Croatian Economic Outlook

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Forecast Update

Euro zone on a stable recovery path

Euro zone recovery remains consistent with an estimated growth rate of 2.4 percent for 2017, which represents an increase of 0.6 percentage points compared to the year before (*European Commission, European Economic Forecast, March 2018*). This growth momentum will continue in 2018, mainly supported by rising household consumption coupled with falling unemployment. The expansionary monetary policy stance of the European Central Bank (ECB), marked with relatively low interest rates, should continue to support business investment and construction activity. ECB has announced, however, to gradually taper the pace of its asset purchases, thus dampening somewhat the growth prospects for 2019. Overall, the latest forecasts of the European Commission suggest a gradual decline in the pace of recovery of 2.3 and 2.0 percent in 2018 and 2019. The projected recovery path for the whole European Union follows that of the euro zone, with growth rates of 2.3 and 2.0 for the current and the following year (Figure 1).

Receding domestic recovery

Following a 3.3 percent growth rate in the third quarter of 2017, the final quarter saw a 2.0 percent increase in Croatian GDP measured year-on-year and a meager 0.1 percent increase measured quarter-to-quarter (seasonally adjusted). This considerable loss of

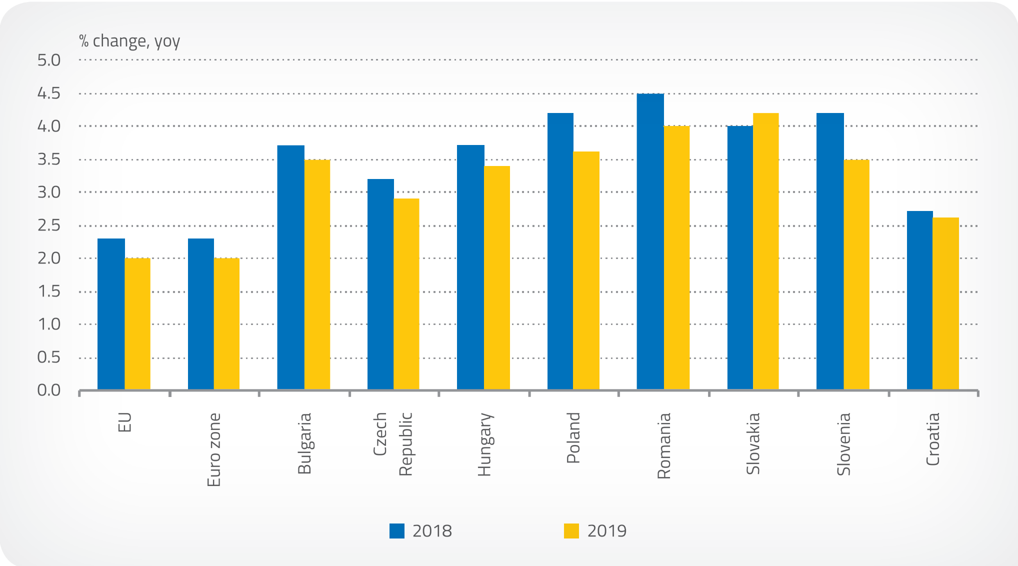
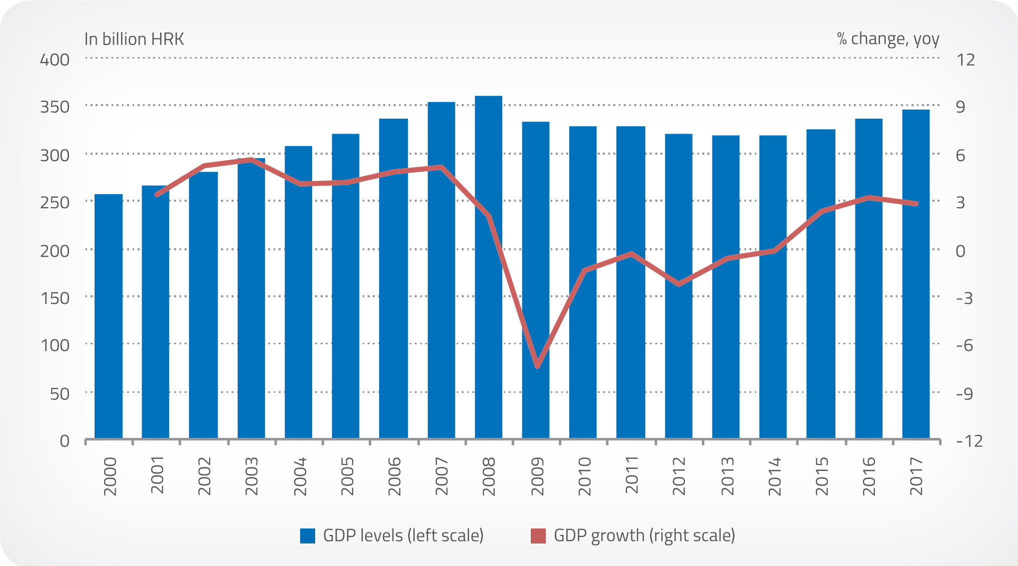


Figure 1
Real GDP Growth Forecasts for the Euro Zone, Croatia and Selected CEE Countries

Sources: European Economic Forecast, EC, Winter 2018, and EIZ for Croatia.

Figure 2
Real Gross Domestic Product

Source: Croatian Bureau of Statistics.



steam is most evident in industrial production, which decreased in both November and December 2017, but also in a milder increase in exports and a weaker-than-expected growth of investment. Despite favorable credit conditions, investment is being held back by a lack of reforms that target the business environment and by stalled capital expenditures of Agrokor-related firms. This underperformance in the final quarter of 2017 brought down the growth figure for the entire year to 2.8 percent, which is somewhat below the 3.2 percent growth in 2016 (Figure 2).

Losing steam

Based on the latest available data, we foresee a continuation of this gradual slowdown in activity. Private consumption will remain the most significant contributor to overall GDP growth. The domestic demand strengthening will also be reflected in higher import growth rates and a negative contribution of net foreign demand to GDP growth. This decrease in the pace of recovery is reflected in our real GDP growth forecasts for 2018 and 2019, which now stand at 2.7 and 2.6 percent (Figure 3 and Table 1).

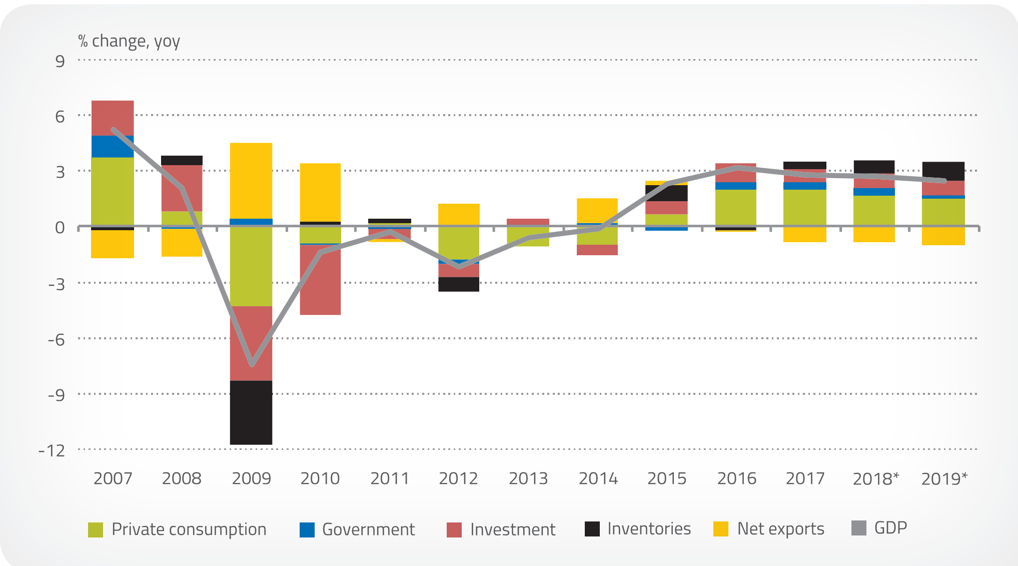
Strong private consumption

Private consumption recorded the highest growth rate among all GDP components in 2017, culminating in a 3.4 percent increase in the last quarter when compared to the same period in 2016 and a 0.7 percent increase (seasonally adjusted), compared to the third quarter of 2017. In annual terms,

Figure 3
Demand Contributions to GDP Growth

Note: * represents EIZ forecasts.

Sources: Croatian Bureau of Statistics and EIZ for forecast.



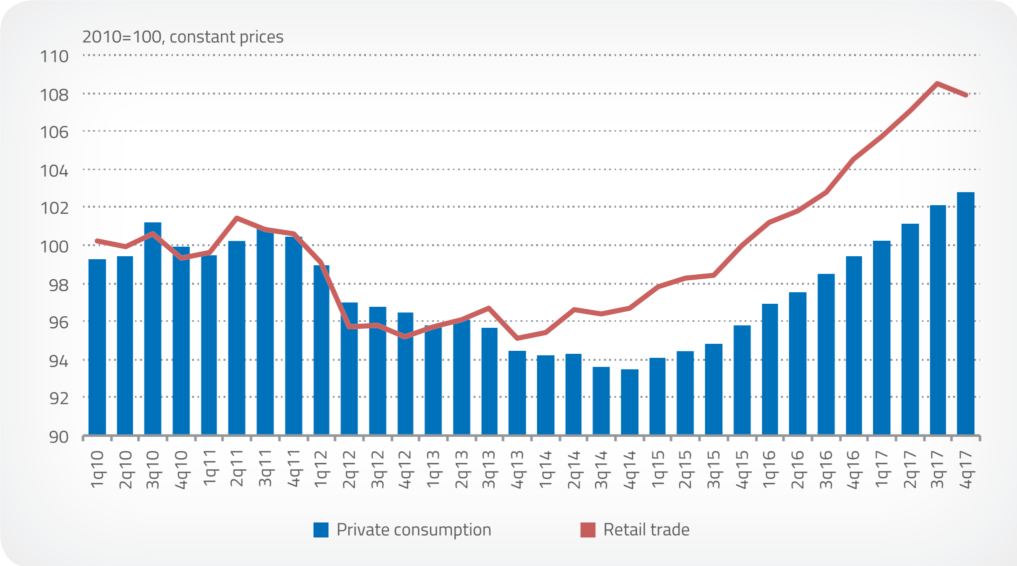


Figure 4
Private Consumption and Retail Trade

Note: Seasonally adjusted by X11ARIMA (Statistics Canada).

Source for the original data: Croatian Bureau of Statistics.

this brought an increase of 3.6 percent—the highest recorded increase since 2007. These favorable trends are a consequence of continued employment growth, increase in real net wages (both in the private and the public sector), higher earnings from another record-high tourist season, and overall improved consumer optimism. Retail trade followed the pace of private spending depicting a record-high 4.4 percent growth in 2017 (Figure 4).

Private consumption growth in this year will remain robust, as both employment and wages rise, while the inflation stays low, but also as entitlements and war veteran transfers increase. In 2019 however, growth will somewhat decelerate as favorable employment and wage effects fade away. With that in mind, our projections for real private consumption now stand at 3.1 and 2.7 percent in 2018 and 2019. These figures translate into 1.7 percentage points contribution to overall GDP growth in 2018, before falling to 1.5 percentage points contribution in 2019 (Figure 3).

Generous government in 2018

Government consumption steadily increased in each successive quarter throughout 2017 compared to 2016, reaching its peak in the final three months of the previous year, with a growth rate of 2.6 percent (year-on-year). Altogether, government expenditure increased by 2.0 percent in the previous year, continuing the recovery trend from 2016 onwards (Figure 5). We expect this newly found space for fiscal easing to continue in 2018 as well, backed by higher VAT revenues from increased spending and improved performance with regard to EU funds absorption. Given the latest available information, we expect the government consumption to increase considerably in this year, by 2.2 percent and decelerate in the next year, to around 1 percent.

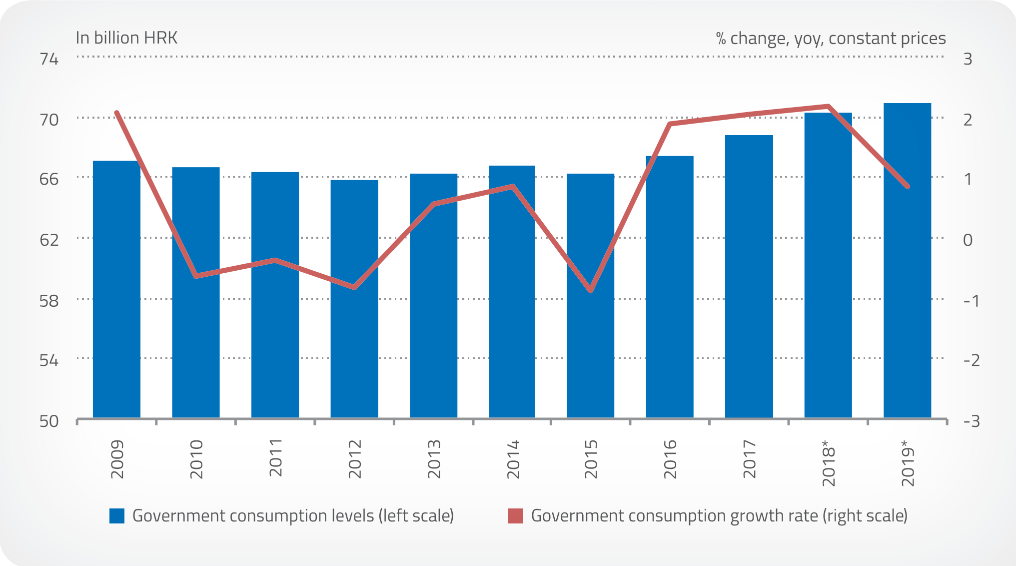
A plethora of uncertainties surrounding investment growth

Following a steady recovery pace in investment in the first three quarters of 2017, which recorded an average year-on-year growth rate of 4.0 percent, the final quarter of the last year brought a notably lower growth of 1.7 percent (also measured year-on-year), or 0.3 percent compared to the third quarter of 2017. This underperformance in the last three months of 2017 also weighed heavily on investment growth for the whole year which, after increasing to 5.3 percent in 2016, decelerated to 3.4 percent (Figure 6). This was likely caused by an ongoing poor business climate lacking major reforms, lower-than-expected EU funds absorption, and discouraged investment decisions of Agrokor-related firms. Since the Agrokor settlement deadline will likely be shifted to mid-2018, the full investment growth potential will be dampened this year. However, on the bright side, parafiscal burden cuts, firm profits from the last year, low funding costs, and

Figure 5
Government Consumption

Note: * represents EIZ forecasts.

Sources: Croatian Bureau of Statistics and EIZ for forecast.



stronger EU funds absorption are all in favor of investment growth—which, we expect—will reach 3.9 percent this year. Following a successful implementation of Agrokor's restructuring plans, the materialization of announced publicly-funded projects, and an increased EU funds absorption, investment growth should accelerate in 2019, when it is projected to reach a 4.3 percent growth rate.

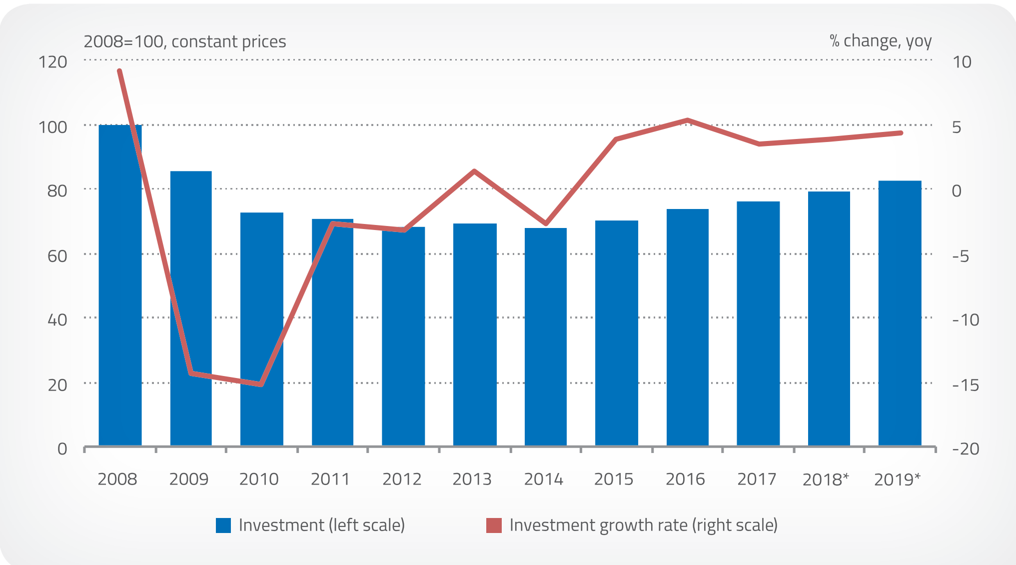
Full imports recovery

Turning our attention to the international sector, the winning streak of exports continued as it increased by 6.1 percent in 2017 as a whole, leading the level of exports almost 25 percent above the pre-crisis level (Figure 7). Similarly, imports increased by 8.1 percent in 2017, and for the first time surpassed the level from 2008 (Figure 8). Given the expectations of another record tourist season and increased growth prospects of our main trading partners, we expect exports to continue with the upward-sloping trend, at rates similar to those from the last two years. Our forecast now stands at 5.6 and 5.3 for the current and the following year. Due to a strong recovery of domestic demand and a high foreign component in private spending, imports are set to increase by 7.4 and 7.5 percent in 2018 and 2019. With imports growth exceeding that of the exports, i.e. higher goods trade deficit, and a growing deficit in primary income due to higher expected foreign-owned bank's profits, current account surplus is forecasted to decrease to 1.4 and 0.6 percent of GDP in 2018 and 2019.

Figure 6
Investment

Note: * represents EIZ forecasts.

Sources: Croatian Bureau of Statistics and EIZ for forecast.



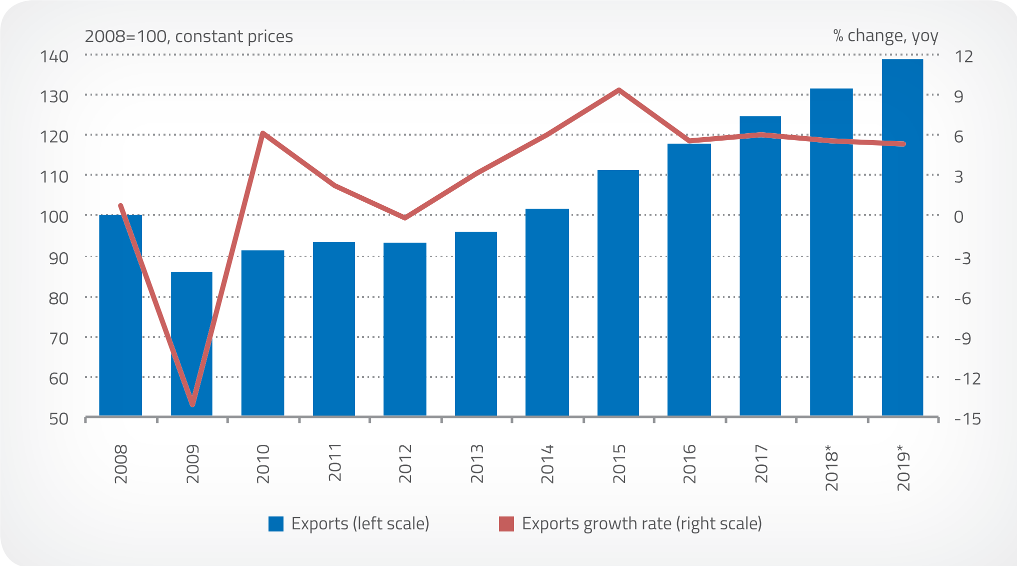


Figure 7
Exports of Goods and Services

Note: * represents EIZ forecasts.

Sources: Croatian Bureau of Statistics and EIZ for forecast.

Agrokor's rise and demise

The Agrokor case is still the main political and economic talking point in Croatia. About six months after the activation of the so-called "Lex Agrokor" in April 2017 and the appointment of the extraordinary management commissioner, Mr. Ante Ramljak, the Parliament established a special political investigative committee aimed at examining the political aspects of Agrokor's rise and demise. As it turned out, the investigative committee hardly found any new facts, leading to its repeal at the end of November, supposedly by the letter of the law, according to which the committee is to be terminated once the official court investigation begins. While the ruling HDZ insisted on the abolishment of the committee, the opposition strongly disagreed, accusing HDZ of hiding the truth concerning their political responsibility.

Mr. Todorić vs. the "criminal conspiracy group"

From mid-September, the majority owner of Agrokor, Mr. Ivica Todorić has been regularly accusing a part of the political elite, and in particular, the Deputy Prime Minister Ms. Martina Dalić, for conspiracy against him. According to Mr. Todorić, the so-called "Lex Agrokor" was not meant to alleviate the negative spillovers from Agrokor's failure, but instead, it was created as a means for a "criminal conspiracy group" to take over Agrokor from him. He argued that he was politically pressured by Ms. Dalić to ask for government help, which would, according to

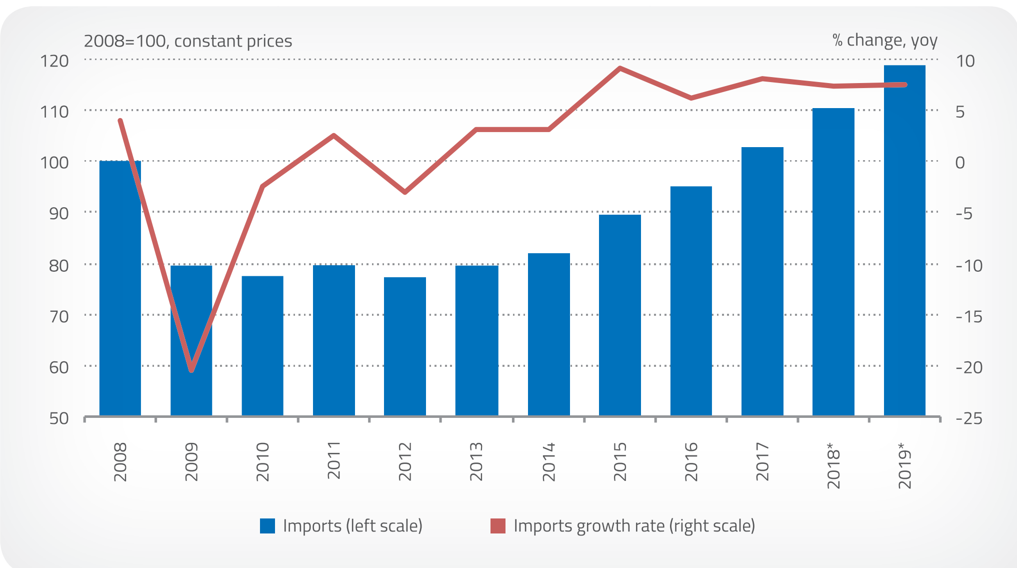


Figure 8
Imports of Goods and Services

Note: * represents EIZ forecasts.

Sources: Croatian Bureau of Statistics and EIZ for forecast.

Table 1
Forecast Summary

	2018	2019
Real GDP (% change)	**2.7**	**2.6**
Real private consumption (% change)	3.1	2.7
Real government consumption (% change)	2.2	0.9
Real investment (% change)	3.9	4.3
Exports of goods and services (constant prices, % change)	5.6	5.3
Imports of goods and services (constant prices, % change)	7.4	7.5
Current account balance (% of GDP)	1.4	0.6
General government balance (ESA 2010 definition, % of GDP)	0.2	0.5
Public debt (ESA 2010 definition, % of GDP)	78.5	76.3
Unemployment rate (registered, %, pa)	10.5	9.7
Exchange rate, HRK/EUR (pa)	7.42	7.40
Total domestic credit (% change, eop)	-0.3	0.9
Consumer prices (% change, pa)	1.6	1.8

Note: Cut-off date for information used in the compilation of forecasts was March 5, 2018.
Conventional abbreviations: pa – period average, eop – end of period, HRK – Croatian kuna, EUR – euro.
Source: Authors' forecasts.

the regulations contained within "Lex Agrokor", thereby effectively deprive him of his private property.

Opposition vs. the Deputy Prime Minister

Due to rising public discontent related to high consultants' fees—disbursed, among others, to his former employer as well—and due to the perceived loss of government support, the Court's extraordinary management commissioner for Agrokor, Mr. Ramljak decided to resign voluntarily on February 27. He was replaced by Mr. Fabris Peruško, who has since last year been a member of the board of directors of Tisak, one of Agrokor's companies. This juncture gave the opposition a strong reason to demand the dismissal of the Deputy Prime Minister Ms. Dalić, as she strongly supported the work of Mr. Ramljak. The opposition recently collected the minimum number of signatures in the Parliament to initiate a no-confidence motion procedure against her, but the request has not yet been submitted. This is expected to happen soon, and according to the law, the vote is to take place within a month upon the submission.

Further improvements on the fiscal front

Although general government statistics based on the ESA 2010 methodology are not yet available for 2017, there are again signs of improvements in government finances based on national accounting rules. In the first three quarters of 2017 general government revenues increased by 2.2 percent when compared to the same period in 2016. At the same time, expenditures increased by a trifling 0.3 percent. Consequently, general government surplus doubled in absolute terms, from two billion kuna in the third quarter of 2016 to over four billion kuna in the third quarter of 2017. Although the data for the fourth quarter are not yet published, normally the Budget in that quarter is in deficit due to seasonality. If the four billion kuna deficit from the last quarter of 2016 is recorded again in the last quarter of 2017, that year might end up with pretty balanced public finances. Despite the lack of published data, the Finance Minister revealed that the general government recorded a surplus in 2017, the first ever since the Croatian independence.

Strong rise in VAT revenues

Budget improvements are mostly due to VAT revenues which went up by 4.4 percent in the first three quarters of 2017 year-on-year

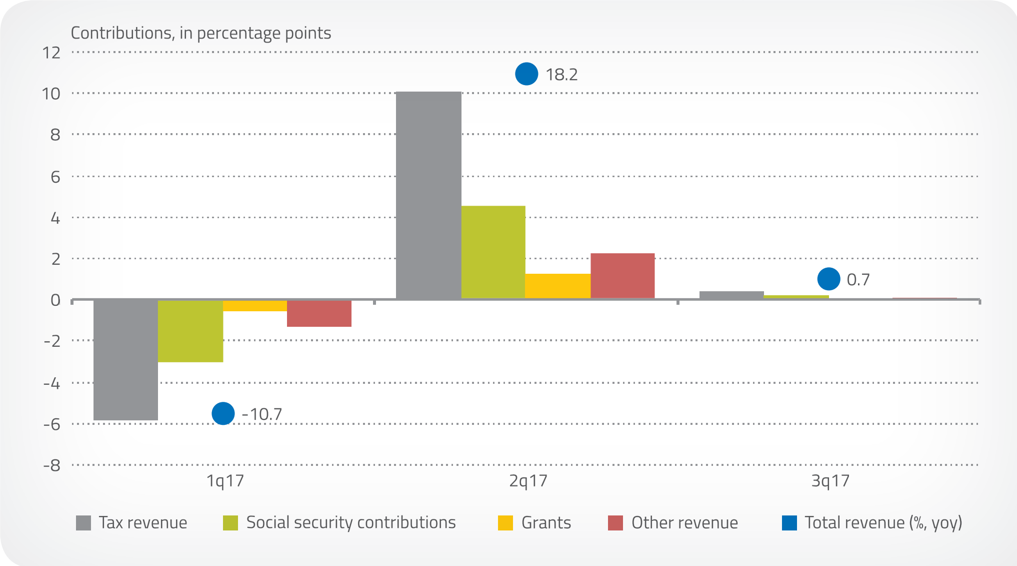


Figure 9
General Government Revenue Contributions to Year-on-Year Growth

Source: Ministry of Finance.

(Figure 9). On the expenditure side, the most significant downsizing came from interest payments and subsidies. Interest payments decreased by 10.2 percent and subsidies by 5 percent in the first three quarters of 2017 when compared to the first three quarters of 2016.

Cosmetic fiscal changes for 2018

For 2018, some fiscal relief—mainly for businesses—has been introduced. The threshold for entry into the VAT system has increased from 230,000 to 300,000 kuna, the costs of accommodation for seasonal workers are now nontaxable and the threshold for determining the annual amount of untaxed pays in kind has increased from 400 to 600 kuna. On the expenditure front, compensations for unemployed war veterans and their family members have been introduced and the amount of minimum pension, depending on the duration of war engagement, has increased. Looking at the projections of state Budget revenues and expenditures for the period 2018–2020, there are no real disturbances due to abovementioned measures, confirming that the changes in fiscal terms are indeed cosmetic. The growth in revenues is related mainly to a higher GDP, while the expenditures are comparatively well under control; increasing moderately, i.e. slower than revenues and GDP. These are the main reasons for the continuation of fiscal consolidation that is expected in 2018 and 2019.

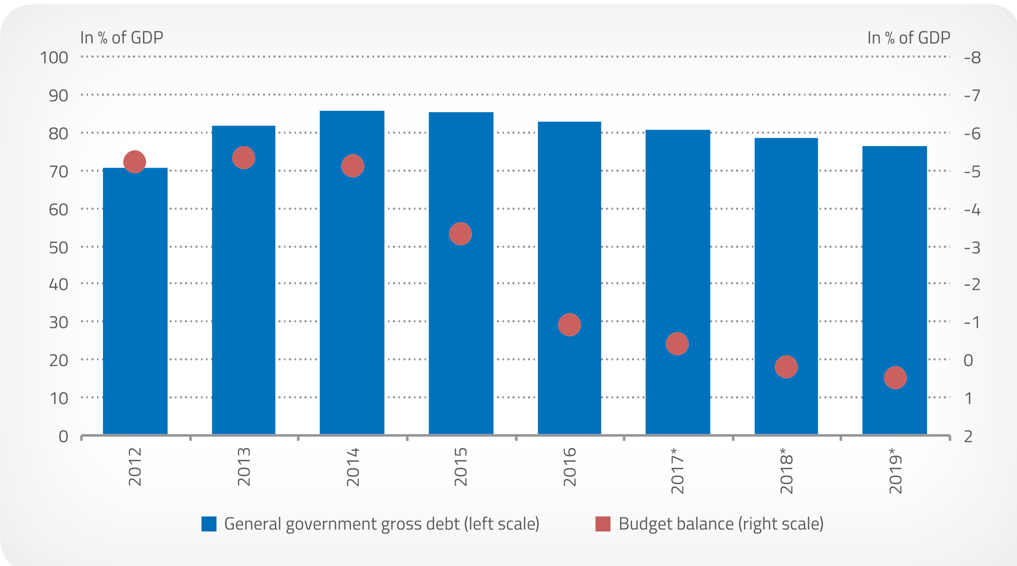


Figure 10
General Government Budget Balance and Debt

Note: * represents EIZ forecasts.

Sources: Eurostat and EIZ for forecast.

Budget surplus in 2018

Based on the latest developments and taking into account changes in growth projections, we slightly revise our fiscal forecasts. For 2017, the government Budget deficit is estimated at around 0.4 percent of GDP. This year we expect general government surplus to be at around 0.2 percent of GDP, increasing further to 0.5 percent of GDP in 2019 (Figure 10).

Public debt going south

General government debt at the end of the third quarter of 2017 stood at 291.6 billion kuna, which represents a modest increase of 1 percent in comparison to the same quarter of 2016. With such mild debt accumulation, the debt-to-GDP ratio in 2017 is estimated to have decreased, to around 80.5 percent (Figure 10). We project this debt reduction dynamics to continue in the following period, implying that the public debt could be at around 78.5 and 76.3 percent of GDP at the end of 2018 and 2019 (Figure 10). Figure 11 presents somewhat lower debt repayment obligations in this year, around 9 billion kuna, which is lower when compared to the 2019–2025 period, when a repayment of more than 130 billion kuna is due. One has to note that the latest European Commission Country Report suggests that the structural Budget balance for 2017, 2018, and 2019 is getting worse, which—in turn—limits the future ability of the government to decrease the size of the public debt.

Limited reform progress

As noted in the European Commission Country Report 2018, Croatia has made limited progress in addressing country-specific recommendations for 2017. The Commission assesses the compliance with the recommendations on a five-grade scale: no progress, limited progress, some progress, substantial progress, and full implementation. Out of five major recommendations concerning the areas of fiscal framework, the pension system, the educational reform, public administration, and business regulation, four areas registered limited progress and one area (the public administration reform) displayed no progress at all. Such weak reform capacity is worrying as it has direct repercussions on the potential output and it is likely to hamper growth prospects of the country as soon as the positive external environment weakens.

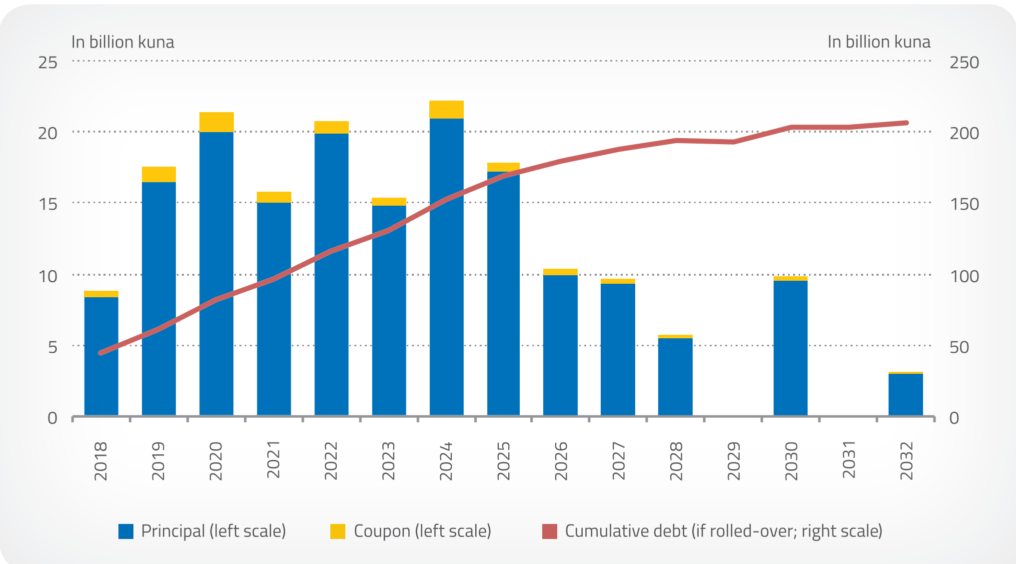
Threats on the fiscal front

The main risks to mid-term fiscal projections are coming from war veteran entitlements, potentially lower corporate income tax revenues associated with the crisis in Agrokor, and possible government liabilities from future court cases also related to Agrokor. In addition, there are plans of further functional integrations of hospitals in 2018, but it is difficult to expect that the healthcare sector arrears of around eight billion kuna will be properly addressed by this measure, indicating therefore that this sector continues to pose a

Figure 11
Croatian Bond Government Debt (Cumulative and by Years)

Note: Transformations to domestic currency were made assuming the following exchange rates: HRK/EUR = 7.5; HRK/USD = 6.0.

Sources: Croatian National Bank and Ministry of Finance.



threat to the positive trajectory of government finances.

Stalled employment

Given the overall positive momentum in the last three years, main indicators on the labor market in 2017 followed the beaten track with a decrease of registered unemployment by more than 20 percent (approximately 45–50 thousand individuals), which represents a drop in the unemployment rate of more than two percentage points and an increase of nominal gross wages by over four percent (Table 2). However, employment seems to be lagging behind these developments since the temporary Croatian Bureau of Statistics (CBS) data point to a drop in average employment of 1.8 percent, or by more than 25 thousand individuals in 2017, while the Croatian Pension Insurance Institute (CPII) data on the number of the insured point to a 1.9 percent employment growth, or around 27 thousand individuals in the same period (Figure 12). The difference between these two figures lies in the definition of employment. The pension insurance data follow a broader definition of employment, which covers all those who pay pension contributions on their earnings. These numbers are generally taken as a more accurate reflection of the labor market dynamics. Regardless of the data source, it is obvious that the strong drop in registered unemployment is not the result of the hiring process, but instead some other factors are at play. Croatian Employment Service (CES) reports that the exits from their unemployment registry due to employment actually decreased in 2017 by about 10 percent in comparison to the previous year, whereas exits due to registration cancellation and failures to regularly report to the Employment Service increased by almost 20 percent. It appears that strong outgoing migration is the main driving force behind the persistent fall in unemployment in recent years.

Declining labor force as a threat to future growth

A drop in registered unemployment brought a decline in the unemployment rate, as shown by the Labor Force Survey (LFS) data (Figure 13). Yet, despite a 2.4 percentage point decrease compared to the previous year, Croatia had the fourth-highest unemployment rate among EU member states in January 2018—9.8 percent, or 2.5 percentage points higher than the EU-28 average. As unemployment declined more sharply than employment grew, the activity rate increased by only 0.1 percentage points and stood at 51.5 percent for the adult population and at 71.0 percent for the working age population (20–64). However, these figures are still among the lowest within the EU, pointing additionally to low labor utilization on the Croatian labor market. This, coupled with population ageing, indicates rather weak labor force prospects in Croatia, which could seriously undermine future growth.

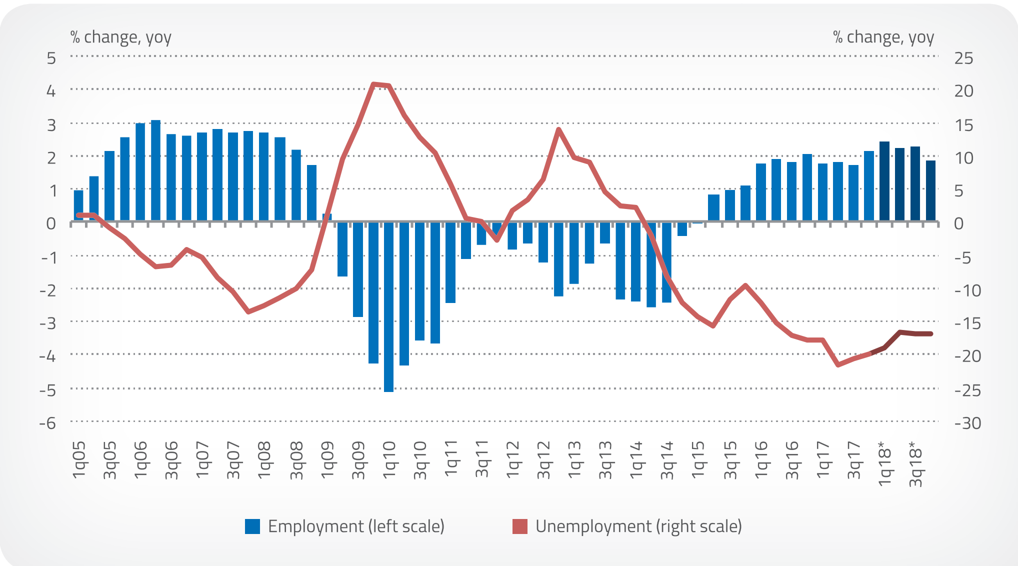


Figure 12
Total Employment and Unemployment

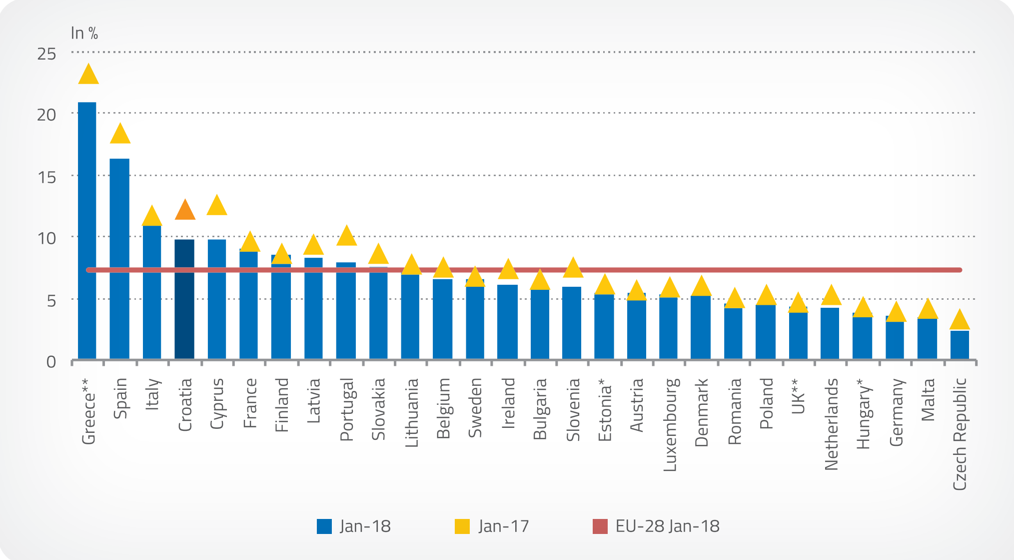
Note: * 1q2018–4q2018 is based on extrapolated values.

Sources: Croatian Employment Service and Croatian Pension Insurance Institute.

Figure 13
Unemployment Rates in the EU

Notes: Seasonally adjusted; based on LFS data; * represents data for December 2017; ** represents data for November 2017.

Source: Eurostat.



Foreign workers to the rescue

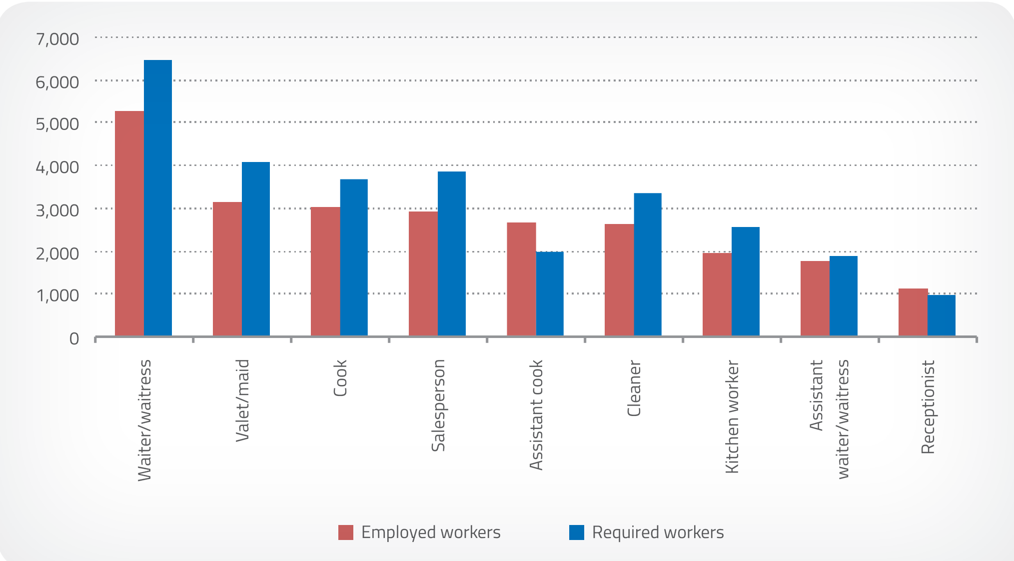
Despite yet another record tourist season in 2017, CES reports that the seasonal employment was lower by more than ten percent when compared to the previous year (or by more than four thousand employees). Actually, 2017 has been marked as the first year in which there were more required seasonal workers than exits to employment on seasonal jobs, pointing to labor shortages. This is mainly evidenced in occupations such as the waiter, valet/maid, and salesperson (Figure 14). Since the outlook for the upcoming tourist season seems even stronger than the projections for 2017, it is no surprise that the government significantly increased the number of working permits for foreigners in 2018—4,660 working permits were issued for the new employment of foreigners in tourism and catering services, as compared to only 175 issued working permits in 2017. Given that labor shortages are present not only in seasonal employment in the tourism sector, but can also be found in construction, retail, and other labor-intensive industries, the government eventually approved 21,210 licenses for the new employment of foreigners in the Republic of Croatia for 2018, with the construction sector taking up more than half—10,770 of all new employment licenses.

Upside risks to unemployment

The sharp drop in unemployment, observed in the last several years, is expected to moderate in 2018 (Figure 12), mainly because emigration is expected to slow down as

Figure 14
Seasonal Employment by Occupation (January–December 2017)

Source: Croatian Employment Service.



prospects of employment and wages rise in the country. Our forecasts for the registered unemployment rate thus stand at 10.5 and 9.7 percent for 2018 and 2019. Risks to these forecasts are mainly to the upside as the restructuring of Agrokor might put some pressure on the level of unemployment in 2018. In theory, the public administration reform, announced for 2019, might cause some employees to lose their jobs. However, we do not expect this to happen since 2019 is the pre-election year and it is highly unlikely that the incumbent government will make some significant moves toward a serious public administration reform prior to election.

Robust wage growth

The year 2017 recorded a rather solid wage growth, with average gross wages increasing by 3.9 percent in nominal and 2.7 percent in real terms (Figure 15). Due to an income tax reform at the beginning of the last year, net wages increased even more, by 5.3 percent and 4.1 percent in nominal and real terms. Wage growth was particularly strong in sectors with high unmet labor demand—construction, wholesale and retail trade, accommodation and catering, and other service activities. In the public sector, the administrative wage hikes distributed throughout 2017 resulted in modest wage growth for the year as a whole, but higher wage level will be passed onto this year. Hence, it seems that a tight labor market with significant labor shortages in some sectors coupled with higher labor productivity (Figure 16) is the main reason behind wage growth in 2017.

As we expect these trends to continue, further wage growth is expected for this and the next year, although with some moderation, especially in 2019. Besides the wage hikes in some private sectors due to insufficient labor supply and higher labor productivity, wages in the public sector will also continue to grow as the effects of wage hikes during 2017 will still be visible in 2018. Wage negotiations in the public sector for 2018 and 2019 are on the way but without clear signs with regard to possible outcomes. However, in the Budget plans accepted by the Parliament there were no significant predictions of increases in the public sector wage bill. Thus, we anticipate the wage negotiations and the expected wage reform in 2019 to bring only a mild increase in public sector wages. The five percent increase of minimum wages at the beginning of 2018 could further increase wages in the private sector. As inflation is expected to stay below two percent in 2018 and 2019, we expect the wage growth together with a moderate increase of employment to continue to be the dominant force behind the rise of real disposable income and private consumption in the near future.

Modest inflation in 2018

Last year Croatia stepped out of the deflation zone and recorded a 1.2 percent consumer prices growth when compared to the previous

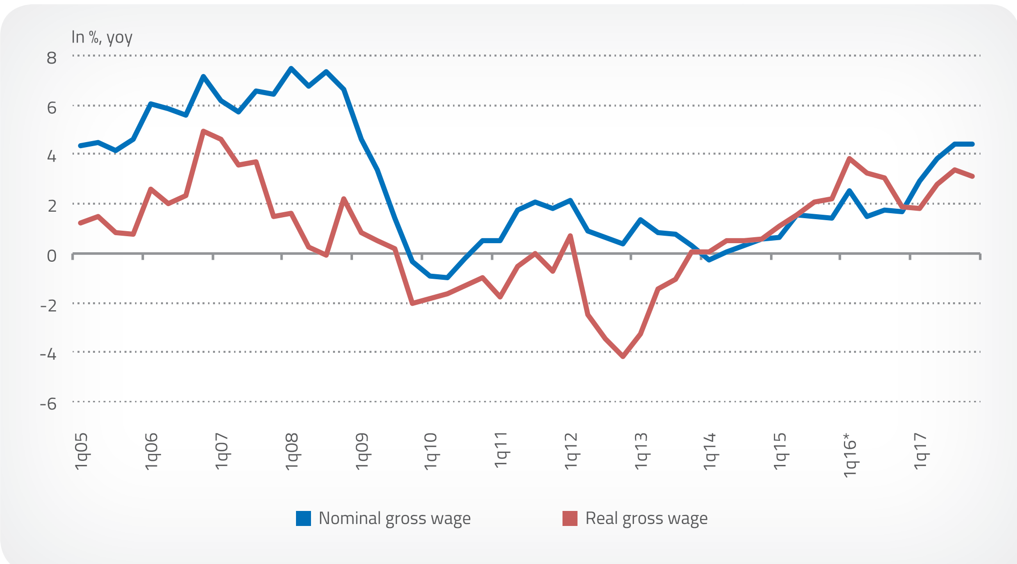


Figure 15
Real and Nominal Gross Wages

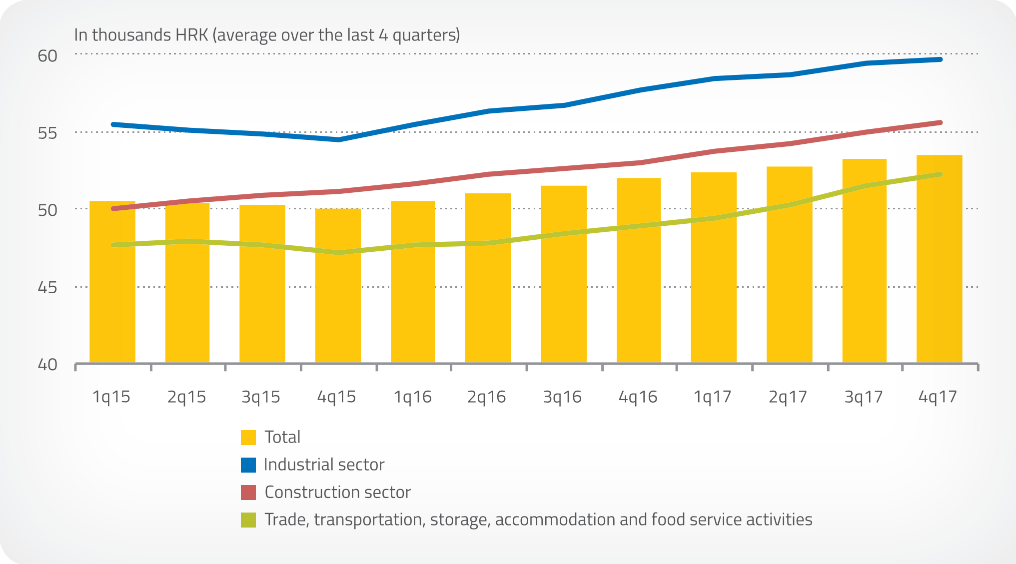
Note: * represents the results of processing data from JOPPD forms.

Source: Croatian Bureau of Statistics.

Figure 16
Labor Productivity*

Note: * productivity is measured as gross value added over the number of employees.

Source: EIZ estimate based on the Croatian Bureau of Statistics data.



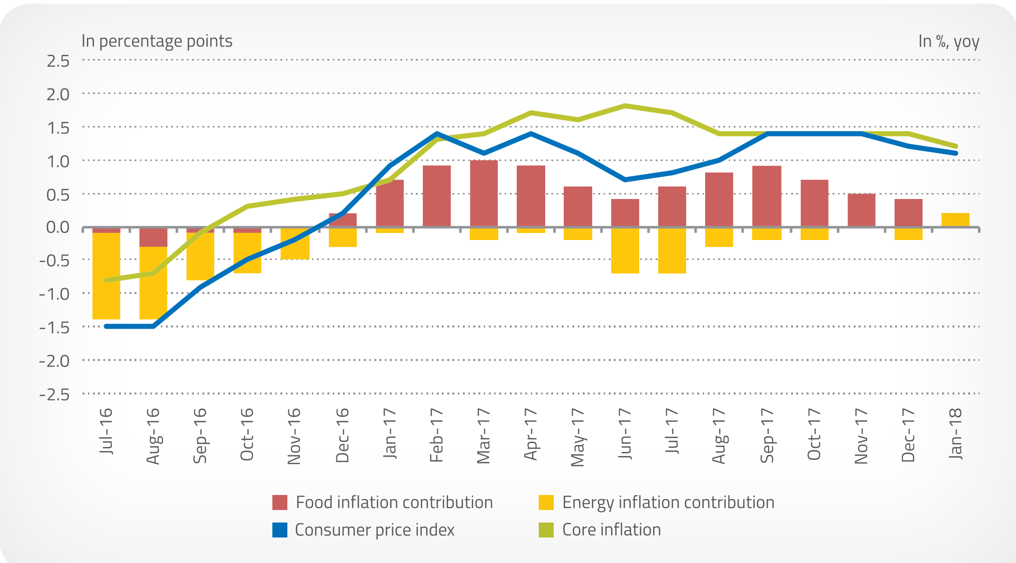
year, driven mostly by food price inflation. Although the data for January 2018 are suggesting abating food inflation, a trend we expect to see in the whole year due to base effects, energy inflation is moderately picking up also due to base effects but of the opposite sign, contributing overall to a positive price index (Figure 17). We believe that the core price inflation will be strongly supported in 2018, owing mostly to wage growth brought by internal demand recovery and a tight labor market. Due to these factors, consumer prices are expected to pick up this year, but only by 1.6 percent as ongoing Agrokor-related structural changes in the retail business continue to contribute negatively to inflation. For the following year, we see consumer price inflation at 1.8 percent, mostly due to further, but still rather limited GDP growth.

Strong kuna ahead

The Croatian National Bank (CNB) has been keeping the kuna money market exceptionally liquid lately, with interest rates hitting all-time lows. Meanwhile, the record-breaking tourism season also brought an ample foreign currency that altogether led to kuna appreciation pressures, leaving the average HRK/EUR rate below 7.50 in 2017. We see this scenario very much repeated in this and the following year with steadfast export growth and bright fiscal outlook supporting the kuna in the months ahead. Recent sovereign rating improvements as well as early talks on euro adoption could also be favorable for foreign currency inflows, thus appreciation-friendly as well. The average exchange rate in this year could

Figure 17
Consumer Price Index and the Contributions from Its Main Components

Sources: Croatian Bureau of Statistics and Croatian National Bank.



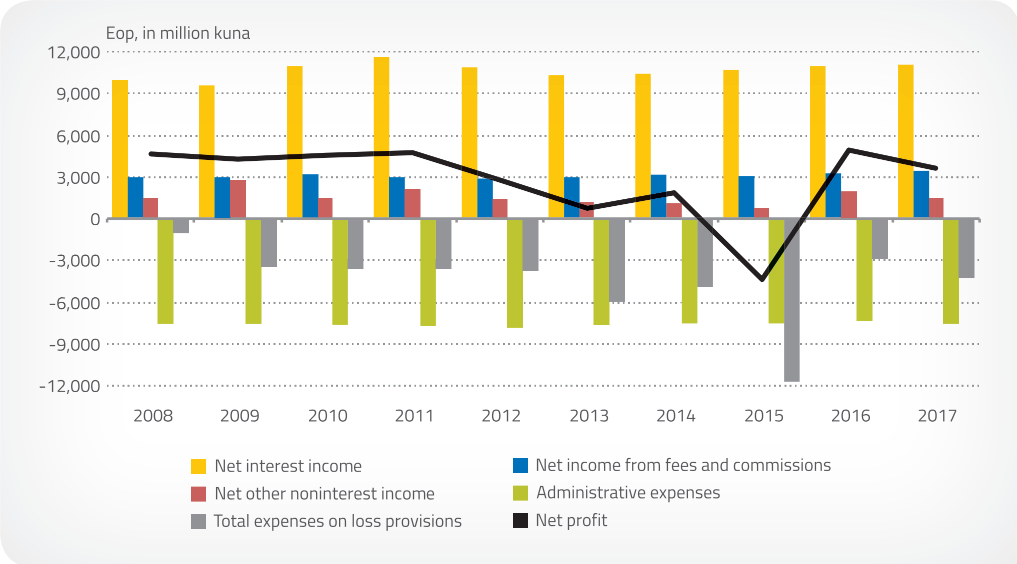


Figure 18
Bank Income and Profit

Source: Croatian National Bank.

end up at around 7.42, while in 2019 it could drop down even further to 7.40.

Banks profit diminished due to Agrokor

The amount of nonperforming loans (NPL) continued to decrease in 2017, and its share in total loans stood at 11.4 percent at the end of the year, or at 28 billion kuna. Unlike 2016, when lower NPLs translated into record-high bank profit, in 2017 the profit went south as it was hit by the Agrokor financial restructuring. Altogether, banking expenses on loss provisions increased by 1.6 billion kuna when compared to 2016, leading to a 27.3 percent drop in net profit, equivalent of 1.3 billion kuna (Figure 18). Despite the fact that in 2017 banks made significant Agrokor-related reservations for loss provisions, hardly any reservations were made for Agrokor suppliers. Therefore, it is possible that the settlement process brings second-round effects in which banks suffer additional expenses on loss provisions that will push down profits once again.

Creditless recovery

Total loans were on a recovery path in 2017, at least until October when an increased sale of irrecoverable claims on the secondary market led loans to enterprises once again into negative territory. On top of that, very strong government deleveraging in December, caused by state road companies debt refinancing, pushed down the total outstanding loan growth towards -4.7 percent in 2017. Household loan growth alone, which reflects a stronger labor market and state-subsidized

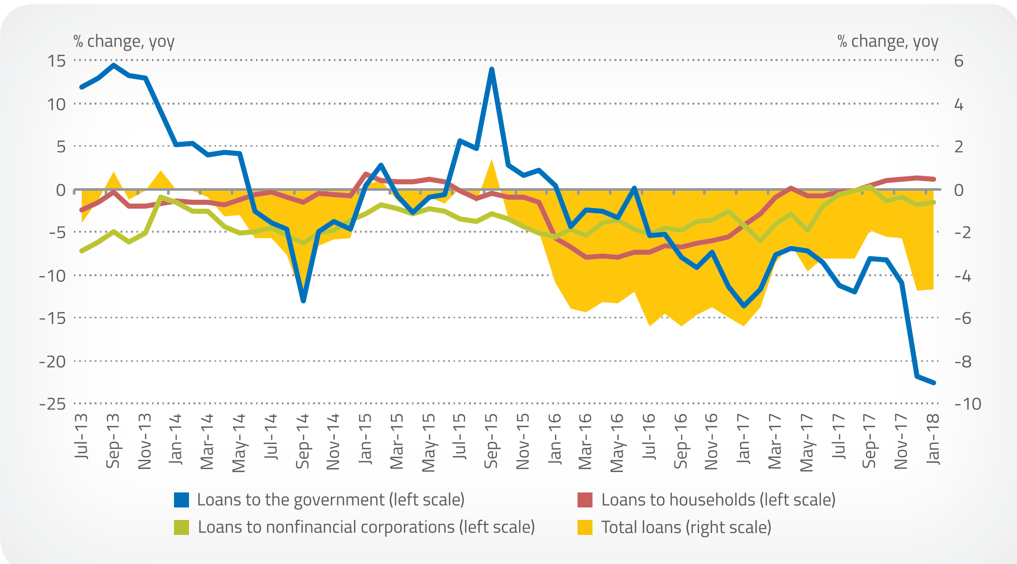


Figure 19
Total Domestic Credit

Source: Croatian National Bank.

Table 2 Main Economic Indicators

	2016	2017	2017			
			Q1	Q2	Q3	Q4
ECONOMIC ACTIVITY						
Real GDP (% change, yoy)	3.2	2.8	2.7	3.1	3.1	2.2
Real private consumption (% change, yoy)	3.5	3.6	3.5	3.8	3.7	3.4
Real government consumption (% change, yoy)	1.9	2.0	1.7	1.5	2.3	2.7
Real investment (% change, yoy)	5.3	3.4	5.2	3.2	3.5	1.8
Industrial output (% change, yoy)	5.3	1.4	2.3	1.2	2.9	-0.6
Unemployment rate (registered, %, pa)	14.8	12.4	15.0	11.9	10.8	12.0
Nominal GDP (EUR million)	46,406	48,695	10,676	12,231	13,754	12,046
GDP per capita (EUR)	11,117	11,803	-	-	-	-
PRICES, WAGES, AND EXCHANGE RATES						
Implicit GDP deflator (% change, yoy)	-0.1	1.2	0.5	1.0	1.6	1.7
Consumer prices (% change, yoy, pa)	-1.1	1.2	1.1	1.1	1.1	1.3
Producer prices (% change, yoy, pa)	-4.0	2.1	1.8	1.9	2.2	2.5
Average gross wage (% change, yoy, pa)	1.9	3.9	2.9	3.8	4.4	4.4
Exchange rate, HRK/EUR (pa)	7.53	7.46	7.47	7.43	7.42	7.53
Exchange rate, HRK/USD (pa)	6.80	6.62	7.02	6.76	6.32	6.40
FOREIGN TRADE AND CAPITAL FLOWS						
Exports of goods (EUR million)	12,317	13,983	3,382	3,344	3,463	3,795
Exports of goods (EUR, % change, yoy)	6.8	13.5	25.6	8.8	13.0	8.8
Imports of goods (EUR million)	19,712	21,808	5,228	5,653	5,598	5,329
Imports of goods (EUR, % change, yoy)	6.6	10.6	17.1	10.4	12.5	3.4
Current account balance (EUR million)	1,172	-	-1,529	154	3,868	-
Current account balance (% of GDP)	2.5	-	-14.3	1.3	28.1	-
Gross foreign direct investment (EUR million)	1,699	-	470	206	610	-
Foreign exchange reserves (EUR million, eop)	13,514	15,706	16,072	14,028	14,954	15,706
Foreign debt (EUR million, eop)	41,668	-	43,877	40,267	39,699	-
GOVERNMENT FINANCE[a]						
Revenue (HRK million)[b]	158,057	-	35,755	42,266	42,577	-
Expense (HRK million)[b]	152,715	-	36,862	38,387	36,947	-
Net = Gross operating balance (HRK million)[b]	5,342	-	-1,107	3,879	5,630	-
Net acquisition of nonfinancial assets (HRK million)[b]	8,086	-	1,091	1,618	1,572	-
Net lending/borrowing (HRK million)[b]	-2,744	-	-2,198	2,261	4,058	-
Domestic government debt (EUR million, eop)	23,895	-	25,054	24,741	24,873	-
Foreign government debt (EUR million, eop)	14,354	-	15,297	14,059	14,025	-
Total government debt (eop, % of GDP)	82.9	-	-	-	-	-
MONETARY INDICATORS						
Narrow money, M1 (% change, yoy, eop)	18.1	19.1	21.1	18.1	21.0	19.1
Broad money, M4 (% change, yoy, eop)	4.2	2.9	3.7	3.1	3.9	2.9
Total domestic credit (% change, yoy, eop)	-6.0	-4.7	-3.4	-3.2	-1.9	-4.7
DMBs credit to households (% change, yoy, eop)	-5.5	1.2	-0.9	-0.8	0.4	1.2
DMBs credit to enterprises (% change, yoy, eop)	-2.6	-1.9	-4.1	-2.0	0.3	-1.9
Money market interest rate (%, pa)[c]	0.5	0.4	0.4	0.4	0.4	0.4
DMBs credit rate for households, short-term, (%, pa)[d]	8.0	7.5	7.8	7.7	7.4	7.2
DMBs credit rate for enterprises, short-term (%, pa)[d]	4.7	4.3	4.6	4.5	4.4	3.9

Notes: [a] Data refer to consolidated general government. [b] On the cash principle. [c] Interbank demand deposit trading, one week interest rate. [d] The weighted average interest rate on new kuna and foreign currency indexed loan agreements, revised data.
Conventional abbreviations: pa – period average, eop – end of period, yoy – year-on-year, HRK – Croatian kuna, EUR – euro, USD – U.S. dollar, DMB – deposit money bank.
Sources: Croatian Bureau of Statistics, Croatian National Bank, and Ministry of Finance.

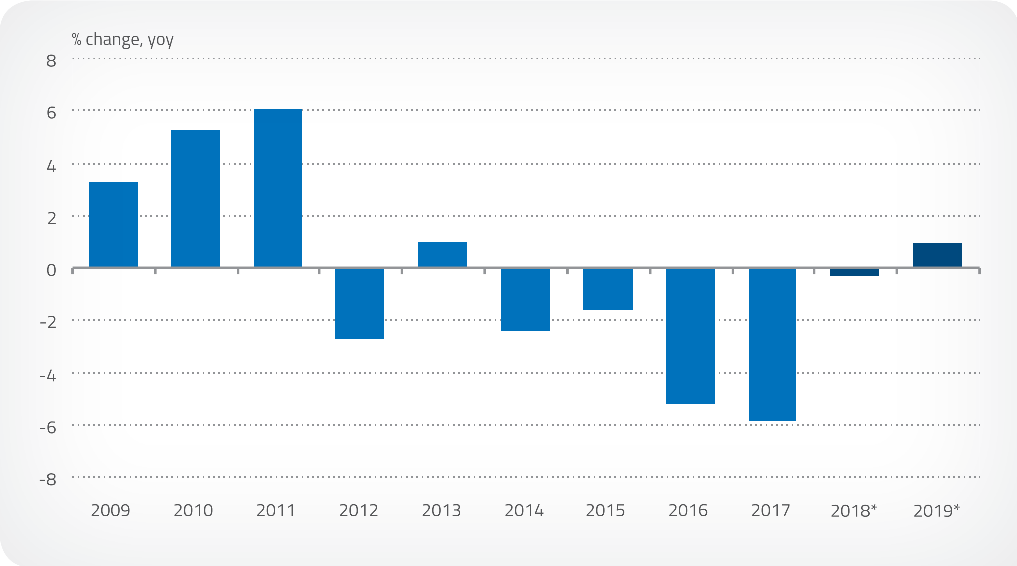


Figure 20
Total Domestic Credit

Note: * represents EIZ forecasts.

Sources: Croatian National Bank and EIZ for forecast.

housing loans program that was introduced during summer, was not enough to offset the negative trend (Figure 19). Although robust wage growth, GDP recovery, and stimulatory loan financing conditions manifested in low interest rates will favor loan growth, sovereign deleveraging could be the culprit of another year of a negative loan growth rate. By the end of the year, we see loans growth set at -0.3 percent, before speeding up to 0.9 percent in the next year as aggregate demand and GDP make a further recovery (Figure 20).

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