

Croatia



The Croatian coalition government is led by the centre-right Croatian Democratic Union (HDZ), whose leader, Ivo Sanader, resigned in May 2009 to be replaced as premier by Jadranka Kosor. This resignation has intensified some of the key challenges facing the government, which include addressing the economic crisis. Unblocking stalled negotiations regarding EU accession is the country's primary foreign policy goal, despite a poll carried out in February 2009 that showed a lack of public enthusiasm about the EU. Accession negotiations are currently being held up by neighbouring Slovenia due to an ongoing bilateral border dispute.

Croatia's population of 4.5 million people has settled following the large fluctuations caused by the 1991 – 95 conflict. Today, a falling birth rate is being compensated by inward migration, including that of ethnic Croats from Bosnia & Herzegovina, which would otherwise mean an annual population decline of some 10,000. Some 48.5% of the population aged 15 and over is economically active, and unemployment stood at 13.5% in 2008 despite a fall of 0.9% during the year. Following an increase in unemployment in early 2009, it fell again in the second quarter – possibly due to an increase in tourism activity – which might boost flagging consumer demand during 2009.

With broad cross-party support for EU integration, the Croatian government is committed to its programme of EU-mandated reforms, which has now reached politically sensitive sectors of the economy such as agriculture, fishing and steel. It is planning to introduce a number

of measures which will enable completion of the negotiations' technical phase during 2009 or early 2010.

The global economic slowdown has, however, forced the government to revise its 2009 budget due to a significant fall in revenues which saw tax receipts fall by 17% year-on-year in the first quarter of 2009. While it has already introduced a range of expenditure cuts, it intends to keep spending at a level that provides some support for the economy. Despite these cuts, falling GDP – which is expected to contract by some 4% during 2009 (after a sluggish growth of 0.2% in 2008) due to a decline in the real estate sector, an expected contraction in investment activity, and an increasingly gloomy export situation, will lead to a larger 2009 budget deficit.



In addition, the global credit squeeze and declining asset values mean that privatisation revenue is not expected to contribute significantly to public finances during 2009.

Despite these challenges, and concern expressed by the IMF about Croatia's external debt, the government and the Croatian National Bank (CNB) currently deny the need for the IMF funding.



This situation may change, however, despite the government's success in May 2009 in raising EUR 750 million through the issue of Eurobonds to cover public sector payments due in the second half of the year.

The CNB is taking action to ensure liquidity in the domestic market and prevent the economy from shrinking, including a reduction in minimum reserve requirements. By holding regular repurchase agreement auctions, it is also helping improve the liquidity of commercial banks and reduce the upward pressure on money market interest rates. The CNB is also keen to control the liquidity of the Croatian currency, the Kuna, to below a level which would undermine its strength. While the Kuna saw some significant appreciation in 2008 to average 7.2 against the Euro, it is expected to depreciate to an average of 7.4 in 2009. There is also a risk of

steeper depreciation, however, particularly if investor insecurity grows as a result of increased anxieties about the economy. Managing the Kuna's volatility remains the CNB's main monetary policy, matching domestic interest rates and money supply with the inflation expectations of the currencies of Croatia's main trading partners (chiefly the Euro and US Dollar).

In 2008, while exports rose by 6.1% to EUR 19.5 billion, imports growth was still significantly higher by 8.2% at EUR 23.4 billion causing the trade balance to widen further to reach 9.6% of GDP compared to 7.5% of GDP in 2007.

By May 2009, industrial production had fallen for seven consecutive months, driven by reduced domestic consumption and foreign demand. This was mainly manifested in lower production of consumer durables, as well as reductions in capital goods, intermediate goods, non-durable consumer goods and energy. While March and April 2009 saw some recovery in month-on-month retail sales volumes, the year-on-year figures remained negative. Falling incomes, difficulty in gaining credit and eroded consumer confidence continue to make a rapid recovery unlikely.

As part of its activities to fulfil the conditions necessary to negotiate on market competition with the EU, the government has reached agreement with the European Commission on the sale of six shipyards that between them account for 15% of Croatia's annual exports and employ 11,500 people. Four of these – Brodosplit, Brodotrogir, 3rd May and Kraljevica – will be offered at the initial symbolic price of one Kuna, and the Split yard for special building projects will also be sold at a symbolic price. For the profitable Uljanik yard, 25% of shares will be sold to employees at a reduced price, and 59.3% to a strategic investor at a nominal price of HRK 400 million (EUR 54 million). The government requires the investor to commit to investing in new technology and taking over some of the obligations currently covered by government guarantees.

Croatia	2005/2007 Average Values	2007-2008	2008
	Change (%)	Change (%)	
Population (mil.)	0.0	0.0	4.5
Average monthly gross wage (EUR)	8.3	8.4	1068.3
EUR Exchange rate vis-à-vis	-1.5	0.5	7.4
USD Exchange rate vis-à-vis	-3.2	5.0	5.3
	Real change (%)	Real change (%)	EUR mil.
GDP	4.4	0.2	46,457
Private consumption	4.7	0.8	27,453
Public consumption	2.3	1.9	8,624
Gross fixed capital investments	7.4	8.2	12,801
Exports (goods and services)	4.8	1.7	19,469
Imports (goods and services)	5.9	3.6	23,359
	Nominal change (EUR mil.)	Nominal change (EUR mil.)	EUR mil.
Trade balance	-404	-737	-3,905
Current account balance	-601	-1,218	-4,454
General government balance	-190	-476	-608
General government gross debt	697	-716	13,487
External debt	942	848	10,247
Foreign currency reserves	957	-186	9,120
	Percentage point change	Percentage point change	%
Economic activity rate	-0.8	-0.4	48.5
Unemployment rate	-1.4	-0.9	13.5
CPI rate (previous year = 100%)	1.0	-3.0	2.8
Central bank interest rate	1.4	1.9	6.0
1-year yield on Treasury Bill	-0.3	2.9	7.9
10-year yield on Treasury Bond	n/a	n/a	6.0

Sources used: Reuters EcoWin Pro

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