

Croatia: private consumption boosted by bank loans

The high growth of Croatia's GDP in the third quarter of 2002 – 6.5% against the same quarter a year earlier – came rather unexpectedly; the average rate for the first nine months was 5%. Thus, for the year as a whole WIIW will revise up its GDP forecast to 4.5% (against 3.5% earlier). The main driver behind that growth was domestic demand – private consumption and strong (public) investment activities, while government consumption continued to shrink. Household consumption, accounting for about one half of the overall GDP, was spurred by intense lending from the banking sector (following the euro conversion, the liquidity of the banking sector is very high). In November 2002 the stock of household loans exceeded the November 2001 level by 40%, that of corporate loans by 21%. The favourable GDP data must be seen against the background of a further worsening of the trade balance, an expanding current account deficit and growing foreign indebtedness. In response to these developments the Croatian National Bank decided to limit the increase of loans both to the household and corporate sectors to a target growth rate of 16% as of February 2003.

High investment translated into booming construction activities (up 13%) mainly related to the construction of the Zagreb–Split motorway and to housing construction. Real retail turnover expanded by about 13%, of which the sale, maintenance and repair of motor vehicles was almost one quarter higher than a year earlier (Croatian citizens had bought about 70 thousand new cars in 2002). Inflation continued its downward trend, with average retail price inflation at 2.2% year on year.

Industrial production growth gained momentum from the second half of 2002 and was up 5.4% in the year as a whole. Within manufacturing, in line with overall industrial output growth, the best performing branches were publishing and printing, machinery and equipment, and other non-metallic mineral products. The worst results were recorded for wearing apparel, leather products and basic metals. Productivity increases were achieved exclusively through further shedding of labour.

Employment, showing some signs of improvement in 2001, fell again in 2002. Mainly thanks to a change in methodology, registered unemployment dropped, but the rate of unemployment remained high, at 21.5%. The international comparable Labour Force Survey (LFS) unemployment rate – traditionally lower than the registered one – fell from 16.3% in the second half of 2001 to 15.2% in the first half of 2002.

The performance of foreign trade was extraordinarily poor. In 2002 the trade deficit reached the highest level (EUR 6.1 billion) since Croatia's gaining independence in 1991. Assuming that net earnings from tourism have reached USD 3.3 billion (based on the optimistic scenario of the National Bank) and the values of other current account items have not changed significantly from those in 2001, the current account deteriorated significantly and closed with a deficit of about 5% of the expected GDP in 2002, up from 3.3% a year earlier. Foreign debt totalled USD 14.1 billion by the end of November and was nearly one quarter higher than in December 2001. FDI inflows totalled USD 763.5 million during the first three quarters of 2002, significantly less than in the same period a year earlier (USD 1.2 billion). The banking sector was the main beneficiary of capital inflows, accounting for two thirds of the total, e.g. with Austria's Erste Bank and Steiermärkische purchasing Riječka Banka and the Charlemagne Capital Fund taking over Dubrovačka Banka. Another 11% was invested into tourist accommodations. The repeatedly announced (partial) sale of the INA oil company is expected to materialise only in 2003.

At the beginning of February 2003 the IMF approved a new standby credit worth USD 146 million. The economic programme agreed upon with the Fund aims at further fiscal consolidation focussing on the stabilization of the public debt ratio (which is rather questionable considering that public investments will at least in the short run translate into an increase in public debt), no further increases in government guarantees and a tight wage policy in the government sector, comprising among others wage freezes and employment cuts in the defence sector. Accordingly the 2003 budget adopted by the Croatian parliament in December 2002 anticipates a reduction of the general government deficit from an estimated 6.2% in 2002 to 5% in 2003. Deficit financing should rely on the domestic capital market rather than on foreign borrowing and privatization receipts as was the case in the past. Priorities of the budget are science and education, the reform of the judicial system, further reforms and the consolidation of the health system. Subsidies for agriculture and the shipbuilding industry are envisaged to increase as well as the funds for infrastructure investments, e.g. the construction of the Zagreb–Split motorway (mainly financed through domestic and foreign loans), the modernization of the Croatian Railways, for water supply infrastructure and the infrastructure on islands. In contrast, spending for the defence and interior ministries will be cut.

In late 2002 Croatia became the eighth member of CEFTA. The expected impact on the country's foreign trade seems to be limited, as most of the countries under this agreement will join the European Union in 2004. An important step towards integration will be Croatia's application for EU membership in February this year. The Croatian authorities

hope that the country may enter the Union together with Bulgaria and Romania, reportedly to take place in 2007 – a quite ambitious target considering the time-consuming negotiations of the earlier joining transition countries. Support for this step has been announced by Germany, Austria and Greece and recently also by the EBRD.

The economic outlook for 2003 is moderately positive. Generally, the current trends will continue but GDP growth will be somewhat lower than in 2002 owing to a slowdown of private consumption, as the credit expansion will come to a halt. Consequently import growth is expected to abate and both the trade and current account deficits will be reduced. Substantial improvements on the labour market can hardly be expected. A continuation of the current policy of the National Bank will allow to maintain the stability of the exchange rate and the inflation rate.

Table HR

Croatia: Selected economic indicators

	1996	1997	1998	1999	2000	2001	2002 ¹⁾	2003	2004 forecast
Population, th pers., mid-year ²⁾	4494	4573	4501	4554	4437	4437	.	.	.
Gross domestic product, HRK mn, nom.	107981	123811	137604	141579	152519	162909	174000	186400	199700
annual change in % (real)	5.9	6.8	2.5	-0.9	2.9	3.8	4.5	4	4.5
GDP/capita (USD at exchange rate)	4422	4398	4805	4371	4153	4403	5000	.	.
GDP/capita (USD at PPP - wiiw)	6330	7820	8240	8180	8840	9380	9960	.	.
Gross industrial production ³⁾									
annual change in % (real)	3.1	6.8	3.7	-1.4	1.7	6.0	5.4	4	5
Gross agricultural production									
annual change in % (real)	1.3	4.0	10.2	-3.5	-10.0	8.4	.	.	.
Goods transport, public, mn t-kms ⁴⁾	213172	203428	170107	146302	146852	142338	101827 ^{I-X}	.	.
annual change in %	6.7	-4.6	-16.4	-14.0	.	-1.0	2.6 ^{I-X}	.	.
Gross fixed capital form., HRK mn, nom.	22089.4	29935.6	32065.6	33025.0	33281.0	37252.0	.	.	.
annual change in % (real)	37.6	26.4	2.5	-3.9	-3.8	9.7	10	7	6
Construction industry, hours worked ⁵⁾									
annual change in % (real)	9.0	16.7	0.7	-7.7	-9.1	3.6	12.8 ^{I-X}	.	.
Dwellings completed, units	12624	12516	12557	12175	12187	18088	.	.	.
annual change in %	71.5	-0.9	0.3	-3.0	0.1	48.4	.	.	.
Employment total, th pers., average ⁶⁾	1329.5	1310.9	1384.8	1364.5	1341.0	1348.3	1340.8	.	.
annual change in % ⁶⁾	-6.2	-1.4	0.4	-1.5	-1.7	0.5	-0.6	.	.
Employees in industry, th pers., average ⁷⁾	315.1	319.7	308.9	299.5	291.9	287.2	277.2	.	.
annual change in % ⁷⁾	-9.8	-6.4	-3.4	-3.0	-2.5	-1.6	-3.5	.	.
Reg. unemployed, th pers., end of period	269.3	287.1	302.7	341.7	378.5	395.1	366.2	.	.
Reg. unemployment rate in %, end of period	15.9	17.6	18.1	20.4	22.3	23.1	21.5	21	21
LFS - unemployment rate in %, average	9.9	9.9	11.4	13.6	16.1	15.9	15.2	15	15
Average gross monthly wages, HRK	3243	3668	4131	4551	4869	5061	5355 ^{I-XI}	.	.
annual change in % (real, net)	7.2	12.3	6.0	10.1	3.4	1.6	2.9 ^{I-XI}	.	.
Retail trade turnover, HRK mn	29412.4	34736.1
annual change in % (real)	3.4	14.9	0.1	-3.5	10.0	10.0	12.7 ^{I-XI}	.	.
Retail prices, % p.a.	3.5	3.6	5.7	4.2	6.2	4.9	2.2	3	2.5
Producer prices in industry, % p.a.	1.4	2.3	-1.2	2.6	9.7	3.6	-0.4	.	.
Central government budget, HRK mn ⁸⁾									
Revenues	31368	33846	43809	46356	44636	53444	63657 ^{I-XI}	.	.
Expenditures	31502	35006	42552	48879	50744	57202	66913 ^{I-XI}	.	.
Deficit (-) / surplus (+)	-134	-1160	1257	-2523	-6108	-3759	-3256 ^{I-XI}	.	.
Deficit (-) / surplus (+), % GDP	-0.1	-0.9	0.9	-1.8	-4.0	-2.3	.	.	.
Money supply, HRK mn, end of period									
M1, Money	11369	13731	13531	13859	18030	23704	30866	.	.
Broad money	36701	50742	57340	56659	73061	106071	116138	.	.
Discount rate % p.a., end of period	6.5	5.9	5.9	7.9	5.9	5.9	4.5	.	.
Current account, USD mn	-955.9	-2512.2	-1452.8	-1397.8	-438.9	-616.8	-1100.0	-900	-900
Current account in % of GDP	-4.8	-12.5	-6.7	-7.0	-2.4	-3.2	-5.0	-3.4	-3.4
Gross reserves of NB excl. gold, USD mn	2314.0	2539.1	2815.7	3025.0	3524.8	4704.2	5885.8	.	.
Gross external debt, USD mn	5307.6	7451.6	9586.2	9872.3	11002.2	11209.3	14070.5 ^{Nov}	.	.
Exports total, fob, EUR mn ⁹⁾	3602.1	3665.8	4046.2	4027.3	4818.0	5210.4	5182.5	5230	5390
annual growth rate in %	0.2	1.8	10.4	-0.5	18.9	8.1	-0.5	1	3
Imports total, cif, EUR mn ⁹⁾	6220.3	8059.7	7476.9	7324.1	8588.5	10232.4	11316.3	11880	12470
annual growth rate in %	7.1	29.6	-7.2	-2.0	16.8	19.1	10.6	5	5
Average exchange rate HRK/USD	5.43	6.16	6.36	7.11	8.28	8.34	7.86	.	.
Average exchange rate HRK/EUR (ECU)	6.80	6.96	7.14	7.58	7.63	7.47	7.41	7.5	7.5
Purchasing power parity HRK/USD, wiiw	3.80	3.46	3.71	3.80	3.89	3.92	3.94	.	.
Purchasing power parity HRK/EUR, wiiw	4.12	3.80	4.07	4.14	4.22	4.25	4.26	.	.

Notes: 1) Preliminary. - 2) From 2000 according to census March 2001. - 3) Enterprises with more than 19 employees. - 4) From 2000 new methodology. - 5) In 1996 enterprises with more than 10 employees, from 1997 more than 19 employees. - 6) From 1998 including persons employed at the Ministry of Defence and Ministry of Internal Affairs. - 7) In 1996 enterprises with more than 10 employees; from 1997 according to NACE classification. - 8) Methodological changes in June 2001 and January 2002 with respect to the stepwise inclusion of extrabudgetary funds. - 9) From 2000 new method of statistical processing. Converted from the national currency to EUR at the official exchange rate.

Source: wiiw Database incorporating national statistics; wiiw forecasts.