

CROATIA

Table 1 **2022**

| | |
|--|---------|
| Population, million | 3.9 |
| GDP, current US\$ billion | 70.5 |
| GDP per capita, current US\$ | 18282.6 |
| International poverty rate (\$2.15) ^a | 0.3 |
| Lower middle-income poverty rate (\$3.65) ^a | 0.8 |
| Upper middle-income poverty rate (\$6.85) ^a | 2.1 |
| Gini index ^a | 29.6 |
| School enrollment, primary (% gross) ^b | 92.9 |
| Life expectancy at birth, years ^b | 76.4 |
| Total GHG emissions (mtCO2e) | 20.2 |

Source: WDI, Macro Poverty Outlook, and official data.

a/ Most recent value (2020), 2017 PPPs.

b/ WDI for School enrollment (2020); Life expectancy (2021).

Croatia's economy remained on an expansion path in the first half of 2023 supported by robust private consumption and buoyant demand for travel services. Over the forecast horizon, economic growth is expected to stay close to 3 percent as inflation moderates, and the external outlook improves. Steady growth and a declining need for fiscal support are expected to keep the fiscal deficit contained and public debt on a declining path. Poverty in 2023 is expected to decline to 1.3 percent.

Key conditions and challenges

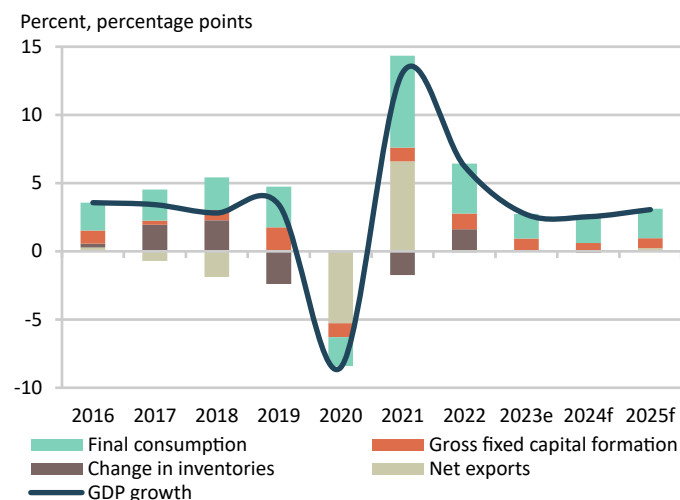
Despite significant headwinds coming from high inflation, monetary tightening, and faltering external demand for goods, Croatia's process of economic convergence continues, with GDP per capita (in PPP terms) in 2022 reaching 73 percent of the average EU27 level. The country has recorded the highest post-pandemic recovery of all EU member states (with notable exception of Ireland). The country's solid performance largely reflects post-Covid revival of global demand for travel, but also robust goods exports and personal consumption. However, as pent-up demand for services in tourism is unlikely to be sustained in the medium to long run, it will be crucial to address key structural issues that will support productivity and long-term growth acceleration. These are linked to low levels of Research and Development (R&D) investments, innovation and technology adoption, weaknesses in managerial and organizational practices, administrative capacity and judicial quality and efficiency. In addition, given unfavorable demographic trends and a tight labor market, improvements in education and labor market policies will be necessary to increase labor supply and improve the quality of human capital. Over the medium term, the elevated uncertainty linked to Russia's invasion of Ukraine and developments in energy and food commodity prices remain the key risk

to the outlook as additional price shocks would dampen both domestic and external demand. Furthermore, the full effect of higher interest rates and monetary tightening is yet to feed through the economy increasing the vulnerabilities in non-financial sector and potential risks for financial stability. At the same time, price pressures might prove to be more persistent, leading to adverse real income and confidence effects. On the upside, economic stimulus coming from fiscal policy might be stronger than anticipated in light of the upcoming parliamentary elections next year.

Recent developments

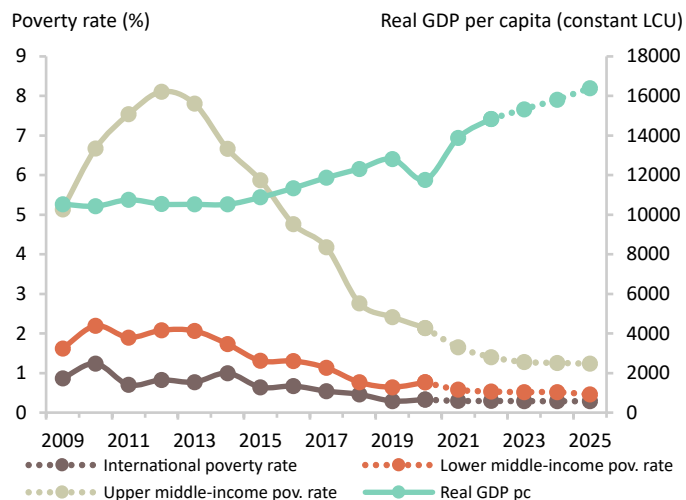
Croatia's economy further expanded in the first half of 2023, mainly owing to recovery of personal consumption and strong growth of tourism. In this period annual real GDP growth rate averaged 2.7 percent, well above EU average of 0.6 percent. Personal consumption recovered after a marked decline at the end of the last year following favorable labor market developments and recovery in consumer optimism. Furthermore, performance of export of services was also strong with foreign tourists' arrivals and overnight stays increasing on average on an annual basis by more than 10 percent. Investment growth was relatively suppressed but business optimism in the construction sector remains high and it improved further at the beginning of Q3. On the other hand, export of goods declined, partly due to the weakening of economic activity in some

FIGURE 1 Croatia / Real GDP growth and contributions to real GDP growth



Sources: CROSTAT and World Bank.

FIGURE 2 Croatia / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see Table 2.

of Croatia's main trading partners. Fiscal policy continued to play an important role in supporting economic activity by extending measures aimed at easing inflationary pressures. Inflation, albeit declining, remains high and, at 8.5 percent in August was the second highest in the eurozone. The ECB continued to increase key interest rates which also had an impact on financing conditions in Croatia. However, this impact was less pronounced compared to other euro area countries reflecting declining country risk premia, high bank liquidity, strong deposit base, and relatively low share of credits with variable interest rates.

The combination of strong economic growth and the rebound of the labor market improved household total income. However, high inflation eroded household real purchasing power. Poverty is estimated to have declined modestly from 1.4 percent in 2022 to 1.3 percent in 2023. Preliminary findings from the World Bank rapid assessment survey in June 2023 showed that one in every two Croatian households (and 75 percent among the bottom

40 percent of the income distribution) reported having some difficulty to make ends meet with their current income.

Outlook

Economic activity growth is expected to moderate in the second half of 2023, as demand for tourism services slows down and goods exports remain suppressed. Nonetheless, thanks to the relatively strong performance during the first six months, real GDP is set to grow by 2.7 percent in 2023, and growth is expected to take a slight uptick by the end of the forecast horizon. Personal consumption is projected to remain robust, as recovery in real incomes continues due to falling inflation and strong labor demand. Furthermore, EU funds are expected to continue supporting investment activity, especially government investments, while private sector investment growth might slow in the near term before strengthening towards the end of the forecast horizon as

monetary policy normalizes. Exports of goods, after a sluggish performance in 2023, are expected to pick up in 2024 and 2025 as external demand strengthens, while, on the other hand, growth of exports of services might become more moderate after strong results in the 2021-2023 period. Inflation is expected to remain elevated over the near term but could decline towards the ECB target of close to 2 percent by the end of the forecast horizon, following monetary measures implemented since end-2021, unwinding of global supply bottlenecks, and easing of commodity price growth. The fiscal deficit is set to remain contained, as growth continues and the need for fiscal support declines. This will allow for further reduction in public debt which is expected to fall below 60 percent of GDP by the end of 2025.

Looking ahead, about 20 percent of Croatian households, and more than 30 percent of those in the bottom 40 expressed a pessimistic view of their financial prospect, according to the World Bank survey in June. Poverty is projected to decline marginally to 1.2 percent by 2025.

TABLE 2 Croatia / Macro poverty outlook indicators

(annual percent change unless indicated otherwise)

| | 2020 | 2021 | 2022 | 2023e | 2024f | 2025f |
|--|-------|------|------|-------|-------|-------|
| Real GDP growth, at constant market prices | -8.5 | 13.1 | 6.2 | 2.7 | 2.5 | 3.0 |
| Private consumption | -5.1 | 9.9 | 5.1 | 2.2 | 2.5 | 2.8 |
| Government consumption | 4.3 | 3.0 | 3.2 | 2.6 | 2.8 | 2.7 |
| Gross fixed capital investment | -5.0 | 4.7 | 5.8 | 4.7 | 3.1 | 3.5 |
| Exports, goods and services | -23.3 | 36.4 | 25.4 | -1.0 | 4.2 | 5.0 |
| Imports, goods and services | -12.4 | 17.6 | 25.0 | -0.9 | 4.2 | 4.5 |
| Real GDP growth, at constant factor prices | -7.5 | 12.6 | 6.4 | 2.7 | 2.5 | 3.0 |
| Agriculture | -0.2 | 8.2 | 6.0 | -0.2 | 3.5 | 3.5 |
| Industry | -4.1 | 9.0 | 2.3 | 1.2 | 3.0 | 3.0 |
| Services | -9.1 | 14.2 | 7.9 | 3.3 | 2.3 | 3.0 |
| Inflation (consumer price index) | 0.0 | 2.7 | 10.7 | 8.4 | 3.9 | 2.3 |
| Current account balance (% of GDP) | -0.5 | 1.8 | -1.6 | -0.6 | -0.8 | -0.7 |
| Net foreign direct investment inflow (% of GDP) | 1.4 | 4.8 | 5.6 | 3.7 | 3.7 | 3.7 |
| Fiscal balance (% of GDP) | -7.3 | -2.5 | 0.4 | -1.1 | -1.3 | -1.1 |
| Revenues (% of GDP) | 46.8 | 46.2 | 45.5 | 44.3 | 43.7 | 43.6 |
| Debt (% of GDP) | 86.9 | 78.3 | 68.8 | 62.8 | 60.2 | 58.3 |
| Primary balance (% of GDP) | -5.3 | -0.9 | 1.8 | 0.2 | -0.1 | 0.2 |
| International poverty rate (\$2.15 in 2017 PPP)^{a,b} | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Lower middle-income poverty rate (\$3.65 in 2017 PPP)^{a,b} | 0.8 | 0.6 | 0.5 | 0.5 | 0.5 | 0.5 |
| Upper middle-income poverty rate (\$6.85 in 2017 PPP)^{a,b} | 2.1 | 1.7 | 1.4 | 1.3 | 1.3 | 1.2 |
| GHG emissions growth (mtCO₂e) | -5.6 | 13.2 | 5.7 | 0.2 | 0.4 | 0.7 |
| Energy related GHG emissions (% of total) | 88.3 | 88.8 | 88.6 | 88.1 | 87.6 | 87.2 |

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.

Notes: e = estimate, f = forecast.

a/ Calculations based on ECAPOV harmonization, using 2021-EU-SILC. Actual data: 2020. Nowcast: 2021-2022. Forecasts are from 2023 to 2025.

b/ Projection using neutral distribution (2020) with pass-through = 0.87 (Med (0.87)) based on GDP per capita in constant LCU.