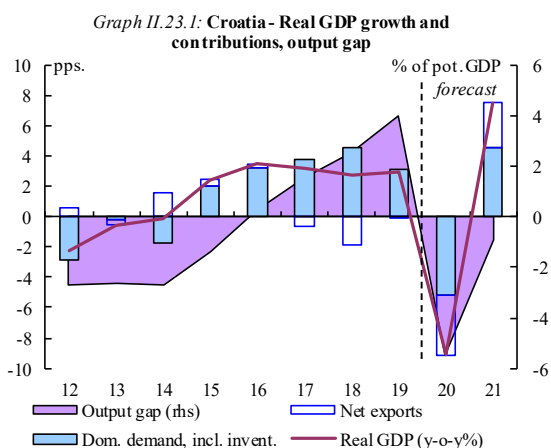


23. CROATIA

Croatia's economy entered the COVID-19 crisis in a significantly better shape than the crisis in 2008. Assuming that suppression and moderation measures are slowly phased out in 2020, Croatia's economy should rebound quickly in 2021 after a strong contraction in 2020. High reliance on tourism exacerbates the slump and poses a risk in case of longer travel restrictions. Domestic demand should remain the main driver of the recovery, as the outlook for global trade remains uncertain. Government measures are expected to cushion the impact of the recession on the labour market, though they come at a high cost for public finances.

Facing this crisis with a more resilient economy

Croatia's economy is facing the negative economic impact of the COVID-19 pandemic from a more resilient starting position than at the outset of the 2008 global financial crisis. In 2019, real output finally surpassed its 2008 level, and unemployment rate reached an all-time low. The magnitude of macroeconomic imbalances (high levels of debt and external liabilities) fell below its 2008 level. Although still relatively high, government debt decreased markedly, helped by three consecutive years of government surpluses. Furthermore, the average maturity and cost of servicing public debt improved substantially. Cost competitiveness gains and EU accession set the stage for a strong expansion of exports and Croatia's market share until 2019.



A sharp contraction in 2020

As high-frequency indicators still pointed to a strong economic performance in the first two months of 2020, Croatia's economy does not appear to have been hit hard by supply chains disruptions in China. However, with the escalation of the pandemic in Europe in early March, and the introduction of stricter suppression measures in Croatia in the second half of March, the bulk of the

economic impact of the pandemic is expected to be concentrated in the second quarter of 2020.

Croatia's economy is forecast to contract by about 9% in 2020 before partially recovering by 7½% in 2021. Despite accounting for more than half of the drop in 2020, domestic demand is expected to recover faster than exports, due to significant uncertainties surrounding the outlook for global trade. Wage support measures and the operation of automatic stabilisers should help sustain household consumption while investment is expected to be supported by the ongoing implementation of projects financed by EU funds and several liquidity support measures for companies. Government consumption should continue contributing positively to growth.

Goods exports are expected to contract in 2020, primarily due to the expected recession in Croatia's main trading partners. Service exports should suffer even more due to the negative impact of the suppression and mitigation measures on the travel, hospitality and transport sectors. Due to the expected increased aversion towards international travel by potential non-resident tourists, tourism is not expected to recover to its 2019 level in 2021. However, the negative impact on GDP of the large fall in exports should be mitigated by the high import component of tourism exports. The trade deficit is expected to temporarily deteriorate in 2020 before partially recovering in 2021. The current account balance should temporarily deteriorate to -1¾% of GDP in 2020, before improving to 0.5% of GDP in 2021.

Employment to contract then rebound quickly

The labour market is expected to react fast to the disruption of economic activity. Although government wage and liquidity support measures should mitigate the fall in employment in some sectors, employment is set to drop sharply in sectors that are likely to experience the longest

disruption, e.g. hospitality. Employment should bottom out towards the end of the year, leaving the unemployment rate at 10¼% in 2020, some 3½ pps. above its level in 2019. Consumer price inflation is expected to decline in 2020 due to the drop in oil prices. Core inflation should be driven by weaker overall demand and the base effects from the VAT rates cut in 2019. Inflation should remain subdued also in 2021.

Public finances

After the third consecutive year of surplus in 2019, the general government balance is projected to deteriorate sharply in 2020 on the back of the economic slowdown, as automatic stabilisers and measures on both the revenue and expenditure side of the budget play their role. Partial and full cancellations of tax and social contributions for the hardest hit companies in the second quarter should undercut revenue by a projected 1½% of GDP. Meanwhile, the subsidy for wages in the private sector is expected to cover more than half a million employees and cost almost 2% of GDP. This measure should drive expenditure growth up, as it will only partly be offset by cuts in investment and savings on public wages. Overall, the general

government balance is expected to turn into a deficit of more than 7% of GDP in 2020. The effect of these deficit-increasing measures, as well as liquidity measures (tax deferrals) and the economic slowdown on financing needs will be pronounced, particularly in the second quarter.

In 2021, tax revenues should recover strongly, driven by the economic recovery and the base effect from 2020. Corporate income tax revenues are expected to lag behind other sources of revenue as many companies offset their losses against future profits. Meanwhile, expenditures should decrease driven by the drop in wage subsidies. Overall, on a no-policy-change basis, the government balance is expected to recover substantially, reaching a deficit of around 2¼% of GDP in 2021.

In 2020, the debt ratio is set to increase in excess of the deficit on the back of the liquidity measures put in place to support firms, mostly in the form of tax deferrals. After reaching a peak of almost 89% of GDP in 2020, the debt ratio should start decreasing again, to below 84% of GDP in 2021.

Table II.23.1:

Main features of country forecast - CROATIA

	2018			Annual percentage change						
	bn HRK	Curr. prices	% GDP	00-15	2016	2017	2018	2019	2020	2021
GDP	383.0	100.0		1.7	3.5	3.1	2.7	2.9	-9.1	7.5
Private Consumption	222.8	58.2		1.6	3.1	3.1	3.2	3.5	-6.9	6.1
Public Consumption	74.5	19.4		1.2	0.5	2.2	1.3	3.3	2.5	0.1
Gross fixed capital formation	76.7	20.0		2.3	6.5	5.1	4.1	7.1	-8.2	4.2
of which: equipment	-	-		-	-	-	-	-	-	-
Exports (goods and services)	193.4	50.5		4.4	7.0	6.8	3.7	4.6	-29.0	33.7
Imports (goods and services)	196.6	51.3		4.1	6.5	8.4	7.5	4.8	-21.2	23.4
GNI (GDP deflator)	377.4	98.5		1.8	1.0	4.7	2.7	2.9	-8.7	7.1
Contribution to GDP growth:		Domestic demand		1.9	3.2	3.3	3.0	4.1	-5.2	4.5
		Inventories		0.1	0.0	0.5	1.6	-1.0	0.0	0.0
		Net exports		-0.2	0.3	-0.6	-1.8	-0.1	-3.9	3.0
Employment				0.1	0.3	2.2	1.8	1.4	-3.9	3.0
Unemployment rate (a)				13.7	13.1	11.2	8.5	6.6	10.2	7.4
Compensation of employees / head				3.1	0.4	0.2	2.2	3.4	-1.2	1.1
Unit labour costs whole economy				1.5	-2.7	-0.7	1.4	1.9	4.5	-3.1
Real unit labour cost				-1.2	-2.6	-1.9	-0.4	0.4	3.7	-4.0
Saving rate of households (b)				-	-	-	-	-	-	-
GDP deflator				2.8	-0.1	1.2	1.8	1.5	0.7	0.9
Harmonised index of consumer prices				2.6	-0.6	1.3	1.6	0.8	0.4	0.9
Terms of trade goods				0.8	-0.6	-1.3	-0.5	0.3	0.9	-0.3
Trade balance (goods) (c)				-18.2	-16.3	-17.2	-18.7	-18.9	-12.6	-18.5
Current-account balance (c)				-	2.0	3.3	1.9	2.4	-1.7	0.5
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-	3.6	4.4	3.3	4.4	0.4	2.6
General government balance (c)				-4.3	-1.0	0.8	0.2	0.4	-7.1	-2.2
Cyclically-adjusted budget balance (d)				-	-1.0	0.1	-0.9	-1.2	-4.4	-1.9
Structural budget balance (d)				-	-1.1	0.2	-0.9	-1.2	-4.4	-1.9
General government gross debt (c)				52.2	80.8	77.8	74.7	73.2	88.6	83.4

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.