Euler Hermes Economic Research

Country Report

Croatia

Improving fiscal deficits lower overall external liquidity risk

General Information

GDP	USD48.7bn (World ranking 81, World Bank 2015)
Population	4.2mn (World ranking 127, World Bank 2015)
Form of state	Parliamentary Democracy
Head of government	Andrej PLENKOVIC (prime minister)
Next elections	2019, presidential

Strengths

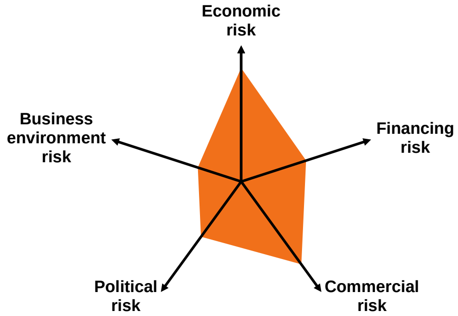
- Good international relations; EU membership
- Exchange rate stability thanks to "managed float"
- Current account surpluses since 2013
- Low inflation
- Solid fiscal consolidation since 2015

Weaknesses

- Vulnerability to EU business cycle
- Ongoing private sector credit contraction as a result of bank deleveraging
- Public debt remains high despite fiscal consolidation since 2015
- Very high external debt
- Considerable refinancing risk of companies and banks

Country Rating

C3



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports		Rank		Imports
Slovenia	14%	1	13%	Germany
Italy	11%	2	13%	Italy
Bosnia and Herzegovina	10%	3	10%	Slovenia
Germany	10%	4	8%	Hungary
Serbia and Montenegro	7%	5	7%	Austria

By product (% of total)

Exports		Rank		Imports
Refined Petroleum Products	7%	1	7%	Crude Oil
Pharmaceuticals	6%	2	6%	Refined Petroleum Products
Miscellaneous Hardware	4%	3	4%	Electricity
Non-Edible Agricultural Prod.	4%	4	4%	Plastic Articles
Electricity	4%	5	4%	Leather

Source: Chelem (2015)

Economic Overview

Growth set to remain robust

Following a six-year lasting recession, real GDP grew by +2.2% in 2015, +3% in 2016 and +2.5% y/y in Q1 2017 (calendar-adjusted by +0.6% q/q and +3.4% y/y). Growth in 2016 was broad-based, with private consumption up by +3.3%, government consumption +1.3% and rebounding fixed investment +5.4%. Exports expanded by +5.7% and imports +5.8% so that net exports were nearly neutral. That pattern broadly continued in Q1 2017. Troubles facing Croatia's largest private company, Agrokor, are likely to weigh on growth, but the company's operations are expected to continue. We forecast full-year GDP growth to ease slightly to +2.9% in 2017 and +2.7% in 2018.

Inflation is back in positive territory

Monetary policy is based on a "managed" exchange rate float which has helped insulate the economy from overly inflationary pressures in the past. The HRK has faced frequent downward pressure in previous years but these have waned more recently as the economy has begun to improve. Meanwhile, consumer price inflation has left deflationary territory at end-2016, after almost three years, and reached +1.4% y/y in April 2017, in line with rising energy prices. We expect inflation to remain in the 1% to 2% range in 2017-2018.

Public finances have surprised positively

The extended recession weakened public finances markedly, with public debt more than doubling from 40% of GDP in 2008 to 87% in 2014 as fiscal deficits exceeded -5% of GDP year after year. But the deficit narrowed rapidly to -0.8% in 2016 thanks to revenues benefiting from the growth rebound and fiscal restraint. We expect the shortfall to remain in check in 2017-2018, enabling a gradual decline of public debt to 82% of GDP by end-2018.

External position remains mixed

The current account has been in surplus since 2013, recording +2.6% of GDP in 2016, and should remain so in 2017-2018. However, total external debt, although declining, remains comparatively high (91% of GDP in 2016), a result of the legacy of large current account deficits in the past. The external debt-service ratio is hefty, forecast at around 50% in 2017, reflecting huge debt amortization obligations that are likely to constrain financing for private investment.

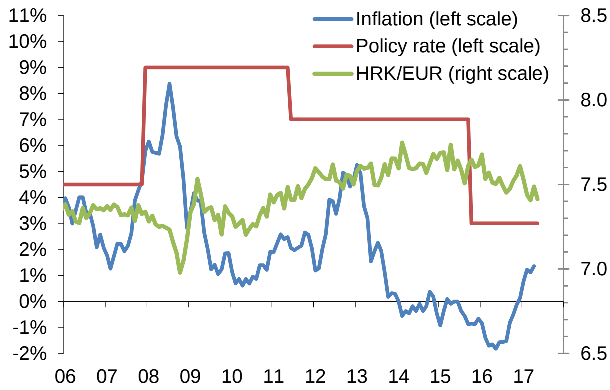
Current FX reserves cover over 7 months of imports (good) but only 94% of the estimated external debt payments falling due in the next 12 months. While this is up from 87% a year ago, it is still well below an adequate level of at least 125%.

Key economic forecasts

	2015	2016	2017f	2018f
GDP growth (% change)	2.2	3.0	2.9	2.7
Inflation (%, end-year)	-0.6	0.2	1.3	2.0
Fiscal balance (% of GDP)	-3.4	-0.8	-1.5	-2.0
Public debt (% of GDP)	86.7	84.2	83.0	82.0
Current account (% of GDP)	4.8	2.6	2.0	1.5
External debt (% of GDP)	103.4	91.4	90.0	89.0

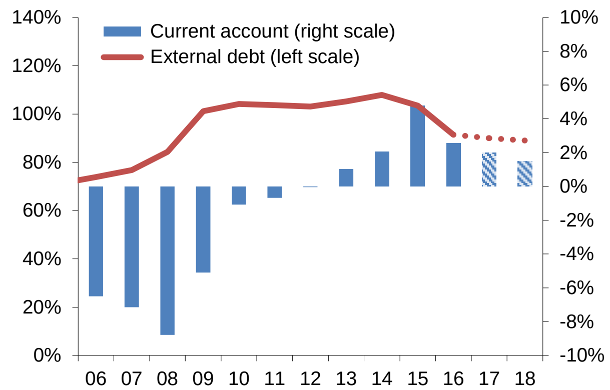
Sources: National sources, IMF, IHS, Euler Hermes

Inflation rate (%), monetary policy interest rate (%), and exchange rate



Sources: National sources, IHS, Euler Hermes

Current account and external debt (% of GDP)



Sources: National sources, Euler Hermes

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Country Risk Analyst:
Manfred Stamer
manfred.stamer@eulerhermes.com