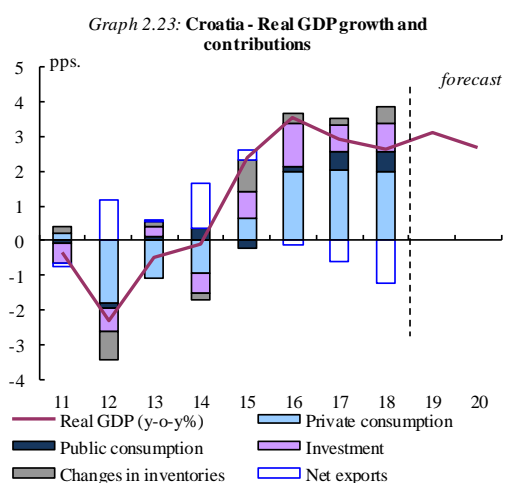


2.23. CROATIA

Croatia's economy grew by 2.6% in 2018, slightly less than expected due to a particularly weak fourth quarter. However, real GDP growth rebounded beyond expectations in the first quarter of 2019 by 1.2% quarter-on-quarter. Domestic demand remained the main driver of growth due to strengthening investment and robust household consumption. Exports rebounded following an unexpected contraction in the previous two quarters. High frequency indicators, labour market and survey data all suggest strong domestic demand-driven growth should continue throughout 2019.

As wages and employment continue to grow amidst low inflation, household consumption is set to remain the main driver of growth throughout the forecast period. Investment growth is expected to strengthen further in 2019 before moderating in 2020, supported by an improved uptake of EU funds and low interest rates. Goods exports are expected to rebound in 2019, while service exports are expected to continue easing as supply side constraints become more evident and international competition in the tourism sector intensifies. Strong final demand growth should be reflected in a pick-up in imports of both goods and services in 2019. Overall, the contribution of net exports to growth is expected to decrease further in 2019 before improving in 2020, though remaining negative. Real GDP growth is forecast to pick up to 3.1% in 2019 as a whole before moderating to 2.7% in 2020.

Employment growth should moderate over the forecast horizon and the unemployment rate is expected to continue declining towards an historic low in 2020.



In the first five months of 2018, inflationary pressures remained subdued due to negative inflation in unprocessed food prices as a result of changes in the applicable VAT rate adopted in September 2018. As labour shortages become more apparent in some sectors, wage growth is projected to accelerate. However, the reduction in the standard VAT rate in January 2020 and stagnating energy prices should dampen inflation. Overall, inflation is forecast to remain subdued at 0.9% 2019 and 1% in 2020.