

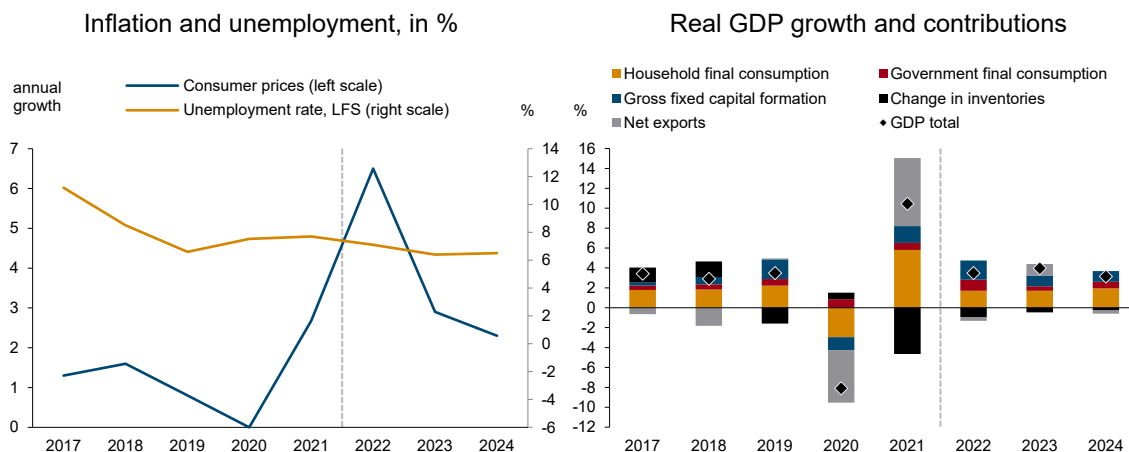


## CROATIA: War taking its toll on economic growth

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The Croatian economy has made a full recovery from the COVID-19 pandemic, with GDP increasing by 10.4% year on year in 2021. However, Russia's invasion of Ukraine has generated much uncertainty regarding Croatia's growth prospects for 2022. The surging energy costs, which are serving to boost inflation, will put pressure on government spending plans and will slow private consumption in 2022. The spill-over effects of the war will also adversely affect Croatia's summer tourist season, which is why we have adjusted the forecast for this year's GDP growth downward to 3.5%.

Figure 4.5 / Croatia: Main macroeconomic indicators



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

**Having had a superb 2021 economically, Croatia will find that the Russo-Ukrainian war will take the shine off its economic growth in 2022.** Croatia's economy in 2021 grew faster than most other EU-CEE countries, with real GDP rebounding by 10.4%. This was a product of a bumper tourist season and a surge in private consumption, as well as stellar 15.8% year-on-year GDP growth in Q3 2021. Even though Croatia's direct exposure to Russia is fairly limited, we expect the war to damage Croatia's economic growth prospects in 2022, largely on account of the inflationary pressures, fewer tourist arrivals and reduced demand from Germany, Italy and Austria, Croatia's most important trading partners. As a consequence, we have reduced this year's GDP growth forecast to 3.5%, from the previous 4.7%.

**The war in Ukraine will put a damper on Croatia's summer tourist season in 2022.** Because of the spill-over effects of Russia's invasion of Ukraine – not least rising inflation and high energy costs – we expect tourist bookings for Croatia's upcoming summer season to drop off. This applies to bookings from EU countries such as Germany, Austria, Italy and Slovenia. Croatia's ban on flights to and from Russia, imposed as a retaliatory measure for the invasion of Ukraine, will only have a mildly negative impact on the country's tourist sector. In 2021, 145,000 Russian tourists visited Croatia, accounting for 800,000 overnight stays, some 1% of all overnight stays recorded last year. Nevertheless, it should be noted that before the war, the Croatian government was expecting 200,000 Russian tourists this year.

**The government's efforts to diversify Croatia's energy supplies are bearing fruit in the light of events in Ukraine.** A vital element of those efforts was the construction of the liquefied natural gas (LNG) terminal on the Croatian island of Krk. In 2021, some 23% of all natural gas consumed in Croatia was delivered via the LNG terminal; only 28% was imported from Russia; while Croatia produced some 30% of its gas supplies domestically. The rest was imported from other sources. We expect Croatia to be able to make up for the lost Russian gas imports through domestic production and additional imports via the Krk LNG terminal. In March 2022, the government said that it would consider expanding the capacity of the LNG terminal, in order to increase the country's energy independence – from 2.6bn to 2.9bn cubic metres. The terminal could also theoretically supply other countries in the Western Balkan region with natural gas. At the beginning of April 2022, Slovenian Infrastructure Minister Vrtovec announced that Slovenia would be interested in importing natural gas through the Krk terminal from October 2022, in a bid to diversify his country's energy supplies.

**A government reshuffle is likely in 2022. Prime Minister Plenković's government has so far managed to head off the risk of a snap election, thanks to its successful management of the COVID-19 crisis in 2021. However, the stability of the government was dented in the first months of 2022 by corruption allegations against members of Plenković's cabinet – such as former Construction Minister Horvat, who was arrested in February by the anti-corruption prosecutor's office USKOK. The risk of snap parliamentary elections still remains low; however, to ease the policy-making process of the Croatian Democratic Union-led government, Prime Minister Plenković is likely to reshuffle his cabinet in 2022.**

**Croatia will see record levels of inflation in 2022.** Inflation accelerated to 6.3% year on year in February – its highest since September 2008. Given the increase in the cost of energy and basic foodstuffs, alongside the persistent global supply-chain disruptions that have been exacerbated by the events in Ukraine, we expect inflation to average 6.5% in 2022. To limit the surge in energy prices, the government has **adopted** a set of measures worth some EUR 640m (about 1% of Croatia's 2021 GDP). The measures include a permanent reduction in VAT on electricity (from 25% to 13%) and a temporary cut in VAT on gas to 5% (from 1 April 2022 until 31 March 2023). In addition, it has also introduced caps on fuel and electricity prices.

**Surging inflation will likely trigger additional fiscal costs, putting pressure on the country's spending plans.** The rise in energy and food prices will increase pressure on the government to spend more, due to the likely wage demands and fiscal measures to offset the impact of higher energy prices on businesses and households. Despite the uncertainties surrounding the war and the increasing inflation, the government is still planning to maintain its pledge to introduce the euro in 2023, which is why it will attempt to maintain fiscal discipline at all costs. Nevertheless, the increasing prices mean that

this year's budget deficit will rise to 3.5% – above the 3% Maastricht requirement, but still below the deficit of the previous two years (7.4% and 3.8%). The public debt-to-GDP ratio will fall to around 79%.

**EU sanctions against Russia will have only a minor direct effect on Croatia's export economy.**

Bilateral trade between Russia and Croatia dropped off sharply following the first wave of EU sanctions against Russia, imposed in 2014 after Russia's annexation of Crimea. In 2020, goods exports to Russia amounted to just EUR 176m (only 0.3% of Croatia's 2021 GDP), compared to EUR 282m in 2013.

**Despite the growing uncertainty, it is expected that the inflow of EU Recovery and Resilience Facility (RRF) funds will support Croatia's growth dynamics in 2022.**

In 2021, the European Commission approved a EUR 6.3bn grant (12.8% of Croatia's 2020 GDP) from the EU's RRF for the period 2021-2026. Those funds will facilitate long-term investment projects, such as modernisation of the Zagreb–Rijeka railway, which should be completed by 2027. According to government estimates, the implementation of RRF-financed projects, including the reconstruction of earthquake-damaged infrastructure in the Zagreb, Krapina-Zagorje, Sisak-Moslavina and Karlovac counties, will contribute 1.4 percentage points to headline GDP growth in both 2022 and 2023.

**Unemployment will remain at some 7% – above the pre-COVID level.** Croatia's unemployment rate stood at 7.8% year on year in February. The spill-over effects of the war in Ukraine, including higher energy prices, will negatively affect Croatia's tourist industry. This is why the unemployment rate in 2022 will remain higher than pre-COVID, in spite of the stellar performance of the country's tourist sector in 2021.

**Table 4.5 / Croatia: Selected economic indicators**

	2018	2019	2020	2021 <sup>1)</sup>	2022	2023	2024
					Forecast		
Population, th pers., average <sup>2)</sup>	4,091	4,067	4,047	3,899	3,885	3,883	3,880
Gross domestic product, HRK bn, nom.	390.9	412.2	378.3	431.5	475	508	536
annual change in % (real)	2.9	3.5	-8.1	10.4	3.5	4.0	3.1
GDP/capita (EUR at PPP)	19,570	20,770	19,230	22,590	.	.	.
Consumption of households, HRK bn, nom.	218.4	229.6	218.2	246.6	.	.	.
annual change in % (real)	3.3	4.0	-5.3	10.1	3.0	3.0	3.4
Gross fixed capital form., HRK bn, nom.	78.5	88.7	84.4	93.0	.	.	.
annual change in % (real)	3.8	9.8	-6.1	7.6	9.0	5.0	5.0
Gross industrial production <sup>3)</sup>							
annual change in % (real)	-1.0	0.6	-2.7	6.3	3.0	3.0	2.5
Gross agricultural production							
annual change in % (real)	6.4	-1.2	1.1	-6.0	.	.	.
Construction output <sup>3)</sup>							
annual change in % (real)	4.9	8.3	4.4	9.5	.	.	.
Employed persons, LFS, th, average <sup>4)</sup>	1,655	1,680	1,657	1,678	1,700	1,730	1,760
annual change in %	1.8	1.5	-1.3	1.3	1.5	1.5	1.5
Unemployed persons, LFS, th, average <sup>4)</sup>	152	119	135	138	130	120	120
Unemployment rate, LFS, in %, average <sup>4)</sup>	8.5	6.6	7.5	7.7	7.1	6.4	6.5
Reg. unemployment rate, in %, eop	8.9	7.8	9.3	7.3	.	.	.
Average monthly gross wages, HRK <sup>5)</sup>	8,448	8,766	9,216	9,599	10,500	11,100	11,600
annual change in % (real, gross)	3.3	3.0	2.4	1.6	2.3	2.5	2.5
Average monthly net wages, HRK <sup>5)</sup>	6,242	6,457	6,763	7,129	7,800	8,200	8,600
annual change in % (real, net)	2.8	2.6	2.6	2.7	2.5	2.5	2.5
Consumer prices (HICP), % p.a.	1.6	0.8	0.0	2.7	6.5	2.9	2.3
Producer prices in industry, % p.a.	2.2	0.8	-3.2	11.6	4.0	2.4	2.2
General governm. budget, EU def., % of GDP							
Revenues	45.7	46.3	47.2	50.0	48.5	46.0	46.0
Expenditures	45.5	46.0	54.5	53.8	52.0	48.7	48.5
Net lending (+) / net borrowing (-)	0.2	0.3	-7.4	-3.8	-3.5	-2.7	-2.5
General gov. gross debt, EU def., % of GDP	73.3	71.1	87.3	81.3	79.0	76.5	75.0
Stock of loans of non-fin. private sector, % p.a.	2.3	3.9	3.5	2.3	.	.	.
Non-performing loans (NPL), in %, eop <sup>6)</sup>	7.5	5.5	5.4	4.3	.	.	.
Central bank policy rate, % p.a., eop <sup>7)</sup>	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Current account, EUR m	976	1,677	-47	1,822	680	1,210	1,070
Current account, % of GDP	1.9	3.0	-0.1	3.2	1.1	1.8	1.5
Exports of goods, BOP, EUR m	12,236	12,858	12,169	15,722	17,530	19,460	20,720
annual change in %	4.5	5.1	-5.4	29.2	11.5	11.0	6.5
Imports of goods, BOP, EUR m	21,881	23,304	20,851	26,166	29,900	33,200	36,000
annual change in %	8.6	6.5	-10.5	25.5	14.1	10.9	8.3
Exports of services, BOP, EUR m	13,858	15,362	8,928	14,168	15,700	17,700	19,200
annual change in %	7.5	10.9	-41.9	58.7	10.5	12.5	8.4
Imports of services, BOP, EUR m	4,645	5,069	3,638	4,362	4,500	4,600	4,700
annual change in %	13.0	9.1	-28.2	19.9	3.0	3.0	3.0
FDI liabilities, EUR m	1,079	3,478	1,046	3,436	.	.	.
FDI assets, EUR m	236	80	374	1,180	.	.	.
Gross reserves of CB excl. gold, EUR m	17,438	18,560	18,943	25,022	.	.	.
Gross external debt, EUR m	42,583	40,278	40,074	44,610	44,900	46,900	48,700
Gross external debt, % of GDP	80.8	72.5	79.8	77.8	71.5	70.0	69.0
Average exchange rate HRK/EUR	7.4182	7.4180	7.5384	7.5284	7.6	7.6	7.6

1) Preliminary and wiiw estimates. - 2) From 2021 based on Census 2021. - 3) Enterprises with 20 and more employees. - 4) From 2021 the new LFS methodology is applied in line with the Integrated European Social Statistics Regulation (IESS). - 5) From 2020 employees expressed in full-time equivalents (FTE). - 6) Loans more than 90 days overdue and those unlikely to be paid. - 7) Discount rate of CB.

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