019	2020 e	2021 f	2022 f	2023 f
Real GDP growth, at constant market prices	2.8	2.9	-8.4	4.7	4.9	4.0
Private Consumption	3.3	3.5	-6.2	2.8	3.0	3.0
Government Consumption	2.3	3.4	2.0	2.4	2.2	2.2
Gross Fixed Capital Investment	6.5	7.1	-2.9	6.0	6.3	6.5
Exports, Goods and Services	3.7	6.8	-25.0	14.2	15.4	6.3
Imports, Goods and Services	7.5	6.3	-13.8	9.7	11.2	5.2
Real GDP growth, at constant factor prices	2.6	2.5	-6.3	4.7	4.9	4.0
Agriculture	6.2	1.2	3.7	2.4	2.4	2.4
Industry	1.4	2.3	-1.3	3.9	4.6	4.1
Services	2.8	2.7	-8.6	5.2	5.2	4.1
Inflation (Consumer Price Index)	1.5	0.8	0.2	0.9	1.7	1.8
Current Account Balance (% of GDP)	1.8	2.8	-1.3	0.3	0.9	2.2
Net Foreign Direct Investment (% of GDP)	1.6	2.0	2.2	2.1	1.9	1.8
Fiscal Balance (% of GDP)	0.2	0.4	-7.2	-3.7	-2.3	-1.1
Debt (% of GDP)	74.3	72.8	87.2	85.8	82.7	79.2
Primary Balance (% of GDP)	2.5	2.6	-5.1	-1.6	-0.3	0.8
International poverty rate (\$1.9 in 2011 PPP)^{a,b}	0.5	0.5	0.5	0.5	0.4	0.4
Lower middle-income poverty rate (\$3.2 in 2011 PPP)^{a,b}	0.8	0.7	0.8	0.8	0.7	0.7
Upper middle-income poverty rate (\$5.5 in 2011 PPP)^{a,b}	2.4	2.2	2.6	2.2	2.1	2.0

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.

Notes: e = estimate, f = forecast.

(a) Calculations based on ECAPOV harmonization, using 2018-EU-SILC. Actual data: 2018. Nowcast: 2019-2020. Forecast are from 2021 to 2023.

(b) Projection using neutral distribution (2018) with pass-through = 0.87 based on GDP per capita in constant LCU.