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Macroeconomic Developments and Outlook

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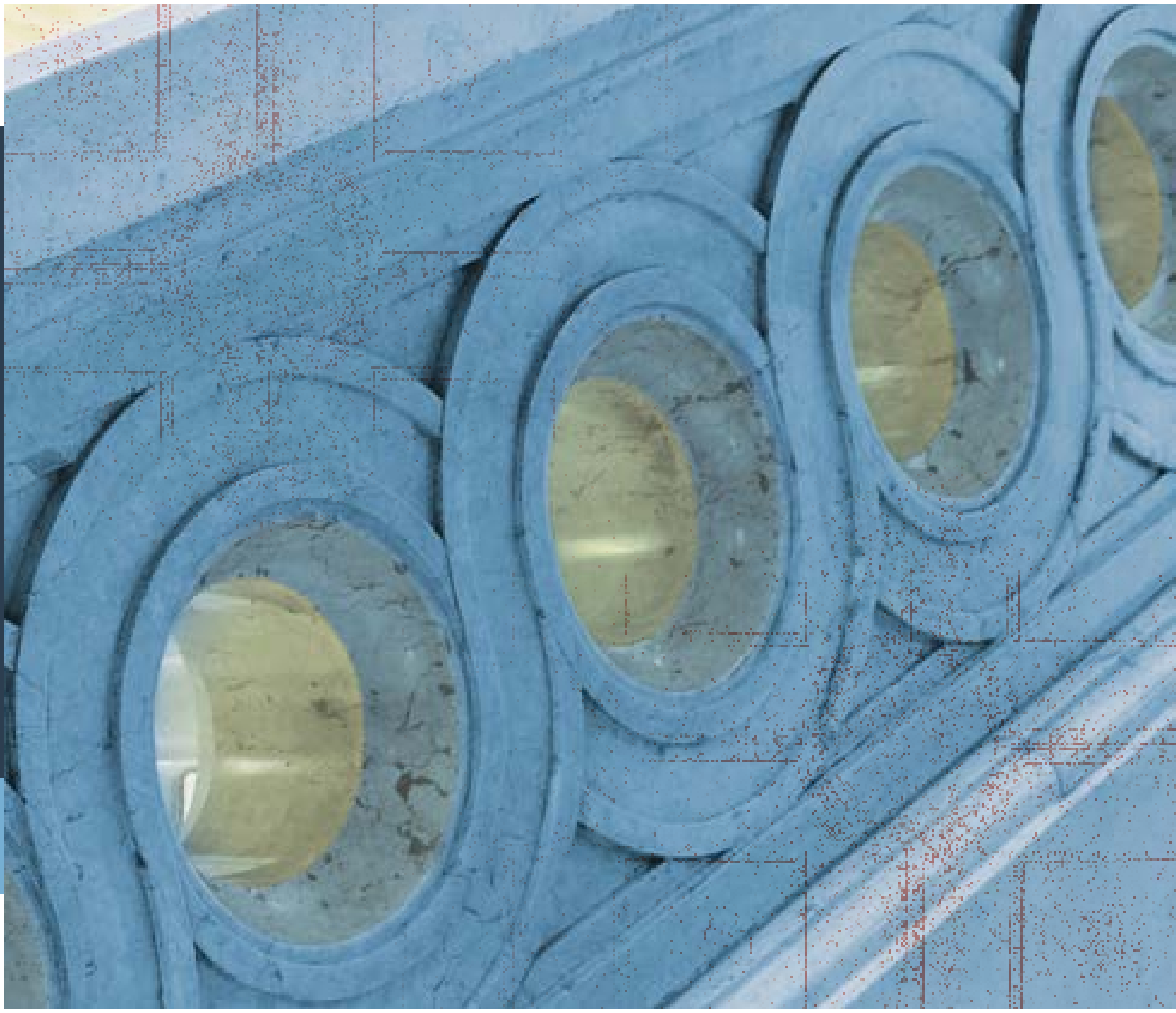

CROATIAN NATIONAL BANK

PUBLISHER

Croatian National Bank
Trg hrvatskih velikana 3, 10000 Zagreb
Phone: +385 1 45 64 555
Contact phone: +385 1 45 65 006
Fax: +385 1 45 64 687

www.hnb.hr

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Contents

General information on Croatia ii

1 Introduction 3

2 Global developments 5
Croatia's main trading partners 6
Prices, exchange rates and monetary and fiscal policy 6
Projected developments 6

3 Aggregate supply and demand 9
Aggregate demand 9
Aggregate supply 11
Projected developments 12
Box 1 Assessing the impact of assumptions about tourism trends on GDP growth forecasts 13
Box 2 Coronavirus and inequalities – insights from the Consumer Confidence Survey 15
Box 3 Household savings in the time of pandemic 17

4 Labour market 19
Employment and unemployment 19
Wages and unit labour costs 21
Projected developments 21

5 Inflation 22
Inflationary expectations 24
Projected developments 24

6 Current and capital account 25
Foreign trade and competitiveness 26
Income and transactions with the EU 27
Projected developments 28
Box 4 Trade in goods – developments during the pandemic 29

7 Private sector financing 32
Projected developments 36

8 Foreign capital flows 37
Projected developments 38

9 Monetary policy 39

10 Public finance 41
General government budget balance 41
Public debt 42
Estimates and projections of fiscal figures under the Convergence Programme of the Republic of Croatia 43

11 Deviations from the previous projection 44

12 Annex A: Macroeconomic projections of other institutions 46

13 Annex B: Comparison of Croatia and selected countries 46

Abbreviations and symbols 51

General information on Croatia

Economic indicators

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Area (square km)	56,594	56,594	56,594	56,594	56,594	56,594	56,594	56,594	56,594	56,594	56,594
Population (million)[a]	4.290	4.280	4.268	4.256	4.238	4.204	4.174	4.125	4.088	4.065	4.047
GDP (million HRK, current prices)[b]	329,432	334,194	331,014	331,990	331,322	339,663	351,197	367,501	385,377	402,332	371,517
GDP (million EUR, current prices)	45,213	44,954	44,033	43,835	43,423	44,636	46,644	49,262	51,979	54,269	49,318
GDP per capita (in EUR)	10,539	10,503	10,317	10,300	10,246	10,618	11,174	11,942	12,716	13,349	12,186
GDP – real year-on-year rate of growth (in %)	–1.3	–0.2	–2.4	–0.4	–0.3	2.4	3.5	3.4	2.8	2.9	–8.0
Average year-on-year CPI inflation rate	1.1	2.3	3.4	2.2	–0.2	–0.5	–1.1	1.1	1.5	0.8	0.1
Current account balance (million EUR)[c]	–974	–764	–788	–464	113	1,472	1,026	1,709	946	1,649	–179
Current account balance (as % of GDP)	–2.2	–1.7	–1.8	–1.1	0.3	3.3	2.2	3.5	1.8	3.0	–0.4
Exports of goods and services (as % of GDP)	36.2	38.7	39.5	40.4	43.3	46.4	47.7	50.0	50.2	52.0	42.8
Imports of goods and services (as % of GDP)	37.8	40.5	41.1	42.4	43.7	46.1	46.5	49.3	51.0	52.2	49.5
External debt (million EUR, end of year)[c]	49,515	49,198	47,624	48,622	49,468	48,340	44,678	43,553	42,589	40,285	40,083
External debt (as % of GDP)	109.5	109.4	108.2	110.9	113.9	108.3	95.8	88.4	81.9	74.2	81.3
External debt (as % of exports of goods and services)	302.8	282.5	273.7	274.5	262.9	233.2	200.8	176.9	163.2	142.6	190.1
External debt service (as % of exports of goods and services)[d]	51.2	42.5	46.1	43.4	46.3	44.0	35.7	33.0	27.0	37.7	35.0
Gross international reserves (million EUR, end of year)	10,660	11,195	11,236	12,908	12,688	13,707	13,514	15,706	17,438	18,560	18,943
Gross international reserves (in terms of months of imports of goods and services, end of year)	7.5	7.4	7.5	8.3	8.0	8.0	7.5	7.8	7.9	7.9	9.3
National currency: kuna (HRK)											
Exchange rate on 31 December (HRK : 1 EUR)	7.3852	7.5304	7.5456	7.6376	7.6615	7.6350	7.5578	7.5136	7.4176	7.4426	7.5369
Exchange rate on 31 December (HRK : 1 USD)	5.5683	5.8199	5.7268	5.5490	6.3021	6.9918	7.1685	6.2697	6.4692	6.6499	6.1390
Average exchange rate (HRK : 1 EUR)	7.2862	7.4342	7.5173	7.5735	7.6300	7.6096	7.5294	7.4601	7.4141	7.4136	7.5331
Average exchange rate (HRK : 1 USD)	5.5000	5.3435	5.8509	5.7059	5.7493	6.8623	6.8037	6.6224	6.2784	6.6223	6.6108
Consolidated general government net lending (+)/borrowing (–) (million HRK)[e]	–21,305	–26,607	–18,252	–18,442	–18,346	–11,750	–3,303	2,796	863	1,199	–27,499
Consolidated general government net lending (+)/borrowing (–) (as % of GDP)[e]	–6.5	–8.0	–5.5	–5.6	–5.5	–3.5	–0.9	0.8	0.2	0.3	–7.4
General government debt (as % of GDP)[e]	57.7	64.3	70.1	81.2	84.8	84.3	80.8	77.6	74.3	72.8	88.7
Unemployment rate (ILO, persons above 15 years of age)	11.6	13.7	15.9	17.3	17.3	16.2	13.1	11.2	8.4	6.6	7.5
Employment rate (ILO, persons above 15 years of age)	46.5	44.8	43.2	42.1	43.3	44.2	44.6	45.8	46.9	47.7	47.2

[a] The population estimate of the Republic of Croatia for 2000 is based on the 2001 Census and that for the 2001-2019 period on the 2011 Census. Data for 2020 are preliminary.
[b] The GDP data are presented according to the ESA 2010 methodology. Data for 2019 and 2020 are preliminary.
[c] Balance of payments and external debt data are compiled in accordance with the methodology prescribed by the sixth edition of the Balance of Payments and International Investment Position Manual (BPM6) and the new sector classification of institutional units in line with ESA 2010. Balance of payments and external debt data are based on the most recent available balance of payments data up to the fourth quarter of 2020 and data on the gross external debt position as at the end of March 2021.
[d] Includes principal payments on bonds, long-term trade credits and long-term loans (excluding liabilities to affiliated enterprises), as well as total interest payments (including FISIM), without interest payments on direct investment.
[e] Fiscal data is shown according to the ESA 2010 methodology.
Sources: CBS, MoF and CNB.

Macroeconomic Developments and Outlook

1 Introduction

Current economic trends were positive late last year and early this year, although the coronavirus pandemic had not ended. In such circumstances, and under the assumption that this year's tourist season will be better than last year, real GDP could increase by 6.8% in the whole of 2021 or about one percentage point more than projected in April. Gross domestic product is expected to continue relatively strong growth in 2022 too, although at a slower pace (4.4%) due to the disappearance of the base effect resulting from the strong contraction of economic activity in mid-2020. Personal consumption could record stronger growth this year due to the continued relaxation of pandemic containment measures with regard to some services and increases in employment and wages, which will bring about an improvement in consumer optimism and boost household borrowing. Gross fixed capital formation could grow at a higher rate, primarily due to the intensification of reconstruction works in earthquake-hit areas, a favourable position in the cycle of withdrawal of EU funds and the use of funds from the Next Generation EU recovery plan. The uncertainty surrounding the pandemic will remain, so that risks to economic growth are mainly tilted to the downside. The average annual consumer price inflation rate is expected to accelerate to 1.7% in 2021, primarily reflecting energy prices (in particular refined petroleum product prices) remaining at the high level reached in the first half of the year. Inflation could slow down slightly to 1.5% in 2022, mainly as a result of the expected decrease in the annual growth rate of energy prices. The current and capital account surplus could increase significantly in 2021 from the previous year, primarily as a result of the strong recovery of tourism revenues and the continued strengthening of the uptake of EU funds, and continue to grow slightly in 2022. Consequently, relative external debt indicators are expected to continue improving. In the first half of 2021, the CNB continued to pursue a highly expansionary monetary policy, maintaining the stability of the kuna to euro exchange rate and ensuring favourable domestic financing conditions. Banks' free reserves thus reached a record high in June, which contributed to reducing financing costs and keeping most interest rates at historically low levels, similar to those before the pandemic outbreak. The growth of household placements saw a slight recovery in the first half of 2021, which could primarily be attributed to the continued several-year acceleration in the growth of housing loans, while the growth of corporate placements decelerated. According to the latest amendments to the 2021 budget, the general government budget deficit could amount to 3.8% of GDP in the current year and continue to decrease in 2022. The general government debt-to-GDP ratio, following a steep increase in 2020, should resume its downward path in 2021 and 2022.

Despite the ongoing vaccination drive and the relaxation of containment measures, the further course of the coronavirus pandemic and its impact on economic developments are still uncertain. Current economic trends were positive late last year and at the beginning of this year. Economic activity decreased by 0.7% annually from the first quarter of the previous year as a result of a drop in the exports of services and personal consumption, while investments and goods exports grew from the same period in the previous year. Goods imports also decreased, whereas services imports increased. Economic activity is assessed to have edged up in the second quarter from the beginning of the year, which is to be translated into a very high (double figure) annual growth rate of real GDP due to a base effect stemming from a steep decrease in GDP in the same period last year. Real GDP is expected to grow by 6.8% in 2021, a quantification that primarily reflects expectations of a strong recovery of tourist demand after the pandemic-induced decline in the previous year. As regards domestic demand components, the largest contribution to economic growth could come from a rise in personal consumption resulting from the lifting of the ban on the consumption of some services imposed to contain the spread of the pandemic, and from the growth of employment and wages, which will improve consumer optimism and boost household lending. Gross fixed capital formation could also grow strongly, spurred by public sector investments. Investment activity is expected to strengthen primarily due to the intensification of reconstruction works in earthquake-hit areas, a favourable position in the cycle of withdrawal of EU funds and the expected start of the use of funds from the New Generation EU fund. Real GDP could continue to grow in 2022, but at a lower rate (4.4%), due to the disappearance of the base effect resulting from the strong contraction of economic activity in mid-2020. Risks to projections of real GDP growth in 2020 and 2021 are predominantly on the downside. The main negative risk concerns the further course of the pandemic and its still uncertain impact on economic developments. Negative risks are also related to an increase in the debt of non-financial corporations and the exacerbation of the problem of insolvency following the termination of fiscal support measures and the absorption of available transfers from EU funds.

Employment recorded quite a small decrease in 2020 despite the strong fall in economic activity due to job preservation measures implemented by the Croatian Government. Therefore, growth is primarily expected in labour productivity in 2021 and 2022, while employment could increase mildly. The ILO unemployment rate could fall to 6.9% of the labour force in 2021 and to 6.3% in 2022. With employee income (including wages and non-taxable compensations) down in 2020, the average nominal gross wage is expected to rise by 2.9% in 2021 due to an increase in wages in both the public and private sectors. The average nominal net wage could grow at an increased rate (3.8%) in 2021 following the reduction of the tax burden early in the year. This year again, employees' disposable income could grow slightly less than suggested by employment and wage indicators due to a very low amount of non-taxable compensations; these compensations could produce an opposite effect next year.

The average annual consumer price inflation could accelerate to 1.7% in 2021 (from 0.1% in 2020), and then decelerate to about 1.5% in 2022. The acceleration of inflation in 2021 should primarily result from the expected strong growth of the rate of change in energy prices, whose contribution to overall inflation could rise from –0.9 percentage points in 2020 to about 1.0 percentage point in 2021, primarily as a result of a sharp increase in oil prices in the global market and a positive base effect, i.e. the plummeting of oil prices after the outbreak of the pandemic. Given the recovery of demand in 2021, the annual growth rate of the consumer price index (excluding food and energy) could increase slightly to about 1.3% (from 1.0% in 2020) due to an increase in the annual growth rate of the prices of tourism-related services and some inflationary pressures resulting from the growth of raw material prices in the world market, increase in freight rates and the shortage of some important products used in the production of other goods. In addition, 2021 is expected to see the annual average growth rate of food prices accelerate gradually, mostly due to the time-lagged effect of the strong price growth of global food raw material prices on food product prices and a positive base effect. The projected inflation deceleration in 2022 should result from the expected decrease in the average annual growth rate of energy prices. In contrast, the average annual growth rates of the prices of food and the consumer price index excluding food and energy could accelerate. The risks of lower than projected and higher than projected inflation are balanced, but material, and to a large extent depend on the intensity of economic recovery in the country and abroad as well as on developments in raw materials prices.

The current and capital account surplus could increase markedly in 2021 from 2020. The recovery of tourism revenues could produce an especially favourable effect and a slightly less pronounced effect could come from a further increase in the use of EU funds. In contrast, these favourable trends could be offset by a deterioration in the trade in goods balance and the primary income account balance following their temporary improvement in the previous year. In line with current and capital account trends, net capital outflow is expected to grow, primarily due, however, to the growth of international reserves. Gross external debt of domestic sectors is also expected to grow, due exclusively to an increase in government liabilities, whereas the rest of the economy is expected to deleverage abroad. However, due to the recovery of GDP, the relative indicator of gross external debt could improve considerably from the previous year. The current and capital account surplus is expected to grow only slightly in 2022, after having risen significantly in 2021. Specifically, the continued recovery of net exports of services and continued growth in the uptake of EU funds could be almost completely offset by an increase in the trade in goods deficit and the worsening of the primary account balance. As regards capital flows, net capital outflows are expected to intensify again in 2022, coupled with continued improvement in relative external debt indicators.

In the first half of 2021, the CNB continued to pursue a highly expansionary monetary policy, maintaining the stability of the kuna to euro exchange rate and ensuring favourable domestic financing conditions. Banks' free reserves thus reached a record high in June, which contributed to reducing financing costs and keeping most interest rates at historically low levels, similar to those before the pandemic outbreak. As regards credit standards, banks slightly loosened credit standards for household loans in the first quarter of 2021 and continued to tighten them for corporate loans, although at a rate considerably lower than the average of the previous year. Credit institutions' corporate placements increased slightly in the first five months, with the contribution to the increase coming from investment loans, while other loans dropped. In addition to borrowing from credit institutions, enterprises also used other forms of financing, with

Table 1.1 Summary table of projected macroeconomic measures

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
National accounts (real rate of change, in %)												
GDP	–0.2	–2.4	–0.4	–0.3	2.4	3.5	3.4	2.8	2.9	–8.0	6.8	4.4
Personal consumption	1.0	–2.4	–1.6	–2.5	0.2	3.1	3.2	3.3	3.6	–6.4	6.3	2.9
Government consumption	0.5	–1.2	–0.1	1.6	–1.6	0.5	2.2	2.3	3.4	3.4	1.9	2.3
Gross fixed capital formation	–2.7	–3.3	1.4	–2.8	3.8	6.5	5.1	6.5	7.1	–2.9	8.4	6.9
Exports of goods and services	2.3	–1.5	2.5	7.4	10.3	7.0	6.8	3.7	6.8	–25.0	15.0	11.0
Imports of goods and services	2.5	–2.4	3.2	3.5	9.4	6.5	8.4	7.5	6.3	–13.8	12.8	9.5
Labour market												
Number of employed persons (average rate of change, in %)	–1.1	–1.2	–1.5	–2.0	0.7	1.9	1.9	2.3	2.3	–1.2	1.6	1.2
Registered unemployment rate	17.8	18.9	20.2	19.6	17.0	14.4	11.6	9.2	7.6	8.9	8.2	7.5
ILO unemployment rate	13.7	15.9	17.2	17.3	16.2	13.1	11.2	8.4	6.6	7.5	6.9	6.3
Prices												
Consumer price index (average rate of change, in %)	2.3	3.4	2.2	–0.2	–0.5	–1.1	1.1	1.5	0.8	0.1	1.7	1.5
Consumer price index (rate of change, end of period, in %)	2.1	4.7	0.3	–0.5	–0.6	0.2	1.2	0.8	1.4	–0.7	2.5	1.3
External sector												
Current account balance (as % of GDP)	–1.7	–1.8	–1.1	0.3	3.3	2.2	3.5	1.8	3.0	–0.4	–0.1	–0.9
Current and capital account balance (as % of GDP)	–1.6	–1.5	–0.9	0.7	4.0	3.6	4.4	3.1	4.7	1.8	2.7	2.9
Gross external debt (as % of GDP)	109.4	108.2	110.9	113.9	108.3	95.8	88.4	81.9	74.2	81.3	76.0	69.9
Monetary developments (rate of change, in %)												
Total liquid assets – M4	5.6	3.6	4.0	3.2	5.2	4.7	2.1	5.5	2.9	9.3	4.9	5.4
Total liquid assets – M4[a]	4.4	3.5	3.8	2.4	4.6	5.3	3.2	6.1	3.5	9.1	4.9	5.4
Credit institution placements to the private sector	4.8	–5.9	–0.5	–1.6	–3.0	–3.7	–1.2	2.0	2.8	3.9	2.9	3.4
Credit institution placements to the private sector[a]	3.5	–1.2	0.8	–1.5	–2.3	1.1	2.9	4.4	4.2	3.9	3.4	3.5
Credit institution placements to corporates[a]	7.6	–1.5	1.8	–3.7	–3.0	3.2	2.5	1.9	0.4	5.6	2.3	3.9
Credit institution placements to households[a]	–0.7	–1.1	–1.2	–0.7	–1.8	0.5	4.0	6.2	7.4	2.1	3.7	3.8

[a] Rates of change are calculated on the basis of data on transactions (see Annex 1 Introduction of data on transactions in monetary developments analysis in the CNB Bulletin No. 221).
Sources: CBS, MoF and CNB.

the result that total corporate financing increased in the first quarter, stagnating on the annual level due to external deleveraging. Household placements increased in the first five months, with the bulk of the increase accounted for by housing loans. The annual growth of household placements saw a slight recovery in the first half of the year, which could primarily be attributed to the continued several-year acceleration of the growth of housing loans and to some extent to a decelerated decline in general-purpose cash loans.

As regards fiscal policy, according to the latest amendments to the 2021 budget in June, the general government budget deficit, amounting to 7.4% of GDP in 2020, could stand at 3.8% of GDP in 2021, due to economic recovery and the gradual lifting of counter-crisis measures, and continue to decrease in 2022. The spring projections of the European Commission from May 2021 show a somewhat wider deficit in 2021 (4.6% of GDP), partly resulting from a slightly lower expected economic growth rate. The general government debt-to-GDP ratio, following a steep increase in 2020, should resume its downward path in 2021 and 2022.

2 Global developments

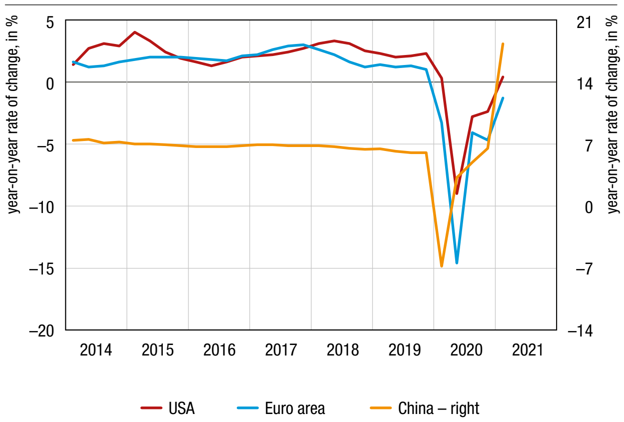
The adverse impact of the coronavirus pandemic on the global economy continued in the first three months of 2021. However, there are increasing differences among the major economies and especially among the most developed and the developing countries, as the latter are considerably lagging behind in vaccination efforts. China continued the economic recovery started in the second quarter of 2020 and the pace of the US recovery also accelerated. However, despite better than expected economic developments in the euro area in the first quarter of 2021, the pandemic still has a perceptibly more pronounced impact on its economy, which shrunk in that period, than on the economies of China or the US (Figure 2.1). In spite of rising concerns surrounding growing inflation pressures, the monetary policy of leading central banks has remained highly expansionary, with only slight indications that key interest rates could be increased earlier than planned, global financing conditions thus having remained extremely favourable.

The US economic recovery further accelerated in the first quarter of 2021, with economic activity growing at a rate of 0.4% from the same period in the previous year, primarily due to increases in investments and personal consumption. The reasons behind this acceleration include better than expected results of the vaccination campaign and improved epidemiological conditions, which have enabled the lifting of containment measures and led to a strong recovery in the labour market, especially in service activities. It is also expected that the new fiscal support package to boost the economy will keep growth at a relatively high level in the following quarters. However, the strong recovery backed by fiscal stimulus, the growth of global raw material prices, supply chain disturbances and resulting pressures on supply, as well as the base effect, have increased inflationary pressures.

The euro area economy has remained the hardest hit by the pandemic among the major economic regions: in the first three months of 2021, in contrast with the US and China, it contracted by 1.4% annually, still failing to reach the pre-crisis level of activity. This is because many member states had strict containment measures imposed in the first quarter and the vaccination campaign picked up pace much later than in the US, which had an adverse effect on service activities in particular. The largest fall was recorded by the economies of Germany and Spain, while the contraction in Italy was less pronounced. France, at the same time, recorded an increase in economic activity from the first three months of 2020. However, it needs to be stressed that the euro area's economic growth performance was still better than expected and that the second quarter, as shown by early indicators of economic activity, could see a major recovery (Figure 2.2).

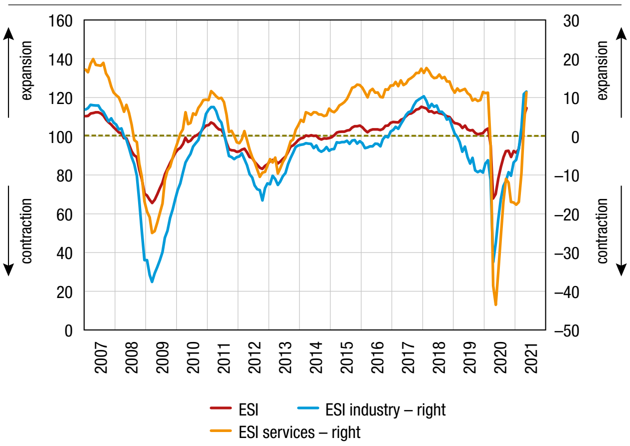
The pace of China's economic recovery accelerated sharply, resulting in the annual economic growth rate of 18.3% in the first quarter. Although this was the largest relative growth of the Chinese economy in the last three decades, it primarily resulted

Figure 2.1 Economic growth in selected markets



Sources: Eurostat, BEA, NBS and IMF.

Figure 2.2 Euro area confidence indicators



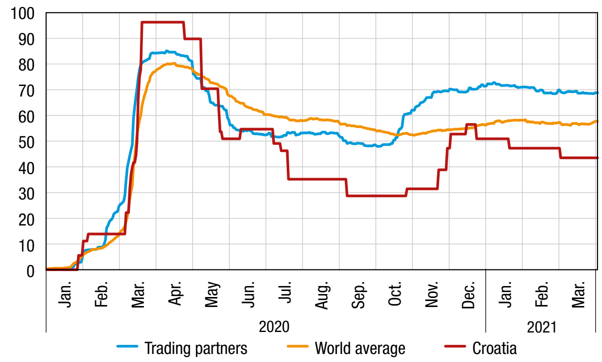
Note: Data are up to May 2021.
Source: Eurostat.

from the base effect. The growth was also driven by rising domestic and foreign demand and the continued implementation of monetary and fiscal measures to support the economy.

Croatia's main trading partners

Croatia's main economic partners recorded diverging economic developments in the first three months of 2021, especially those in the euro area. Germany saw a decrease in economic activity from the previous quarter, while Italy recorded a mild growth and Slovenia's pace of recovery increased, with its economy growing on an annual level too. As regards trading partners outside the euro area or those in the environment, Serbia and Hungary recorded sharp increases in economic activity from the previous quarter, which in Serbia even reached the level before the crisis. It should be noted that the stringency index was considerably above the world's average in Croatia's main trading partners over the whole observed period (Figure 2.3).

Figure 2.3 Stringency index of epidemiological measures in Croatia's main trading partners relative to the world average



Notes: Data from the beginning of the year up to 31 March 2021. The stringency index for trading partners is calculated as the weighted average in terms of the countries' share in Croatian exports. The global average was calculated as an unweighted average of all countries in the world. Zero indicates a minimum and a hundred indicates a maximum level of stringency of the epidemiological measures imposed.
Source: Oxford COVID-19 Government Response Tracker.

Prices, exchange rates and monetary and fiscal policy

The price of Brent crude, having risen to USD 51 per barrel by the end of 2020, its level at the start of the pandemic, continued the growth trend in the first five months of 2021, standing at USD 69 per barrel at the end of May. In addition to the improved global epidemiological situation, the recovery of demand and increasingly better economic indicators, the growth of prices was also occasionally affected by supply disturbances that were, among other things, triggered by the stranding of the container ship in the Suez Canal and a cyber-attack on a major US pipeline. Some temporary restrictions to the price growth resulted from increases in the US crude oil reserves, expectations of a rise in output by the OPEC and other oil producing countries and the periodic worsening of the epidemiological situation caused by the Delta variant.

Raw materials excluding energy continued the growth trend of prices from mid-2020 in the first five months of 2021. The price growth of metals was the highest in 2021 and was primarily driven by the recovery of industrial production worldwide, optimism related to fiscal stimuli in the US and the weakening of the US dollar. The price growth of food products was slightly less pronounced due to adverse weather conditions in the US and South America, which resulted in harvest losses in soybean and corn. The prices of wheat grew as a result of weaker harvests in the US and EU, an increase in demand due to stocking up and the introduction of taxes on Russian wheat exports in 2021. Meat prices rose due to an increase in demand from East Asian countries, especially China.

The monetary policy of leading central banks mostly remained highly expansionary, with most instruments introduced after the outbreak of the pandemic remaining in force. However, there are growing concerns about the rise in inflationary pressures, as it is unclear to what extent they are caused by temporary factors, such as the base effect and bottlenecks in the supply of some goods and services resulting from the strong recovery and generous fiscal stimulus package. Inflation in the US reached 5% annually in May, while the euro area consumer price inflation rate was lower, approximately 2%. However, at the last meeting in June the Fed responded to inflation growth by signalling that the range for the benchmark interest rate could increase in 2023, that is, one year earlier than expected at the beginning of the year. Although yields on government bonds grew on both sides of the Atlantic at the beginning of the year, their level remained stable and financing conditions relatively favourable, which enabled a number of governments to continue implementing generous fiscal measures aimed at mitigating the consequences of the pandemic.

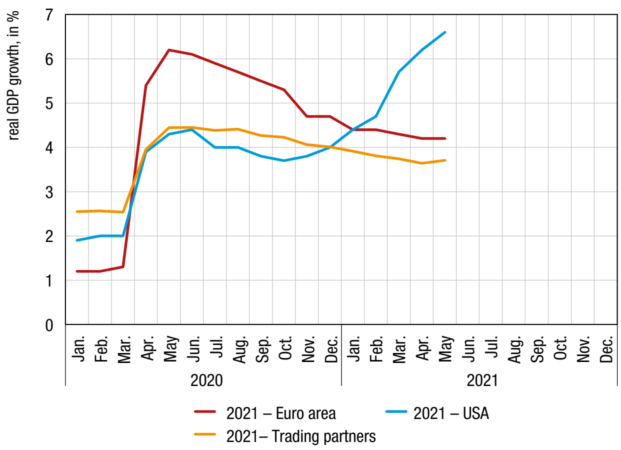
Developments in the global foreign exchange market were less volatile at the beginning of 2021. During the first three months of 2021, the exchange rate of the US dollar against the euro strengthened slightly to stand at EUR/USD 1.21 in late May, which is a decrease of 0.2% from the end of 2020. The Swiss franc, in contrast, continued to depreciate against the euro, with the result that the exchange rate at the end of May increased by 1.4% (EUR/CHF 1.10) from the end of 2020.

Projected developments

The expectations of economic growth in the euro area and in major trading partners mostly stabilised in the last few months at a somewhat higher level than at the end of the previous year following the release of data on the weaker than expected contraction in 2020. Expectations in the US, where a generous new fiscal support package was adopted and a new infrastructure renovation and construction programme is expected to be implemented, are much more favourable (Figure 2.4).

Most of the projections of international financial institutions

Figure 2.4 Expected real GDP growth for 2021 in selected countries



Source: Consensus Forecasts.

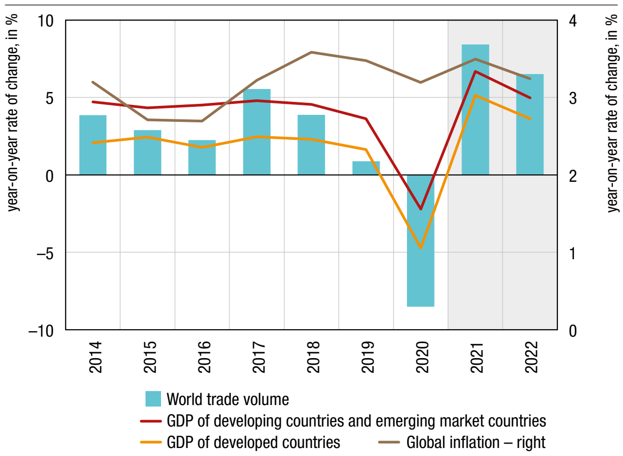
are based on the assumption of normalisation of the epidemiological situation in the course of 2021 and the relaxation of containment measures, primarily due to the fast deployment of the vaccine, which should lead to a recovery of economic activity and the volume of global trade. Still, it is not until 2022 that the coronavirus is expected to become a marginal public health problem. Despite the expected continuation of recovery and rising inflationary pressures, it is anticipated that the Fed's and the ESB's monetary policy will remain highly expansionary. Furthermore, crude oil prices should drop gradually, while the prices of other raw materials excluding energy might just edge down.

IMF projections (WEO, April 2021) suggest that the global economic growth could stand at 6.0% in 2021, primarily due to fiscal stimuli, considerably exceeding the projections from the end of the previous year. While the projections assume that the epidemiological situation will remain favourable as a result of the successful vaccination drive, the expectations are still exposed to negative risks, primarily stemming from uncertainty surrounding the course of the pandemic. Global growth is expected to slow down at an annual rate of 4.4% in 2022. However, this is still an above-average growth rate, since the pandemic is expected to produce a considerably weaker long-term impact on the world's economy than, for example, the 2008 global financial crisis.

According to European Commission projections from May, the euro area economy could grow by 4.3% in 2021, while its annual growth rate could accelerate slightly to 4.4% in 2022 (Figure 2.6). However, more optimistic ECB projections from June suggest a growth rate for the euro area economy of 4.6% in 2021. The ECB expects that recovery could remain at an approximately similar level (4.7%) in 2022 and that the euro area economy could return to its pre-crisis level already in the first quarter of that year. However, euro area growth projections are significantly exposed to negative risks, taking into account the European economy having been the hardest hit by the pandemic among the most developed regions.

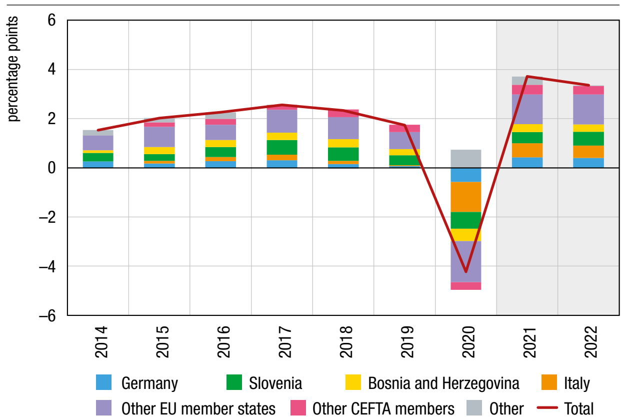
In accordance with the described trends in the global economy, demand for Croatian export products is expected to recover noticeably in 2021 (Figure 2.7). This might be mostly due to an increase in imports from key partners from the euro area, especially from Slovenia, Italy and Germany, and from non-euro area EU member states. Foreign demand is expected to grow at a slightly weaker rate in 2022.

Figure 2.5 Global economic developments



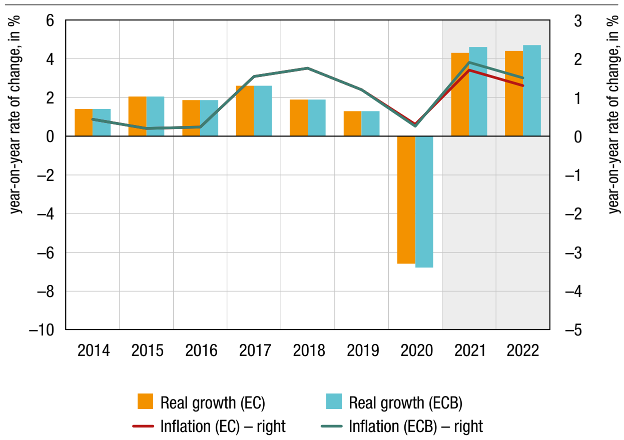
Source: IMF (WEO, April 2021).

Figure 2.7 Foreign demand
contributions of Croatia's trading partners



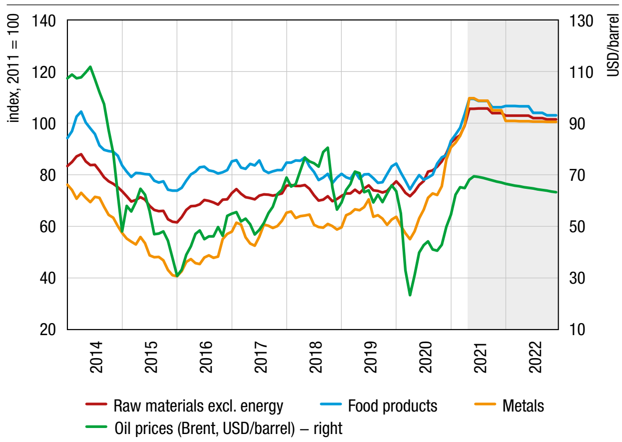
Note: Foreign demand is calculated as the weighted average of real GDP growth of Croatia's trading partners, with their shares in Croatia's exports of goods used as weights.
Source: IMF (WEO, April 2021).

Figure 2.6 Economic growth and inflation in the euro area



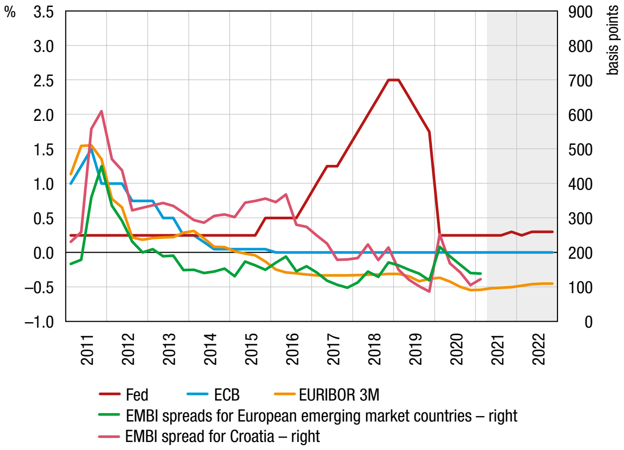
Sources: ECB (June 2021) and EC (May 2021).

Figure 2.8 Prices of raw materials on the international market



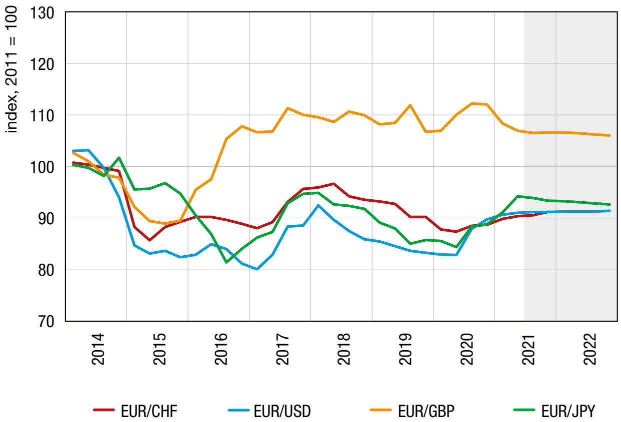
Sources: IMF, prices of oil: Bloomberg (Brent crude oil futures, 27 May 2021) and CNB estimates.

Figure 2.9 Benchmark interest rates and the average yield spread on bonds of European emerging market countries
end of period



Source: Bloomberg.

Figure 2.10 Exchange rates of individual currencies against the euro



Note: A growth in the index indicates a depreciation of a currency against the euro.
Sources: Eurostat and Foreign Exchange Consensus Forecasts (June 2021).

As regards the global prices of raw materials, market expectations suggest that crude oil prices could decline slightly in the rest of the year and in 2022 (Figure 2.8). The slight drop in prices could be influenced by the growth of OPEC+ output. Such expectations notwithstanding, due to the growth recorded so far, the overall price level in 2021 could be considerably higher than in the previous year.

The prices of all other types of raw materials, especially metal, could remain relatively high in the rest of the year after their strong growth in the first half of 2021. The prices of raw materials without energy are expected to drop slightly in the following year and the prices of all subcomponents are expected to decrease.

Markets expect that the exceptionally expansionary monetary policy will be maintained for the time being. Benchmark interest rates might stay at their current very low levels during most of the projected period and they are not expected to be raised in 2022 (Figure 2.9). As regards monetary policy normalisation, the first step could again be made by the Fed's terminating or at least reducing the volume of unconventional measures, with interest rates being raised for the first time in 2023.

According to the expectations published in the June Foreign Exchange Consensus Forecasts, the exchange rate of the euro against the US dollar on the global foreign exchange market is expected to remain mostly unchanged until the end of 2022 (Figure 2.10). The average exchange rate of the US dollar against the euro could stand at EUR/USD 1.21 in 2021, an increase of 6.1% from EUR/USD 1.14 in 2020. As regards the Swiss franc, the average exchange rate in 2021 could stand at EUR/CHF 1.1, an increase of 2.7% from 2020.

The negative risks related to the pace and efficiency of the vaccination drive mostly have not materialised and are now much less pronounced than in the previous projection cycles, so that most of vaccination-related risks now stem from an uneven global dynamics, that is, the fact that a relatively small number of people outside the US and EU have been vaccinated. In addition, the recovery of some segments of the world economy is much better than expected so that positive risks have become increasingly more pronounced. Specifically, recovery could accelerate further in the following months on the back of strong personal consumption growth based on high precautionary savings accumulated during the pandemic and better than expected epidemiological conditions. However, despite a decline in negative risks, there are rising market concerns about growing inflationary pressures remaining steady, which would prompt the leading central banks to tighten monetary policy earlier than planned and, in turn, reflect unfavourably on developments in government bond yields and the sustainability of high debt levels created during the pandemic.

3 Aggregate supply and demand

Strong economic recovery continued in the first quarter of 2021, when the seasonally and calendar adjusted GDP increased by 5.8% from the previous quarter. All domestic and foreign demand components grew on a quarterly level. Available high-frequency economic indicators suggest that recovery could continue into the second quarter, albeit at a slightly slower pace than early in the year.

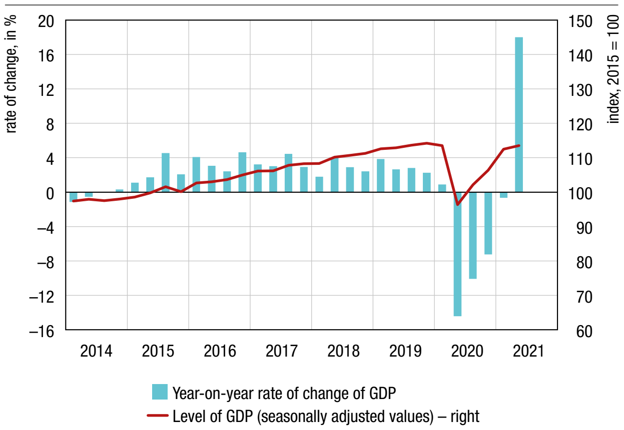
Real GDP came close to the pre-crisis level in the first quarter of 2021 (it was 0.7% lower than in the same period in the previous year). The annual fall in the first quarter of 2021 resulted from a decline in the exports of services and personal consumption from the same period in the previous year. In contrast, investment activity, goods exports and a decrease in total imports made a positive contribution to the change in total economic activity, mitigating its fall.

The production side of the calculation of GDP also shows that gross value added grew on a quarterly level (3.8%) at the beginning of 2021. Similarly as in the previous quarter, GVA grew less than GDP, but the difference between the two decreased, which can be attributed to the recovery of tax revenues. However, the quarterly growth was still insufficient, so that GVA was 0.8% lower than in the first quarter of 2020. The largest negative contribution to the annual change in GVA came from wholesale and retail trade, transportation and storage, accommodation and food service activities, followed by real estate and other service activities.

Aggregate demand

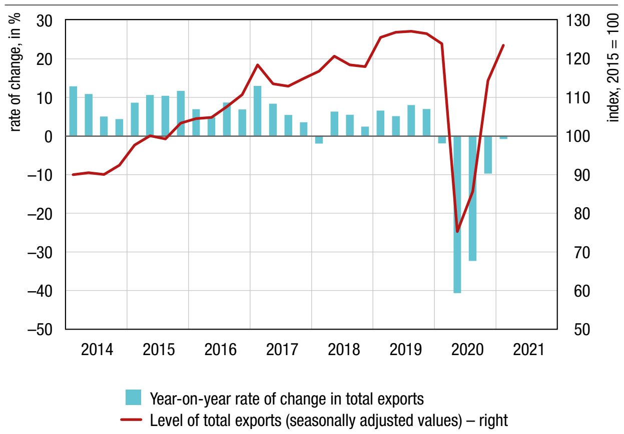
The first quarter of 2021 saw a continuation in the recovery of real exports of goods and services, started after a sharp decrease in the second quarter of the previous year. Total exports increased by 8.0% in real terms from the growth of 33.5% in the previous quarter. Goods exports and services exports also grew on a quarterly basis, by 1.4% and 7.4% respectively. In contrast,

Figure 3.1 Gross domestic product (GDP)
real values



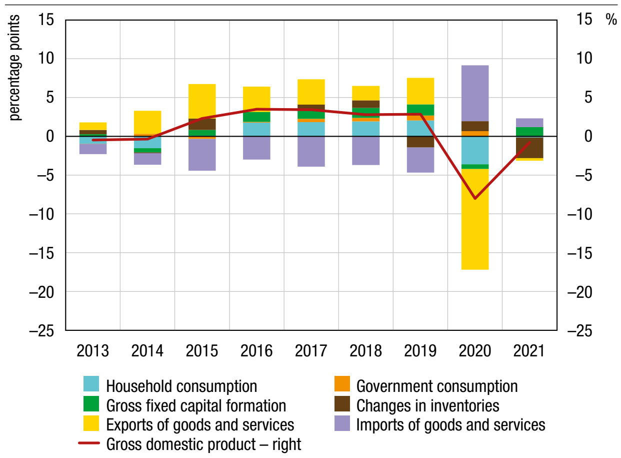
Note: Data for the second quarter of 2021 refers to the CNB's monthly indicator of real economic activity, estimated on the basis of data published until 30 June 2021.
Source: CBS (seasonally adjusted by the CNB).

Figure 3.3 Exports of goods and services
real values



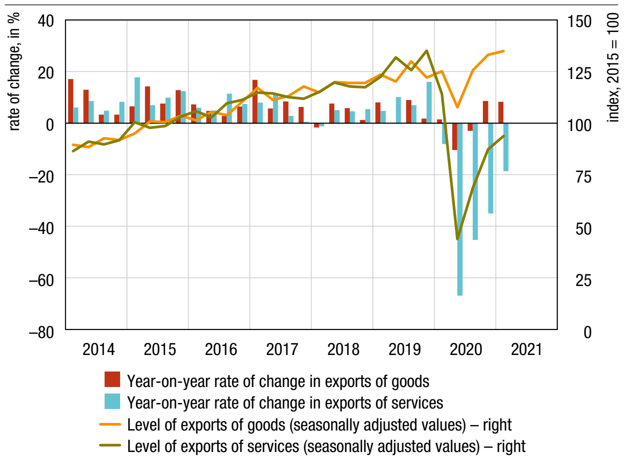
Source: CBS (seasonally adjusted by the CNB).

Figure 3.2 GDP rate of change
contributions by components



Note: Data for 2021 refer to the first quarter.
Source: CBS.

Figure 3.4 Exports of goods and services



Source: CBS (seasonally adjusted by the CNB).

nominal CBS data on trade in goods show that goods and services exports grew at a rate of 6.0%, the same as in the previous quarter. Broken down by main industrial groupings, exports of intermediate goods, energy and non-durable consumer goods increased in the first three months of this year on a quarterly basis, while imports of capital goods and durable consumer goods dropped. In comparison with the same period in the previous year, total exports dropped 0.9% from the first quarter of 2020 due to an annual decrease in services exports (–18.6%), while goods exports went up (8.3%).

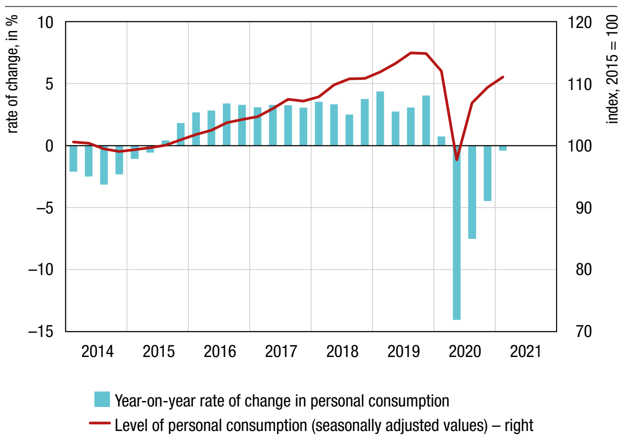
Personal consumption grew by 1.5% in the first three months of 2021, as against the 2.4% of the previous quarter. The increase in the first quarter reflects the improvements of the epidemiological situation late in the quarter and the start of the recovery in consumer lending. The continued recovery in personal consumption was probably positively influenced by improved consumer optimism, with the confidence index primarily reflecting improved expectations about the economic situation in Croatia in 12 months from now compared with the current situation (for more information on trends in consumer confidence resulting from the outbreak of the pandemic, see Box 2 Coronavirus and inequalities – insights from the Consumer Confidence Survey). These trends prevented a further annual decrease in household consumption, with the result that personal consumption dropped by 0.4% from the same period in the previous year.

Gross fixed capital formation grew considerably in the first quarter in 2021, with an increase of 4.6% in investment activity from the same period in the previous year and of 2.1% from the previous quarter. Capital investments picked up pace early in the year on the back of heightened construction activity, which also benefited from favourable weather conditions. Contributions to investment growth came both from private and public sector investments, as indicated by the continued growth of the volume of works on buildings and civil engineering works.

The growth of government consumption decelerated sharply in early 2021, down to 0.3% from the previous three months and therefore stagnated on an annual level. It recorded only a slight increase from the same period in the previous year, which was most probably due to the base effect as the annual growth rate of government consumption in the first quarter of 2020 was 6.1%.

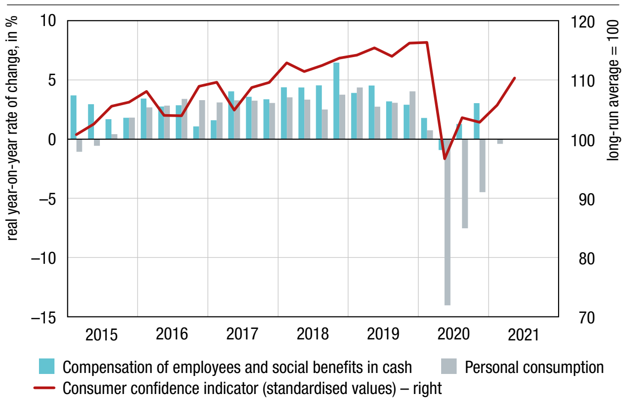
The growth of goods and services imports continued to slow down in early 2021, up by 1.8%, as against the high of 7.0% in

Figure 3.5 Personal consumption
real values



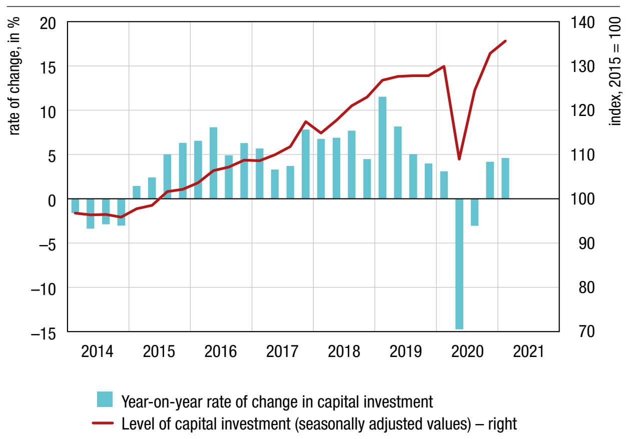
Source: CBS (seasonally adjusted by the CNB).

Figure 3.6 Determinants of personal consumption
real values and index



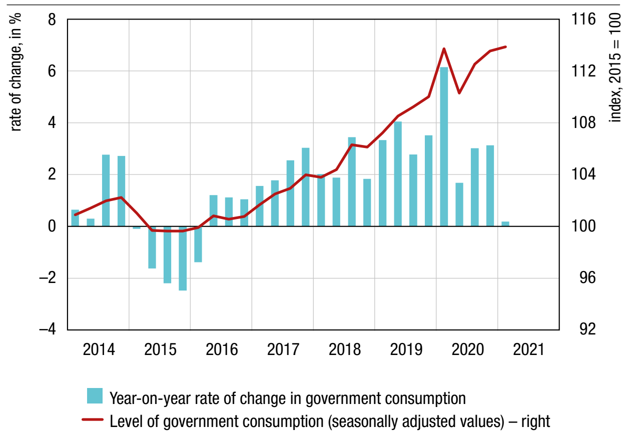
Notes: Real values of compensation of employees and social benefits in cash were calculated by deflating nominal values using the personal consumption deflator. Consumer confidence indicator values were calculated as three-member averages of monthly data, where the most recent data refers to June 2021.
Sources: CBS, Ipsos and CNB.

Figure 3.7 Gross fixed capital formation
real values



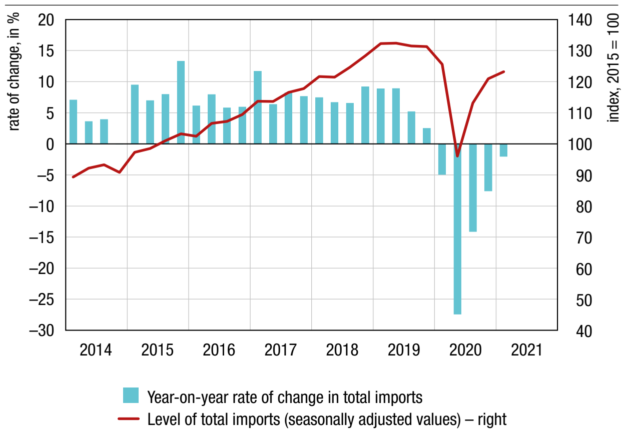
Source: CBS (seasonally adjusted by the CNB).

Figure 3.8 Government consumption
real values



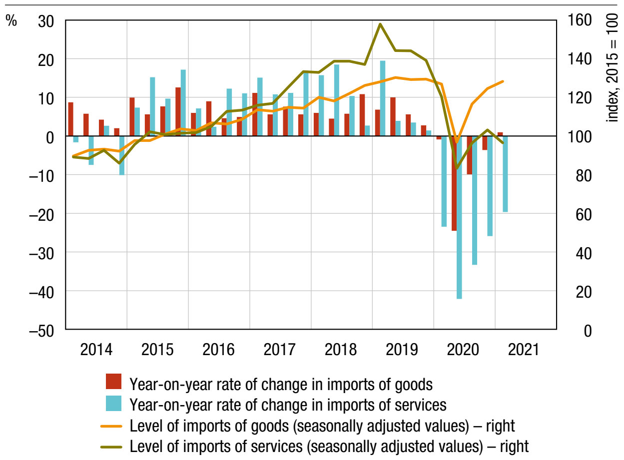
Source: CBS (seasonally adjusted by the CNB).

Figure 3.9 Imports of goods and services
real values



Source: CBS (seasonally adjusted by the CNB).

Figure 3.10 Real imports of goods and services



Source: CBS (seasonally adjusted by the CNB).

the previous quarter. The growth of goods imports decelerated on a quarterly basis, whereas the imports of services dropped. Nominal data on trade in goods show an accelerated growth of imports of energy and intermediate goods, while imports of capital goods and non-durable consumer goods fell, which is the reason why goods imports slowed down a quarterly basis. If viewed on an annual level, goods imports rose from the first three months of 2020, reflecting investment and goods exports growth, but the imports of services shrank sharply, with the total imports on an annual level falling. The contribution of net foreign demand to total economic growth was thus positive (0.8 percentage points).

Aggregate supply

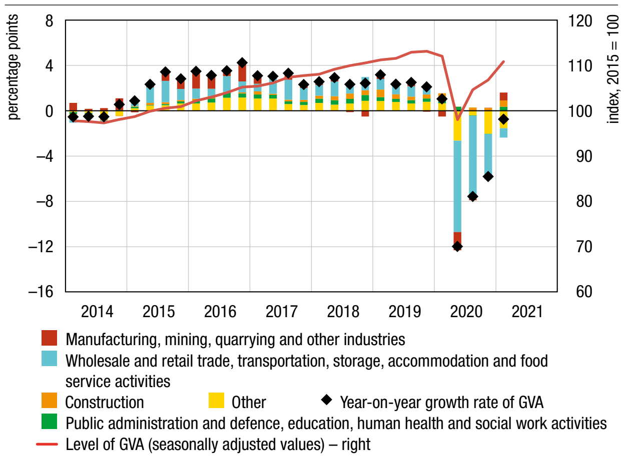
Gross value added rose at a quarterly rate of 3.8% in the first quarter of 2021 from 2.1% in late 2020, primarily due to an acceleration of GVA growth in wholesale and retail trade, transportation and storage, accommodation and food service activities, which can be attributed to the improvement of the epidemiological situation late in the quarter and a partial recovery of supply and demand in activities associated with tourism and hotels and restaurants. GVA showed quarterly growth in all activities, except in financial and insurance activities and in real estate activities.

If viewed on an annual level, real GVA was 0.8% lower than in the same period of the previous year. The quarterly growth notwithstanding, wholesale and retail trade, transportation and storage, accommodation and food service activities failed to reach the levels from the same period in the previous year and so did real estate activities and other service activities. In contrast, manufacturing and construction increased sharply on an annual level, alleviating the fall in real GVA.

The GDP nowcasting model, based on high-frequency data, mostly available for April, suggests that the recovery of economic activity could continue in the second quarter of the current year, although at a lower pace than at the beginning of the year. This probably reflects a gradual return to the pre-pandemic GDP level, the impact of the third pandemic wave in Croatia (which peaked in the first half of the second quarter) and the seasonal strengthening of activities that are still negatively influenced by the pandemic, mainly those depending on tourism.

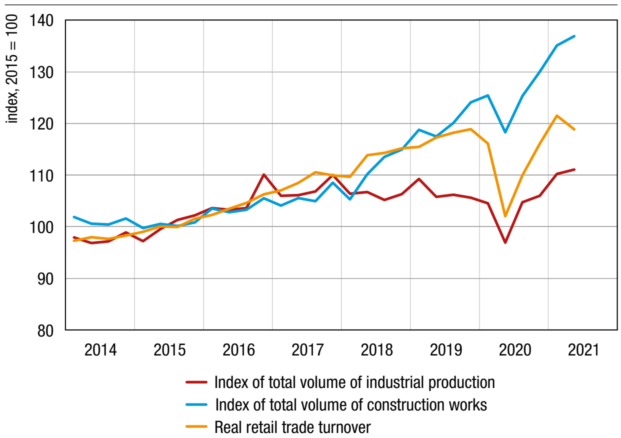
Industrial production was 0.2% lower in April than the first

Figure 3.11 GVA rate of change
contributions to the annual change by components



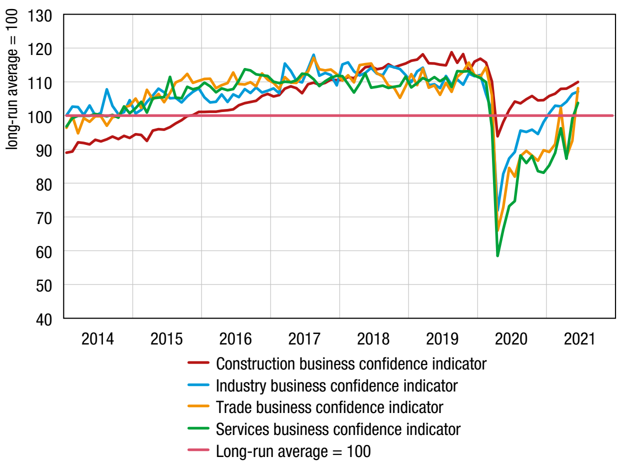
Source: CBS (seasonally adjusted by the CNB).

Figure 3.12 Short-term economic indicators
seasonally adjusted values



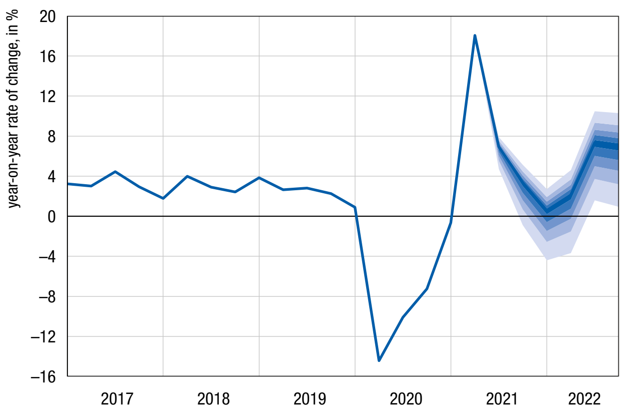
Notes: Quarterly data are calculated as an average of monthly data. Data for the second quarter of 2021 refer to April.
Source: CBS (seasonally adjusted by the CNB).

Figure 3.13 Business confidence indicators
standardised seasonally adjusted values



Sources: Ipsos and CNB (seasonally adjusted by the CNB).

Figure 3.14 Projection of real GDP dynamics



Sources: CBS and CNB.

quarter average this year due to a decrease in the production of durable and non-durable consumer goods, whereas the components of main industrial groupings increased. At the same time, real retail trade turnover increased by a slight 0.9% relative to the performance in the first quarter of this year. The real volume of construction works increased by 1.3% in April from the previous quarter average, with both works on buildings and other construction works recording growth. Consumer and business confidence surveys show that confidence indices increased in the second quarter from the first quarter of 2021, but remained below the pre-crisis level.

Projected developments

GDP is expected to grow at a rate of 6.8% in 2021, following a decline in economic activity of 8.0% in 2020. Although strong, this growth will not suffice to bring back economic activity to the pre-crisis level. Recovery is expected to decelerate in 2002 following the disappearance of the base effect resulting from the economic slump in mid-2020, while real growth is expected to stand at 4.4%.

Total exports are projected to increase by 15.0% in 2021, after having decreased by 25.0% in 2020. The growth of services exports is expected to exceed the growth of goods exports due to a partial recovery of tourist demand following the steep decrease in the previous year caused by the coronavirus pandemic (for more information on the impact of tourism on GDP growth projections see Box 1 Assessing the impact of assumptions about tourism trends on GDP growth forecasts).

As regards domestic demand, personal consumption could increase by 6.3% in 2021 after falling by 6.4% in 2020 and make the largest positive contribution to total economic growth of all domestic demand components. The projected recovery of personal consumption reflects relatively favourable developments that are expected in the labour market and the reduction of the income tax burden, coupled with the improvement of consumer optimism and the gradual recovery of supply of and demand for services that require close physical proximity, which were the hardest hit by the pandemic. Gross fixed capital formation could also grow by a high of 8.4%, after falling by 2.9% in the previous year. Investment growth is expected in both the public and private sectors. Investment activity should be additionally spurred by the intensification of reconstruction works in earthquake-hit areas, a favourable position in the cycle of withdrawal of EU funds and the expected start of the use of the Next Generation EU fund. Government consumption is also expected to make a positive contribution to economic growth, and to increase by 1.9% from the previous year. The expected recovery of domestic demand and the growth of total exports could result in goods and services imports increasing by a high 12.8% at the 2021 level. The contribution of net foreign demand to total economic growth could thus be neutral.

Economic recovery is expected to continue in 2022. Real GDP could grow annually by 4.4% and exceed the 2019 level in absolute terms. The expected deceleration of economic activity in 2022 is due to the base effect and the lower anticipated growth of personal consumption, investments and total exports, especially services exports. GDP growth is expected to be driven by all of its components, with the main driver being foreign demand.

Mean estimated and projected values for 2021 and 2022 are projected to be more exposed to negative risks. The main negative risk concerns the further course of the pandemic and its still uncertain impact on economic developments, which primarily depends on the vaccination efforts and epidemiological measures. In addition, new virus variants may appear against which the currently available vaccines could be less effective. Other negative risks refer to the fact that, despite the grants paid, operating in the crisis circumstances caused major falls in revenues for a number of enterprises, so that a wave of deferred bankruptcies could be expected. Furthermore, the still present uncertainty in the business environment could have an adverse impact on the decisions of business entities related to increasing investments in the forthcoming period. Also, the absorption of EU funds could have a lower dynamics than currently expected. In contrast, a positive risk is related to the probability that the vaccination drive and the introduction of COVID certificates will facilitate international and domestic travel and the use of services.

Box 1 Assessing the impact of assumptions about tourism trends on GDP growth forecasts

With another uncertain tourist season ahead, economic forecasters project Croatian GDP growth in 2021 in the range of 3.5% to 6.8%. This is the largest dispersion of GDP growth forecasts in the last ten years, reflecting the uncertainty surrounding pandemic developments. Much of the uncertainty regarding economic trends in Croatia arises from various assumptions by professional forecasters about the results of the upcoming tourist season. In an effort to quantify the possible impact of different assumptions about the outcome of the tourist season, this box presents simulation results of the impact of three alternative paths for tourism revenues on GDP growth rates forecast for Croatia. The simulation results confirm that different assumptions about the success of the tourist season might explain much of the projected dispersion as simulated real growth rates for 2021 range from 3.2% (stress scenario) to 7.5% (optimistic scenario).

In view of another uncertain tourist season ahead, the short-term outlook for economic growth in 2021 remains exposed to considerable risks. These risks are best illustrated by the degree of disagreement among economic forecasters as regards short-term growth prospects for Croatia in the current year, which are given in Figure 1.[1] The dispersion of projected growth rates, which was already elevated in 2020, hit a ten year record high in 2021.

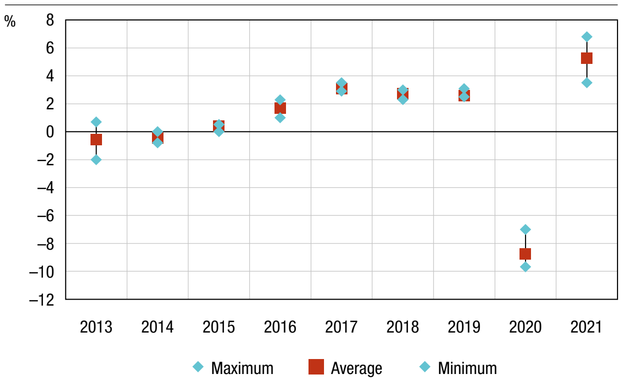
The wide dispersion of growth forecasts is a common feature of uncertainty and is not specific to Croatia alone. However, the factors behind the variability may be largely country-specific so that the uncertainty about short-term economic prospects for Croatia is probably strongly correlated with expectations regarding tourism, one of the sectors most severely affected by the coronavirus pandemic, with social distancing measures sharply restricting tourist activity. On the other hand, an improved epidemiological situation, relaxation of measures and eased cross-border travelling may encourage tourism recovery in the short run.

The tourism sector was severely and negatively hit by the pandemic in 2020. The structure of the Croatian tourism industry has changed; the concentration of the five main outbound markets, for which Croatia is predominantly a road destination, grew considerably, while the share of tourists arriving from air destinations further decreased. Some of these structural characteristics of Croatian tourism, i.e. high seasonality in the summer months, which coincided with the improvement in the epidemiological situation, and the widespread use of roads as means of transportation to Croatia, cushioned the fall in tourism relative to other Mediterranean countries.[2] Nevertheless, because of the major role tourism plays in the economy, Croatia experienced one of the sharpest GDP contractions in Europe in 2020.

The extent of a possible recovery in tourism over the current year remains uncertain. While growing vaccination rates in Croatia and a number of outbound countries give rise to hopes of a faster recovery in the tourism industry, it remains a challenge to reach the collective immunity threshold in view of the slowdown in vaccine rollout, emergence of new, more contagious virus variants and the associated smaller efficiency of existing vaccines. Therefore, one cannot ignore a risk of a sudden tightening of epidemiological measures that would raise the caution of potential travellers.

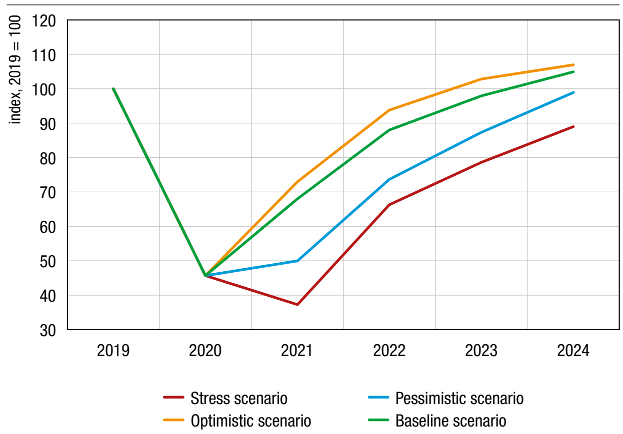
Macroeconomic forecasters obviously use very different assumptions because of the uncertainty regarding the progress of the tourist season. For this reason, this box presents the results of real GDP growth simulations for four assumed paths for tourism revenues. The baseline scenario assumes that revenues from exports of tourist services in 2021 might come to 68% of the pre-crisis level (Figure 2). This assumption is justified by the earlier beginning of the season and the more rapid increase in tourist activity than last year. However, in view of the mentioned uncertainty, it is believed that the risks are tilted to the downside, and so two pessimistic scenarios are considered that assume that tourism revenues in 2021 will reach either 50% (pessimistic scenario) or 37% (stress scenario) of the record year 2019. Upside risks to the baseline projection arise from the relatively

Figure 1 Dispersion of forecast real GDP growth rates for Croatia



Note: Forecasts of relevant institutions for each given year are released in the second quarter of that year.
Sources: Eastern Europe Consensus Forecasts, Economic Institute of Zagreb, European Bank for Reconstruction and Development, European Commission, Addiko Bank Economic Research, Croatian National Bank, International Monetary Fund, Ministry of Finance, Raiffeisen Research and World Bank.

Figure 2 Alternative assumptions about tourism trends in Croatia from 2021 to 2024



Source: CNB.

1 Forecasts given in publications of relevant institutions that publish current year macroeconomic projections for Croatia were used to illustrate the dispersion of GDP growth forecasts.

2 See Box 1 in Macroeconomic Developments and Outlook from December 2020.

high vaccination rates in European countries and the still high vaccine efficacy as well as the expected significant relaxation of epidemiological measures over the summer months, so that the simulated optimistic scenario assumes that tourism revenues in 2021 might come to 73% of those made in 2019.

Tourism revenues in 2022 are projected at 66% of the 2019 level under the stress scenario, 74% under the pessimistic scenario, 88% under the baseline scenario and 94% under the optimistic scenario. They might exceed the record high of 2019 only in 2023 under the optimistic scenario and in 2024 under the baseline scenario. Under the stress and pessimistic scenarios, tourism revenues remain below the 2019 level over the entire projection horizon.

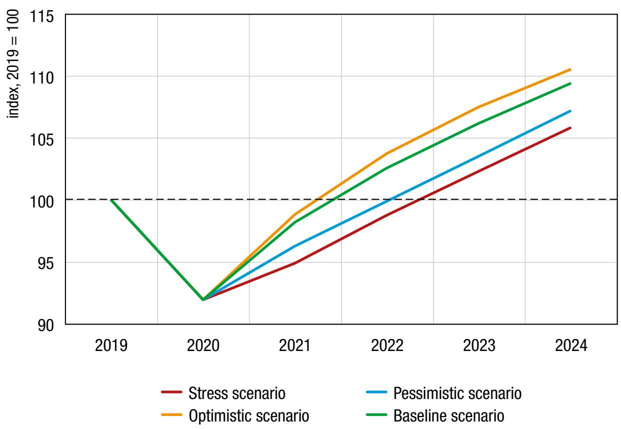
The estimated effects of these scenarios on the Croatian economy given in Figures 3 and 4 are based on simulations made using the macroeconometric model called PACMAN[3] (Policy Analysis Croatian Macroeconomic Model) developed by the CNB for forecasting and scenario analysis.[4] Using the model, an exogenous path of total services exports under four different scenarios is created based on the mentioned assumptions on tourism trends. Shocks to the domestic economy are implemented by exogenising the endogenous variable (services exports) as differences in services export trends under an alternative scenario relative to the baseline scenario, while exports of goods and other services are kept at baseline scenario levels.[5] Effects of this shock are then transferred to other domestic variables both directly (first round effects) and indirectly (second round effects). Exports of services, that is, have a direct impact on aggregate demand through the GDP identity, whereas the change in aggregate demand in turn affects almost all components of GDP, from household consumption and corporate and household investments to imports of goods and services[6].

The simulation results show that in 2022 GDP might exceed the pre-crisis levels in two out of the four observed scenarios (baseline and optimistic), while under the remaining scenarios projecting a slower domestic recovery GDP might exceed the pre-crisis levels only in 2023 (Figure 3).

The greatest differences are seen in growth rates for 2021, which range from 3.2% (stress scenario) to 7.5% (optimistic scenario) (Figure 4). As all scenarios envisage a noticeable increase in tourism revenues in 2022, the spread between the highest and the lowest growth rate is much smaller, 1.2 percentage points, and decreases throughout the rest of the projection horizon.

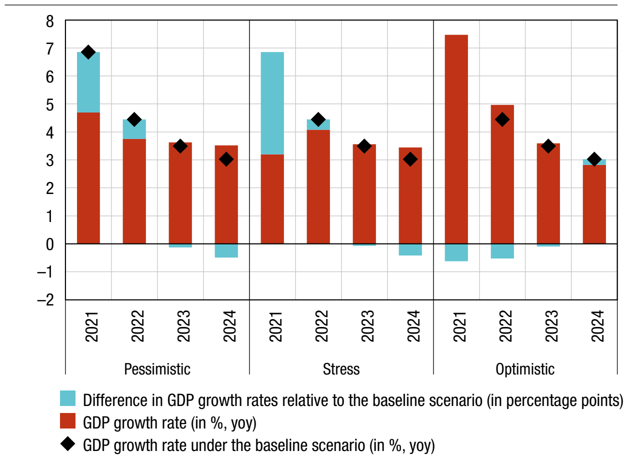
In conclusion, the simulation results clearly show that GDP growth forecasts are extremely sensitive to initial assumptions about the trends in the upcoming tourist season. The simulation results show that relative to the baseline projection the GDP growth rate might be as much as 3.6 percentage points lower under the most pessimistic scenario and up to 0.7 percentage points higher under the optimistic scenario.

Figure 3 GDP trends under the baseline and alternative scenarios



Source: CNB.

Figure 4 GDP growth rates under the baseline and alternative scenarios



Source: CNB.

3 PACMAN is a medium-sized macroeconometric model characterised by a high level of aggregation, which accounts for the relationships among key macroeconomic variables in a systematic manner. Although highly aggregated, the model is sufficiently detailed to be able to describe the most important characteristics of the Croatian economy. For further information, see Nadoveza Jelić, O., and R. Ravnik (2021): *Introducing Policy Analysis Croatian MAcroecoNometric Model (PACMAN)*, CNB Surveys, S-41.

4 Euro-area GDP growth projections from the second quarter of 2021 were used to simulate the effects of alternative scenarios. The database was updated in May 2021. The first simulation period was the first quarter of 2021.

5 For more details on the implementation of shocks by exogenising the endogenous variable, see Nadoveza Jelić, O., and R. Ravnik (2021): *Introducing Policy Analysis Croatian MAcroecoNometric Model (PACMAN)*, CNB Surveys, S-41.

6 Changes in exports reflect the high import dependency of the Croatian economy.

Box 2 Coronavirus and inequalities – insights from the Consumer Confidence Survey

The adverse impact of the pandemic crisis on employment, wages and household income has not been equally distributed among all segments of the population. The Consumer Confidence Survey provides a quick and simple insight into perceptions of the crisis impact and expectations of various household groups. The Survey results show a notable deterioration in assessments of the current situation and expectations immediately following the pandemic escalation, but without major differences among income groups. In contrast to assessments by income groups, situation assessments by region show significant segmentation, so that the sharpest deterioration is evident in households from the coastal region, whose economy strongly depends on tourism, while the negative shock is perceived as less intense in Slavonia.

The pandemic crisis has adversely affected employment and wages and therefore also the financial situation of households. However, the impact of the crisis is not equally distributed, but is extremely asymmetric, depending on the characteristics of each individual household. The pandemic has most severely affected employment and wages in activities that require close physical proximity and that have been most adversely affected by the pandemic, such as tourism-related activities and some other service activities. People working in those activities are usually less educated and paid lower wages than those working in activities less dependent on physical proximity, such as information and communication activities. As vulnerable activities are further characterised by lower job security, seasonality and a larger share of fixed term employment, the pandemic has further exacerbated workplace inequalities arising from access to and use of modern information and communication technology (the digital divide).

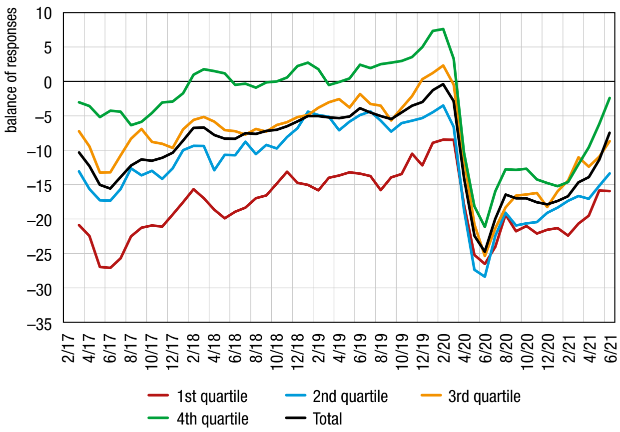
Data used to derive inequality indicators for households, such as the Household Consumption Survey, are generally compiled relatively rarely and are available with a significant time lag, which makes current analysis of the pandemic's impact more difficult. However, quick and simple information on differences in crisis perceptions and expectations across household groups may be constructed on the basis of the Consumer Confidence Survey data. The consumer confidence index is a composite index composed of answers to four questions from the Consumer Confidence Survey[7], which combines households' perceptions of the general economic situation in the country and their financial situation as well as their expectations for the future.

The aggregate consumer confidence index steadily increased in the years preceding the pandemic, up to the outbreak in March 2020, when it suddenly and sharply deteriorated. The economic recovery from mid-2020 on was also reflected in the rise in the confidence index, which was very gradual at first and then picked up early in 2021. To gain an insight into the evolution of perceptions about the financial situation and expectations of different groups of households, the confidence index itself and the balance of individual responses included in the index may be broken down according to various criteria such as income, education level of the household head or region.

In the pre-pandemic period consumer confidence indices constructed for income quartiles grew in parallel for all household groups, with a notable difference across levels, that is, the confidence of households in higher income brackets was consistently higher[8] (Figure 1). The consumer confidence index dropped sharply in all income groups after the pandemic outbreak, with the gap among different income groups narrowing down. The recovery of the consumer confidence index was also seen across all income brackets, with confidence growing more in higher brackets, which had contracted more at the beginning of the pandemic. Notwithstanding the relatively strong recovery in the first half of 2021, pre-crisis confidence levels have not yet been restored in any of the income brackets.

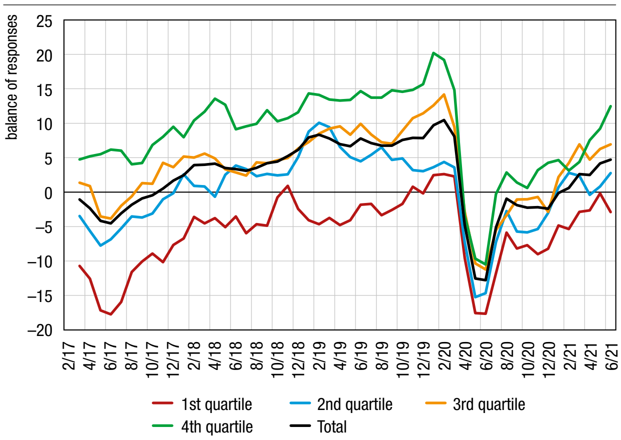
As the consumer confidence index aggregates the assessment of the current situation and expectations, it is useful to monitor developments in the balance of responses to

Figure 1 Consumer confidence index by income



Note: The calculation is based on the quarterly moving average of the balance of responses.
Sources: Ipsos and CNB.

Figure 2 Expectations regarding a household's financial situation in the next 12 months compared to the situation today by income



Note: The calculation is based on the quarterly moving average of the balance of responses.
Sources: Ipsos and CNB.

7 The consumer confidence index is calculated by numerical coding and weighting of answers to four questions: assessment of a household's financial situation today compared to the situation 12 months ago; expectations regarding a household's financial situation in the next 12 months compared to the situation today; expectations regarding the overall economic situation in Croatia in the next 12 months compared to the situation today; and expectations regarding spending on durable consumer goods in the next 12 months compared to the past 12 months.

8 Households with monthly income up to HRK 4500 are in the first quartile, those with income of HRK 4500-6000 are in the second quartile, the third quartile is between HRK 6000 and HRK 8275 and the fourth quartile comprises households with income over HRK 8275.

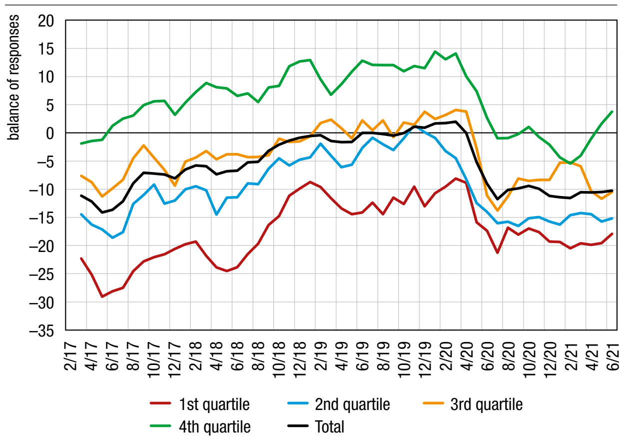
individual questions contained in the index. Expectations regarding a household's financial situation mirror developments in the aggregate confidence index (Figure 2). Expectations of households from all income brackets evened out at very low levels after the pandemic started, but they dispersed to some extent and came close to initial levels by mid-2021.

Though the assessment of the current financial situation deteriorated less than expected after the onset of the pandemic, it failed to recover significantly by mid-2021. The only exception came in households in the highest income bracket, whose assessment of the financial situation has been improving slightly from the beginning of the year. Also, the intensity of the deterioration was relatively balanced across income groups so that significant differences in financial situation assessments among the groups remained constant during the pandemic. However, a somewhat sharper deterioration was seen in households from the highest (fourth) income quartile as well as those in the second quartile, whose assessment of the financial situation came close to that of households in the lowest income bracket. By contrast, the deterioration in the assessment by the lowest (first) income quartile was somewhat less than the average (Figure 3).

A more moderate deterioration in situation assessment than in expectations may be associated with the relative stability of household incomes thanks to the ample fiscal support and, on the other hand, with the heightened uncertainty triggered by the pandemic crisis. The relatively stable assessment of the financial situation in the lowest income bracket may probably be attributed to a high share of pensioners, who have not been significantly financially affected by the pandemic as their income is less dependent on labour market developments. The above average worsening of the assessment in the second and the fourth (highest) quartile probably means that workers on the "wrong" side of the digital divide are not concentrated only in the least-paid service professions, but also include some workers in better paid professions.

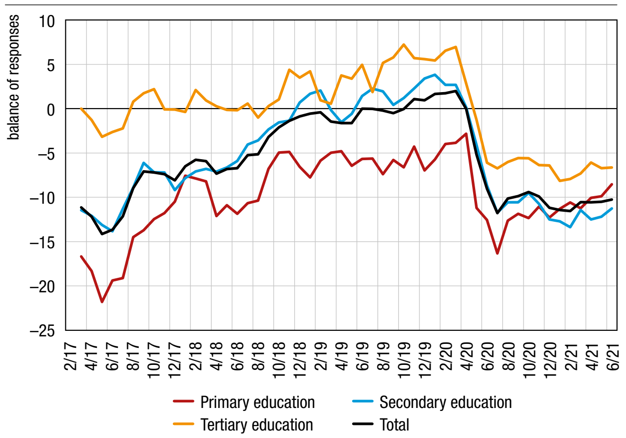
Assessment of a household's financial situation by education level of the household head shows a pattern similar to assessments by income groups, that is, a sharp and concerted deterioration following the onset of the pandemic (Figure 4). Also, similar to assessments by income brackets, households headed by persons with a high level of education recorded the sharpest deterioration in financial situation assessment, though it remained

Figure 3 Assessment of a household's financial situation today compared to the situation 12 months ago by income



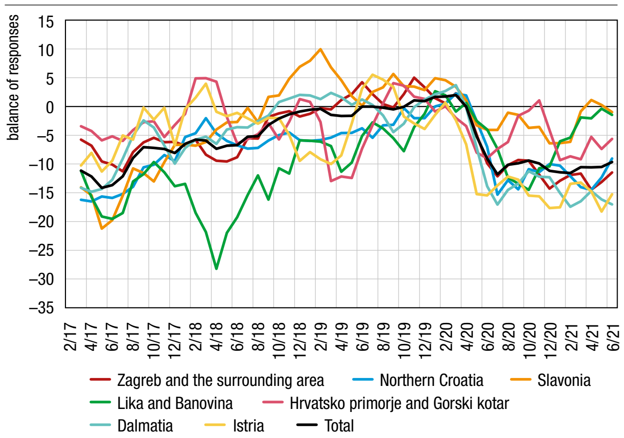
Note: The calculation is based on the quarterly moving average of the balance of responses.
Sources: Ipsos and CNB.

Figure 4 Assessment of a household's financial situation today compared to the situation 12 months ago by education level



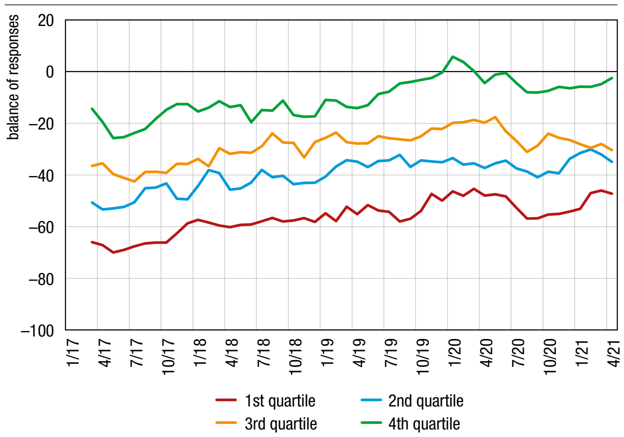
Note: The calculation is based on the quarterly moving average of the balance of responses.
Sources: Ipsos and CNB.

Figure 5 Assessment of a household's financial situation today compared to the situation 12 months ago by region



Note: The calculation is based on the quarterly moving average of the balance of responses.
Sources: Ipsos and CNB.

Figure 6 Probability of an increase in savings in the next 12 months by income



Note: The calculation is based on the quarterly moving average of the balance of responses.
Sources: Ipsos and CNB.

at a higher level than for other groups. Specific developments were seen in situation assessment by the least educated group – it has steadily improved after the initial fall, exceeding the assessment by households whose heads have a medium education level and coming close to the assessment by the highly educated group, which further confirms the finding that adverse pandemic effects have not been concentrated exclusively in lower income brackets.

In contrast with financial situation assessments by income groups, assessment segmentation by region is very perceptible, the strongest deterioration being seen in assessments by households in the coastal region, where the economy relies heavily on tourism. On the other hand, the negative shock was perceived as less intense in Slavonia, while the fastest improvement in situation assessment was seen in Lika and Banovina. Developments in situation assessments by income groups may also be correlated to different intensities of disturbance across regions as those more exposed to tourism often have above-average income levels, while situation assessment improved more rapidly in lower-income regions.

The sharp worsening of expectations as well as the inability to spend on some goods and services encouraged households to save more. It is not then surprising that the survey assessment of the probability of an increase in savings has remained at a relatively high level for all income groups throughout the pandemic (Figure 6) (for more details on the phenomenon of forced and precautionary savings see Box 3 Household savings in the time of pandemic).

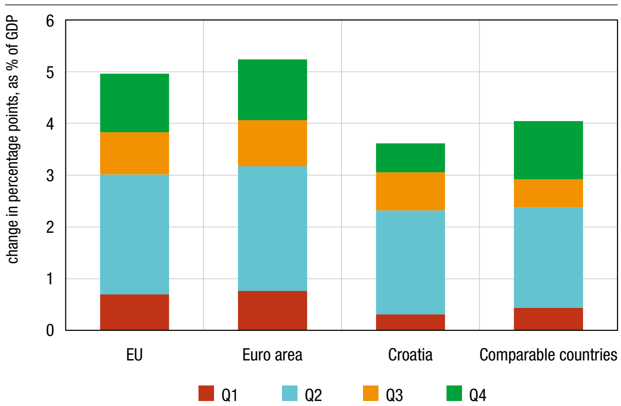
Box 3 Household savings in the time of pandemic

One of the characteristics of the pandemic-driven economic crisis is an upswing in household savings. Household consumption has decreased due to the lack of access to some goods and services amid strict epidemiological measures, heightened caution by households themselves and voluntary reduction in social contacts, as well as precaution triggered by job and income insecurity. At the same time, ample fiscal support helped to preserve incomes to a large extent. Expectations about unemployment and financial situation explain well the movements in savings in the period before the pandemic. However, the surge in savings in 2020 considerably exceeds the growth that may be attributed to those factors, which suggests that much of the growth was "forced" savings associated with the inability to spend. Improvement in the epidemiological situation and the gradual lifting of restrictive measures will prompt a reduction in savings rates. Nevertheless, in view of their specific features, it is difficult to assess the extent to which these "excess" accumulated savings might be converted into additional consumption and encourage economic recovery.

Everyday social and economic life has been considerably constrained by the pandemic and containment measures. The lockdown of many businesses and restrictions on movements and activities coupled with growing economic uncertainty caused an abrupt contraction of personal consumption. In conditions of relatively stable incomes, the slump in consumption was mirrored in the surge in savings rates. The household savings rate in Croatia rose by 4.5 percentage points in 2020, reaching 14.4%. The fact that this rate is almost 4 percentage points higher than the several-year average illustrates its exceptionally high growth well (Figure 1). Savings rates in most EU member states grew even more in 2020 – the average growth in the EU as a whole was 6.4 percentage points (6.8 percentage points in the euro area) (Figure 2), and only Hungary saw a smaller increase in the savings rate (2.6 percentage points) among CEE countries.

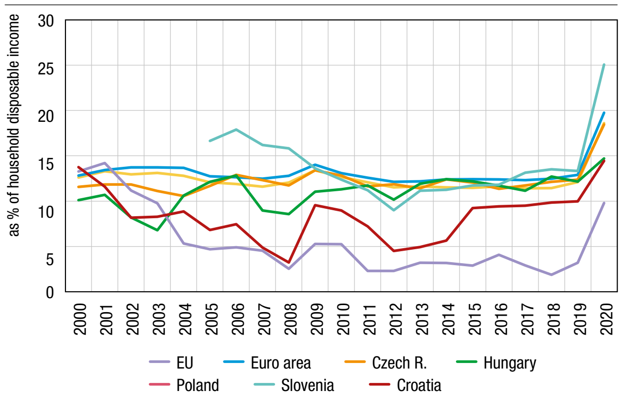
In addition to growing strongly, savings rates fluctuated sharply in the course of 2020 (Figure 3). Particularly noteworthy was a jump in savings in the second quarter of 2020, during the first pandemic wave and the huge increase in economic uncertainty. The savings rate in Croatia peaked at 20.4% in that period, but dropped by the end of the year to 12.4%, which was still around 3 percentage points higher than at end-2019. The EU savings rate rose even more: it hit a high of 24.0% (25.1% in the euro area) in the second quarter of 2020 and remained at the elevated level of 18.9% (19.8% in the euro area) through to the end of the year. The jump in EU savings at the turn of the year may be partly attributed to the deterioration in the epidemiological situation and the tightening of epidemiological measures,

Figure 1 Excess savings



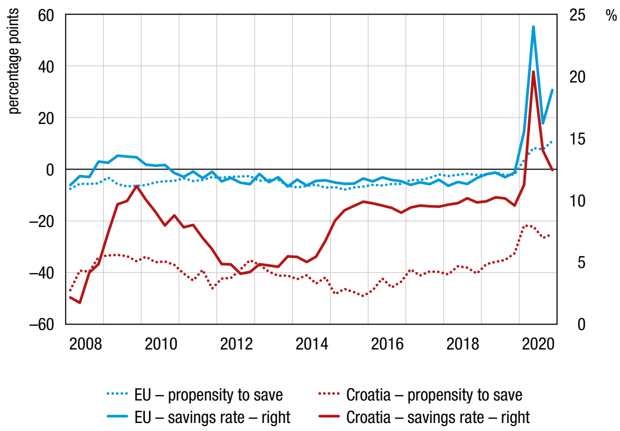
Notes: Excess savings refers to 2020 deviations in savings from the average savings in the past five years. The values for comparable countries were calculated using the weighted average for the Czech R., Hungary, Poland and Slovenia.
Sources: Eurostat and CNB calculations.

Figure 2 Household savings rate



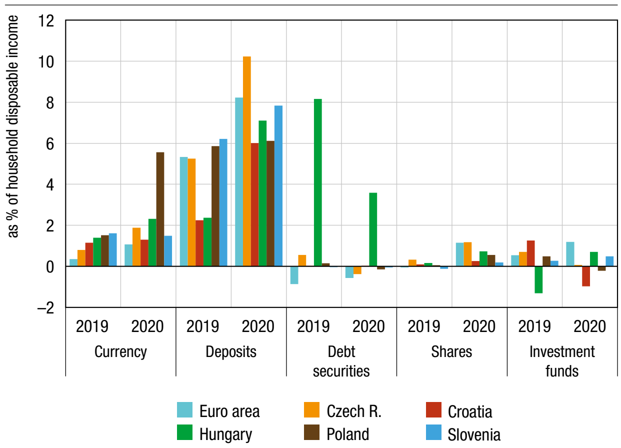
Notes: The 2020 savings rate for individual countries was constructed on the basis of quarterly data, the same as the complete time series for Croatia, while annual data were used for the EU and the euro area. Household disposable income includes the effect of changes in pension rights.
Sources: Eurostat and CNB calculations.

Figure 3 Savings rate and propensity to save



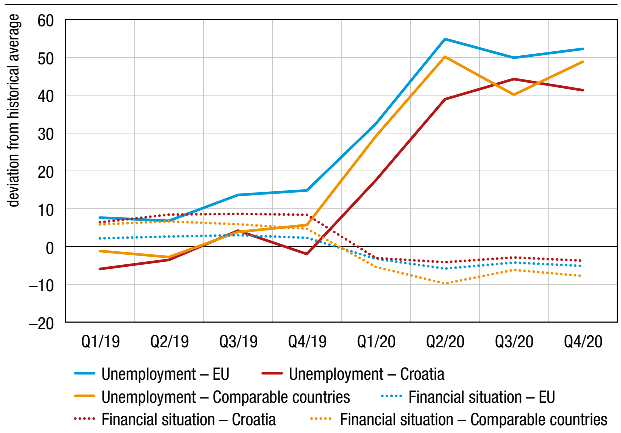
Sources: DG-ECFIN, Eurostat and CNB calculations.

Figure 4 Household financial assets



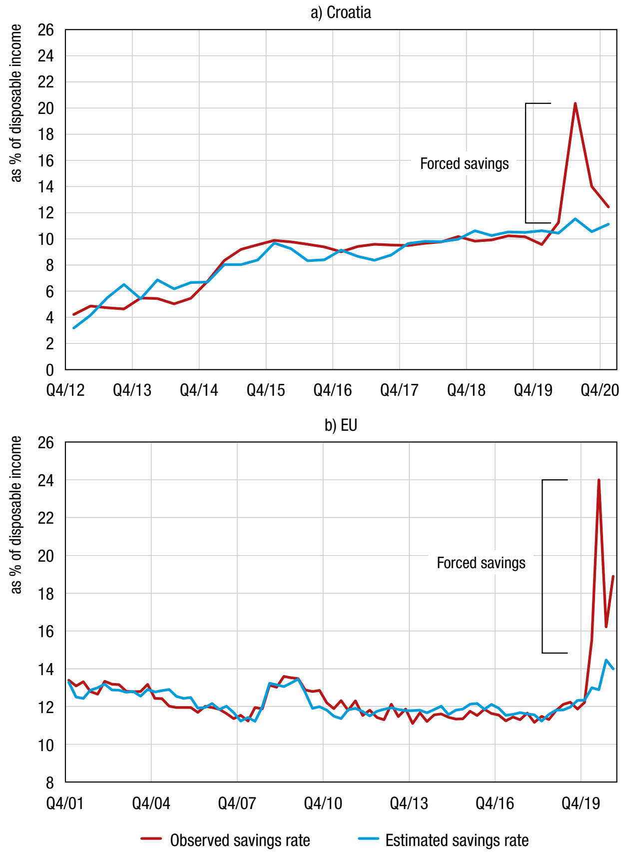
Note: Household disposable income includes the effect of changes in pension rights.
Sources: Eurostat and CNB calculations.

Figure 5 Household expectations about unemployment and financial situation in the next 12 months



Note: The values for comparable countries were calculated using the weighted average.
Sources: DG-ECFIN, Eurostat and CNB calculations.

Figure 6 Gap between the actual and estimated savings rate



Source: CNB estimate.

which at the time affected Croatia less than most other EU member states.

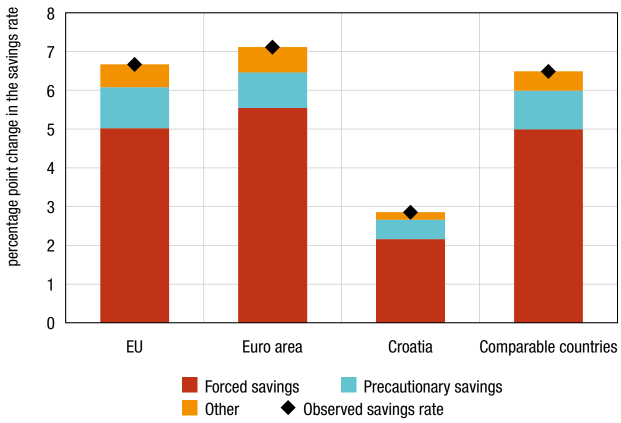
Households placed a large portion of additional savings in bank deposits, mostly those in transaction accounts. This was also due to increased volatility in financial markets, exceptionally low interest rates and propensity to save in liquid assets amid heightened uncertainty (Figure 4). The 2020 increase in household deposits exceeded that in 2019 by around 3 percentage points of disposable income in the euro area, 4 percentage points in Croatia and around 5 percentage points in the Czech Republic and Hungary. Noteworthy is the example of Poland, where the growth in currency in circulation exceeded the rise in deposits, which picked up only slightly from 2019.

There are two reasons for the sharp increase in savings. First, epidemiological measures prevented the spending on some goods and services, with a further reduction in consumption being driven by caution on the part of individuals who voluntarily reduced their mobility. Second, adverse economic effects of the pandemic raised uncertainty about job security and income stability (Figure 5), pushing up precautionary savings. Uncertainty measured by household expectations remained elevated in all EU member states through to the end of 2020, with only minor oscillations, which reflected, among other factors, the specificities of the local epidemiological situation.

A model that quantifies individual contributions of these factors was used to assess their contribution to the recent increase in household savings[9]. The model relatively well describes the

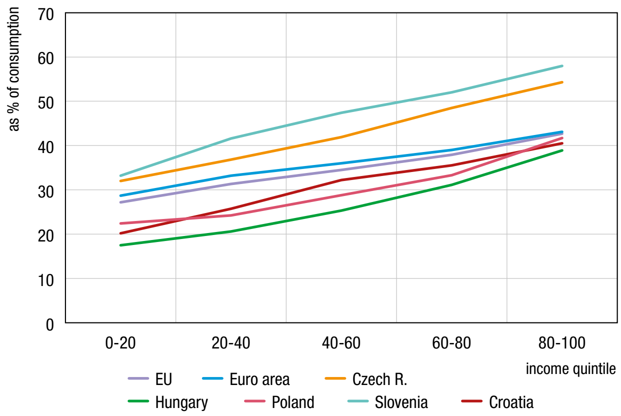
9 To capture the nature of savings this box uses a regression model that is based on a simplified form of the model in Mody et al., *Precautionary*

Figure 7 Contributions of the main factors to savings growth



Note: Cumulative change in the savings rate (that is, percentage points of its factors) relative to the end of 2019.
Source: CNB estimate.

Figure 8 Share of vulnerable savings



Note: The following consumption items were taken into account: clothing and footwear, furniture and maintenance, transportation, recreation and culture, and hotels, cafés and restaurants.
Sources: Eurostat and Household Consumption Survey.

trends in savings prior to the pandemic, with a perceptible importance of precautionary savings, which are even more important in Croatia and comparable CEE countries than in the euro area. However, the sudden increase in the propensity to save and large accumulation of savings in 2020 cannot be attributed to the usual determinants of savings (such as expectations about future income, unemployment, financial situation and net worth of households). Assuming that relations among these determinants and savings have remained unchanged during the pandemic, the difference between the actual and estimated savings rate may be identified as "forced" savings accumulated due to the inability to spend (Figures 6a and 6b). These "forced" savings explain the bulk of the 2020 increase in savings; their contribution to the total increase in Croatia was around 77% and it was even larger in the euro area (Figure 7).

Accumulated excess savings might give a further boost to consumption on the back of the continued improvement in the epidemiological situation, relaxation of restrictive epidemiological measures and a parallel increase in the share of vaccinated population coupled with a reduction in perceived uncertainty. However, evolution of savings is very difficult to predict in the light of crisis specifics as well as factors that influence savings accumulation. The greatest reduction in consumption was seen in services segments, such as travel and food consumption in restaurants, for which subsequent enhanced consumption cannot be expected. Also, excess savings may be mostly concentrated in households belonging to higher income groups (Figure 8). Consumption items[10] that have been hardest hit by the consequences of the pandemic are concentrated in the baskets of households with higher disposable income and lower propensity to spend. All this might limit the intensity of possible spending of accumulated excess savings, that is, the intensity of its spillover into enhanced personal consumption.

4 Labour market

Employment and unemployment

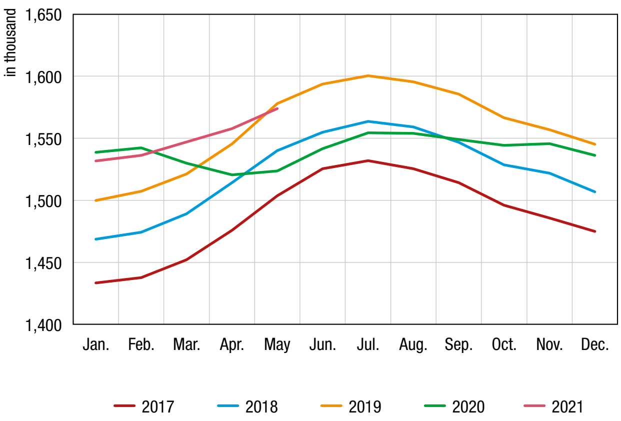
The recovery in employment, which marked the second half of 2020, is losing momentum as the peak tourist season approaches, due to much slower employment in tourism-related service activities. Seasonal fluctuations in employment are subdued in 2021 as well. Early in the year, employment surpassed the 2019 level and almost reached the pre-crisis figures from early 2020. Nevertheless, even with the mild growth in the first five months of 2021, employment was somewhat lower in May 2021 than in the same month of 2019, but was 3.3% above that in May 2020, when the pandemic's effects on the labour market were most perceptible (Figure 4.1). The structure of employment growth in April and May this year was in line with the slower recovery in service activities that require close physical proximity, which grew only slightly, with the most pronounced employment growth seen in construction, information and communication activities and education.

Unemployment trends have also remained subdued this year, mirroring a slowdown in seasonal employment. Unemployment figures have this year stayed above those seen in 2019, with the difference growing towards the mid of the year. Early in 2021, the number of unemployed persons exceeded that from early

Savings in the Great Recession, IMF Economic Review, Vol. 60, 2012, pp. 114-138. The savings rate (as a share in disposable income) is the dependent variable, while independent variables are expectations about unemployment and financial situation (to capture precautionary savings), expected income growth (based on income earned in the next period) and household financial net worth (as a share in disposable income, lagged by one time unit relative to other explanatory variables). Available literature defines forced savings as a prediction error, that is, a residual difference between the estimated and actual savings rate. The model thus explains determinants of savings such as precautionary savings and other income variables, while the unexplained share of the increase is attributed to forced savings.

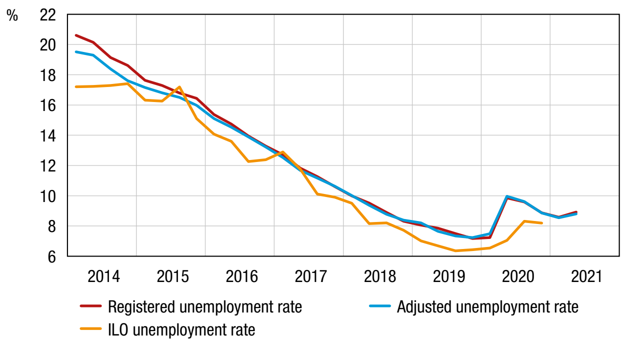
10 To better capture the relation between non-essential consumption and the part of the consumption basket that has been the most vulnerable during the pandemic, only the following consumption items under the COICOP classification are taken into account: clothing and footwear, furniture and maintenance, transportation, recreation and culture, and hotels, cafés and restaurants.

Figure 4.1 Employment
levels



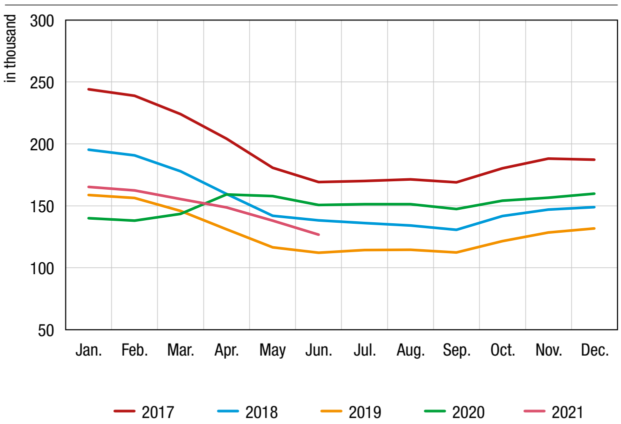
Source: CPII.

Figure 4.3a Unemployment rates
seasonally adjusted data



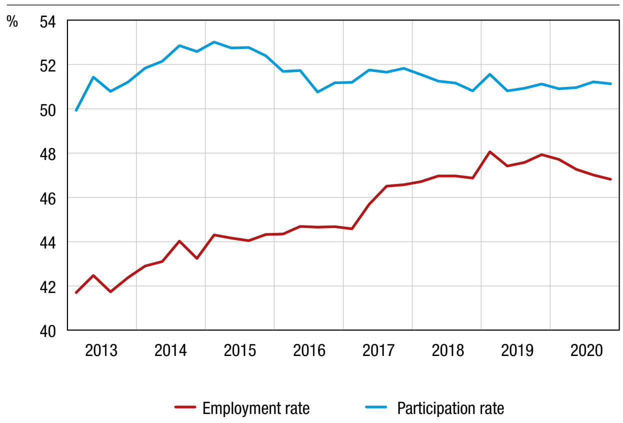
Notes: The adjusted unemployment rate is the CNB estimate and is calculated as the share of the number of registered unemployed persons in the working age population, estimated as the sum of unemployed persons and persons insured with the CPII. Since January 2015, the calculation of the registered unemployment rate published by the CBS has used the data on employed persons from the JOPPD form. Data for the second quarter of 2021 for the registered and the adjusted unemployment rate refer to April and May.
Sources: CBS, CES and CNB calculations (seasonally adjusted by the CNB).

Figure 4.2 Total unemployment
levels



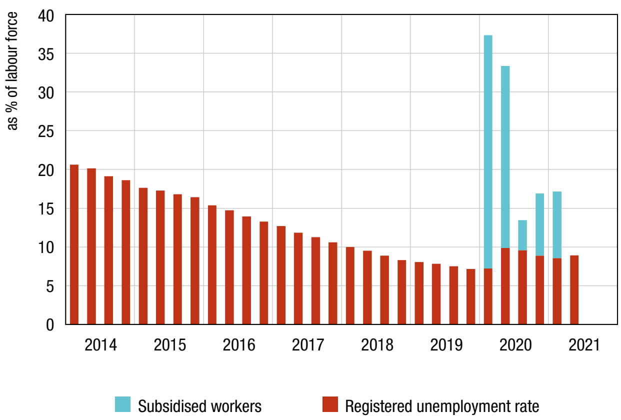
Note: Data for June 2021 refer to the situation as at 21 June.
Source: CES.

Figure 4.4 Labour Force Survey
seasonally adjusted series



Source: CBS (seasonally adjusted by the CNB).

Figure 4.3 Registered unemployment rate (seasonally adjusted data) and subsidised workers, in % of the labour force



Source: CES (seasonally adjusted by the CNB).

2020. However, due to the extremely negative effect of the pandemic on the labour market in the second quarter of 2020, by mid-2021 there were 20,000 fewer unemployed than a year ago (Figure 4.2).

According to the latest available data, job preservation subsidies covered 9.5% of total employed persons from January to March 2021, or 8.6% of the labour force (Figure 4.3). The volume of subsidised jobs was the same in January and February this year as in late 2020, and dropped by only 2 percentage points in March, which points to a gradual decrease in latent risks to employment. However, while the number of subsidised jobs was notably lower in the first quarter of 2021 than in March 2020, it was slightly higher than in the third and fourth quarters of 2020.

The registered unemployment rate decreased in parallel to the drop in the number of unemployed persons, from the average of 9.6% of the labour force in the first quarter of 2021 to 8.2% in May. The ILO unemployment rate for the first quarter of 2021 is to be released in July 2021.

Wages and unit labour costs

Wage growth continued in the first quarter of 2021 at a pace similar to that in the second half of 2020, but came to a halt in the second quarter (seasonally adjusted data) (Figure 4.5). Average wages in the public sector and the rest of the economy grew by 5.4% and 4.8% respectively in April and May, so that the average nominal gross wage in the entire economy grew by 5.1% from the second quarter of 2020. At the beginning of 2021, the increase in gross wages was particularly perceptible in the public sector, whereas wages in the rest of the economy followed suit in April and May, with the sharpest growth seen in information and communication activities.

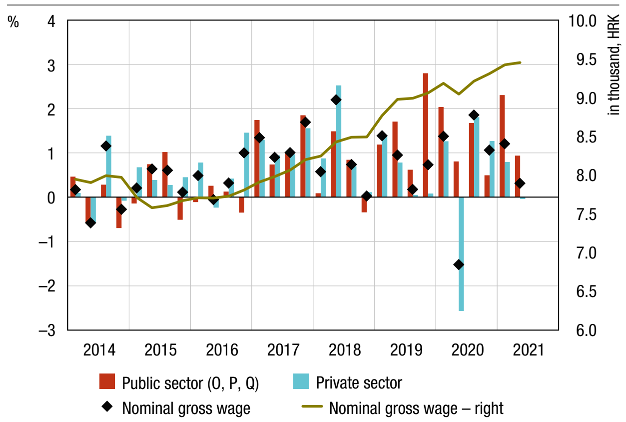
The 2021 rise in nominal net wages was also favourably impacted by the tax changes effected in this January, which reduced income tax rates (from 24% and 36% to 20% and 30% respectively). The average nominal net wage thus grew by 6.9% from May 2020 to May 2021. However, total employee income has been very adversely affected by the almost complete absence of payments of non-taxable compensations since the onset of the pandemic (though not included in wage statistics, they have had a significant impact on employee disposable income in recent years), with this impact being particularly significant in 2020 as well as early 2021. Nominal net wages increased by non-taxable compensations grew by 2.5% from January to April 2021, after falling by 3.5% in 2020 (Figure 4.5a).

Nominal unit labour costs continued to fall rapidly in the first quarter of 2021 because labour productivity increased more (GDP growth exceeded employment growth) than compensation per employee (according to national accounts data) (Figure 4.6).

Projected developments

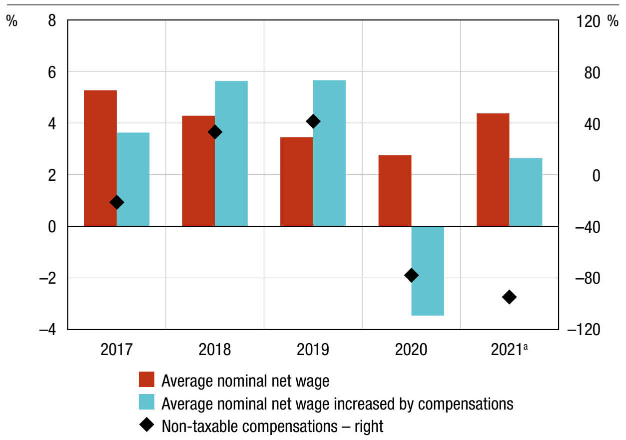
The labour market reacted relatively mildly to the economic slump in 2020 thanks to Government measures aimed at preserving jobs and is not expected to react any more strongly to the economic upswing forecast for 2021. Taking into account the performance in the first five months and projected economic developments, employment is expected to increase by 1.6% by the end of 2021, thereby returning to pre-crisis levels. A notable contribution to total employment growth might come from rising employment in construction, also driven by the reconstruction of earthquake-hit areas, which will probably require the

Figure 4.5 Average nominal gross wage
seasonally adjusted data, quarterly rate of change, levels



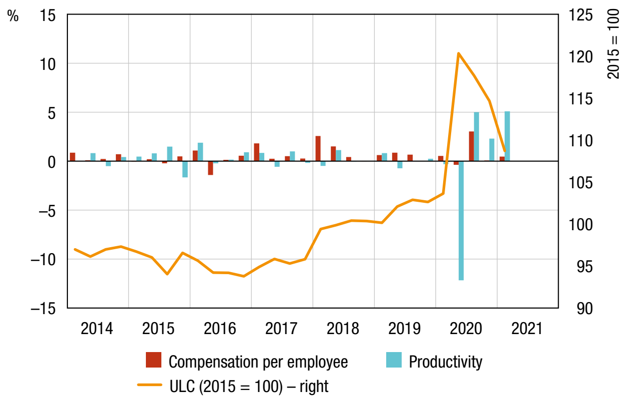
Notes: Data on the average nominal gross wage by activity refer to data from the RAD-1 form, and from January 2016 to data from the JOPPD form. Data for the second quarter of 2021 refer to April and May.
Sources: CBS and CNB calculations (seasonally adjusted by the CNB).

Figure 4.5a Average nominal net wage and non-taxable compensations
year-on-year rate of change



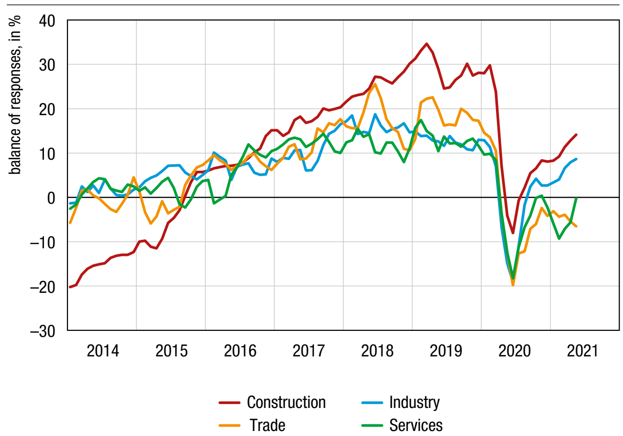
ª The rate of change is calculated for the first four months of 2021 relative to the average value in 2020.
Source: CBS.

Figure 4.6 Compensation per employee, productivity and unit labour costs
seasonally adjusted data, quarterly rate of change and levels (2015 = 100)



Note: In the calculation of unit labour costs, paid compensation of employees and real GDP were taken from the national accounts, while data on the number of employees (persons employed in legal persons and natural persons who received compensation) and total employment were taken from the CPII.
Sources: CPII and Eurostat (seasonally adjusted by the CNB).

Figure 4.7 Employment expectations by sectors (in the following three months)
seasonally adjusted data, three-member moving average of monthly data



Source: Ipsos (seasonally adjusted by the CNB).

engagement of foreign as well as domestic labour.[11] In addition, employment in industry and services is also expected to grow (Figure 4.7). Parallel to the expected increase in the number of employed persons, a decrease is expected in unemployment figures, the ILO unemployment rate possibly dropping to 6.9% of the labour force in 2021.

The average nominal gross wage is expected to increase by 2.9% in 2021, primarily on the back of higher public sector wages (owing to the 4% increase in the wage calculation base for civil servants and government employees at the beginning of 2021), as well as the wage increases seen in the rest of the economy. The average nominal net wage might grow even more as a result of the tax disburdening from January 2021, which is estimated at 3.8%. As the economic recovery gains a stronger footing in 2021 and 2022, a shift is expected to occur in the effect of non-taxable compensations, which will add to the rise in disposable income.

Employment growth is expected to continue into 2022, though at a slower pace than in 2021 (1.2%), while the ILO unemployment rate might fall to 6.3% of the labour force. At the same time, the average nominal gross wage might grow by around 1.6%.

Table 4.1 Estimate and projection of labour market indicators for 2020 and 2021

year-on-year rates of change, in %

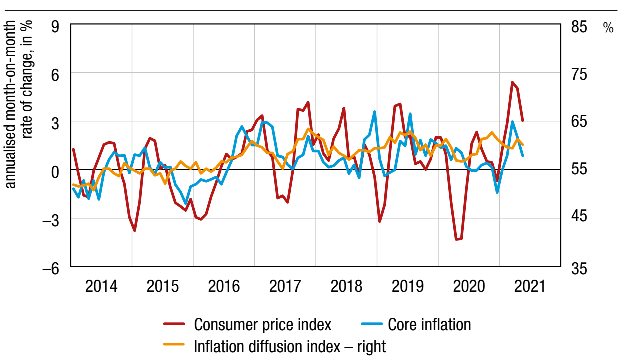
	2018	2019	2020	2021	2022
Number of employed persons – CPII	2.3	2.3	–1.2	1.6	1.2
Number of employed persons – national accounts	2.6	3.1	–1.2	1.6	1.2
Participation rate (ILO)	51.2	51.2	51.0	51.7	52.3
Unemployment rate (ILO)	8.4	6.6	7.5	6.9	6.3
Average nominal gross wage	4.9	3.8	2.5	2.9	1.6
ULC	4.0	1.6	9.9	–2.1	–1.5
Productivity	0.5	0.5	–7.0	5.1	3.2

Notes: The year-on-year rates of change in employment refer to data on persons insured with the CPII, year-on-year rates of change in the average gross wage until 2015 refer to data from the RAD-1 monthly survey, and from 2016 to data from the JOPPD form, whereas year-on-year rates of change in unit labour costs and productivity refer to national accounts data. The estimate and projection of unit labour costs (and productivity) assume that the rise in employment and total employment in the national accounts will be equal to the expected increase in the number of persons insured with the CPII. Average gross nominal wages are recorded on an accrual basis.
Sources: CBS, Eurostat, CPII and the CNB projection.

5 Inflation

The indicator of current trends in overall inflation rose considerably in the first five months of 2021, with a sharp acceleration of the annual consumer price inflation rate in the first five months, from –0.7% in December 2020 to 2.1% in April and May 2021 (Table 5.1). This was almost entirely the consequence of the increase in the annual rate of change in energy prices (most notably petroleum products), partly due to this year's increase in the retail prices of petroleum products, and partly due to the base effect, that is, a sizeable decrease in the prices concerned at the onset of the pandemic. As opposed to the inflation rate, the inflation diffusion index edged down in the same period, suggesting that the share of products that have gone up in price in the total number of products was somewhat smaller in May 2021 than in December 2020 (Figure 5.1). In addition, in the first five months of 2021, core inflation (excluding agricultural product prices, energy prices and administered prices) was low and stable, ranging from 0.4% to 0.6%.

Figure 5.1 Indicators of current inflation trends



Notes: The month-on-month rate of change is calculated from the quarterly moving average of seasonally adjusted consumer price indices. The inflation diffusion index is measured by a 6-month moving average. The inflation diffusion index shows the share of the number of products that increased in price in a given month in the total number of products and is based on the monthly rates of change derived from the seasonally adjusted components of the HICP.
Sources: CBS and CNB calculations.

Indicators of price developments in earlier phases of production and distribution suggest that the inflationary pressures stemming from the growth in the prices of raw materials (energy excluded) in the global market have as yet not started spilling over to producer prices in any considerable amount. Thus, the annual growth rate of producer prices, excluding energy, accelerated mildly and stood at 1.0% in May (up from 0.1% in December). The annual increase in producer prices of intermediate goods and, to a lesser extent, of durable consumer goods, also accelerated. At the same time, the annual fall in the prices of non-durable consumer goods accelerated additionally, among other things due to the producer prices of tobacco products, whereas, despite a significant increase in the prices of food products in the global market, the annual rate of change in producer prices of food products in Croatia remained unchanged and is still in negative territory. However, in terms of total producer prices, the annual rate of change in the domestic market accelerated, from –1.2% in December 2020 to 7.3% in May 2021, mostly due to the increase in the annual rate of change in producer prices of energy.

Broken down by individual components, the acceleration of consumer price inflation in the first five months of 2021 almost entirely mirrors the increase in the contribution of energy prices, up from –1.0 percentage point in December 2020 to 1.7 percentage points in May 2021 (Figure 5.2). The contribution of the prices of unprocessed food products rose only slightly (from –0.3 percentage points to –0.2 percentage points), primarily due to prices of vegetables. However, the contributions of the prices of other components remained unchanged. Services (with a contribution of 0.4 percentage points) and processed food products

11 The survey on business expectations also predicts that employment in construction will increase in the next three months.

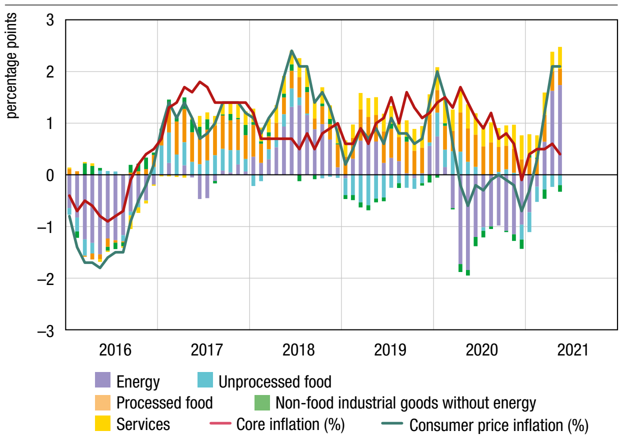
Table 5.1 Price indicators

year-on-year rate of change

	12/2019	5/2020	12/2020	3/2021	5/2021
Consumer price index and its components					
Total index	1.4	–0.6	–0.7	1.2	2.1
Energy	3.4	–10.9	–5.7	3.9	10.6
Unprocessed food	0.7	3.1	–3.5	–3.3	–2.3
Processed food	2.3	2.8	1.3	2.2	1.3
Non-food industrial goods without energy	–0.6	–0.4	–0.7	–0.7	–0.5
Services	1.5	1.8	1.8	1.7	1.7
Other price indicators					
Core inflation	1.2	1.4	–0.1	0.5	0.4
Index of industrial producer prices on the domestic market	1.4	–4.7	–1.2	3.2	7.3
Index of industrial producer prices on the domestic market (excl. energy)	0.5	0.2	0.1	0.7	1.0
Harmonised index of consumer prices	1.3	–0.7	–0.3	1.6	2.4
Harmonised index of consumer prices at constant tax rates	2.1	–0.6	–0.1	1.1	2.2

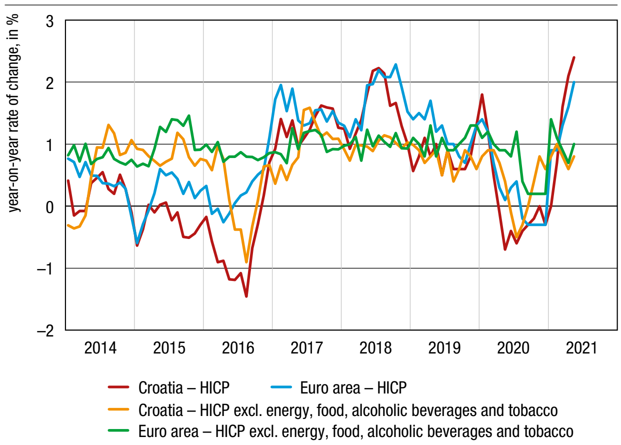
Note: Processed food includes alcoholic beverages and tobacco.
Source: CBS.

Figure 5.2 Year-on-year inflation rate and contributions of components to consumer price inflation



Note: Core inflation excludes agricultural product prices, energy prices and administered prices.
Sources: CBS and CNB calculations.

Figure 5.3 Indicators of price developments in Croatia and the euro area



Sources: CBS and Eurostat.

(0.3 percentage points) still made a positive contribution to total inflation, while the contribution of industrial products to total inflation was slightly negative (–0.1 percentage point).

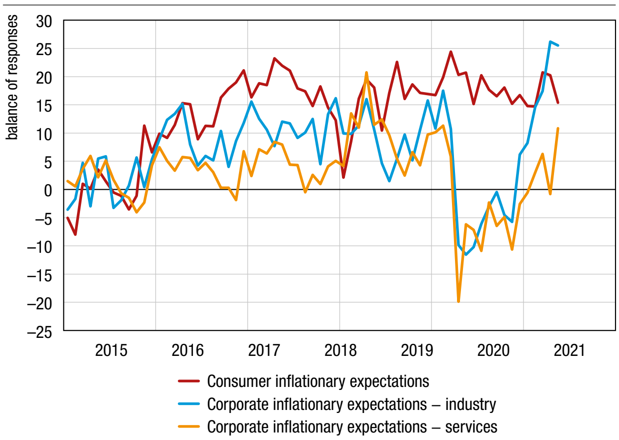
The annual inflation rate in the euro area measured by the harmonised index of consumer prices (HICP) accelerated from –0.3% in December 2020 to 2.0% in May 2021 (Figure 5.3). This was mostly due to the same factors that influenced the inflation trends in Croatia, i.e. the growth of energy prices, whose annual rate of change rose from –6.9% in December to 13.1% in May. In addition to energy prices, the pick-up in inflation was also, to a lesser extent, due to prices of industrial products and services. In contrast, despite the recent rise in the prices of food products (both unprocessed and processed) that may be attributed to the increase in the prices of raw materials in the global market and to the rise in demand, their contribution to inflation trends declined in the observed period. This was due to the negative base effect, that is, a significant growth of these prices amid disturbances in the supply chains following the outbreak and the spread of the coronavirus pandemic in the first half of 2020. Core inflation, which excludes the prices of energy, food, alcoholic beverages and tobacco, picked up from 0.2% in December to 1.0% in May.

Much in the same way as in the euro area, Croatia's annual inflation rate measured by the HICP increased from –0.3% in December 2020 to 2.3% in May 2021. This was almost entirely due to the increase in the contribution of energy prices and, to a lesser degree, due to the increase in the contribution of prices of food products (both unprocessed and processed) to inflation trends. Although inflation, as measured by the HICP, in Croatia was equivalent to that in the euro area in December 2020, a slightly pronounced pick-up in Croatian inflation in the first five months of 2021 led to inflation being by 0.2 percentage points higher in Croatia than in the euro area in May. This is due to a higher contribution of energy prices to inflation trends in Croatia due to its larger share in the basket for the calculation of the HICP, which was partly alleviated by a smaller contribution of the prices of industrial products. Core inflation, measured by the HICP, which excludes the prices of energy, food, alcoholic beverages and tobacco, accelerated mildly from 0.6% in December 2020 to 0.8% in May 2021 and was lower than that in the euro area by 0.2 percentage points.

Inflationary expectations

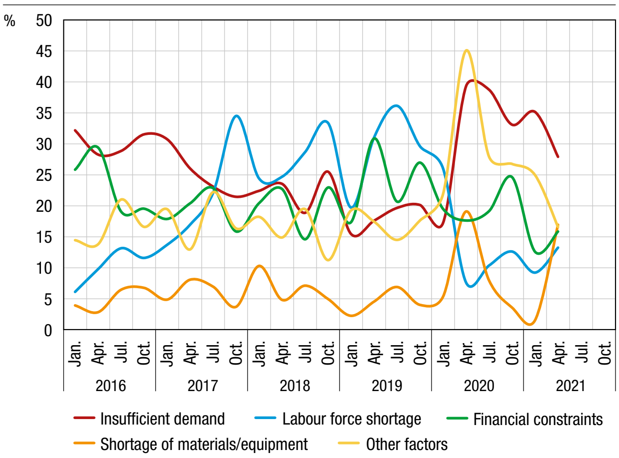
A trend of reduced consumer inflationary expectations in Croatia was noticeable from April 2020 to the end of 2020 (Figure 5.4), which was, apart from the pandemic, also probably fuelled by a considerable slowdown in the annual growth of the prices of food, which entered negative territory in December 2020. In terms of food prices, in the first five months of 2021 inflation remained in negative territory, consumer inflationary expectations staying relatively stable in such conditions. In contrast, since December 2020 there has been a trend of a strong increase in short-term corporate inflationary expectations in industry, up from record lows, which is probably associated with the upward cost pressures caused by the growth in the prices of raw materials and freight charges in the world market, as well supply chain disruptions. In addition, the increase in demand, one of the factors affecting inflationary expectations, is evident from the latest available data from the Business Confidence Survey, showing that a substantial number of enterprises in industry believe that a lack of materials and equipment was a limiting factor for their operations (Figure 5.5), with such problems being present in several industrial activities. A rising optimism spurred by the normalisation of tourism flows also fuels an increase in corporate inflationary expectations in the services sector, albeit at a much slower pace.

Figure 5.4 Short-term consumer and corporate inflationary expectations



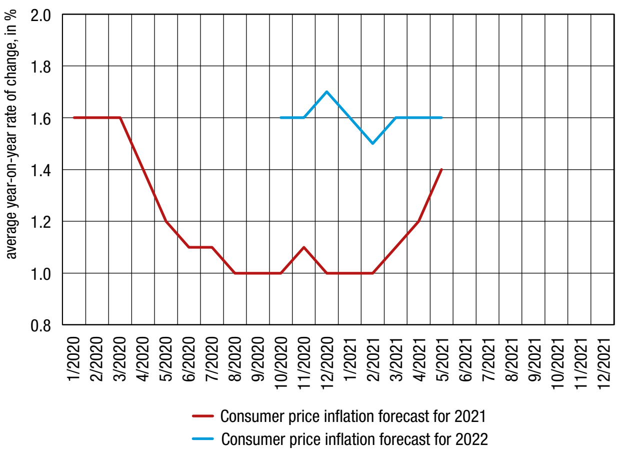
Note: The consumer expectations refer to a twelve-month period ahead and the corporate expectations refer to a three-month period ahead.
Source: Ipsos.

Figure 5.5 Factors limiting industrial production



Source: Ipsos.

Figure 5.6 Short-term inflationary expectations by economic analysts



Source: Eastern Europe Consensus Forecasts.

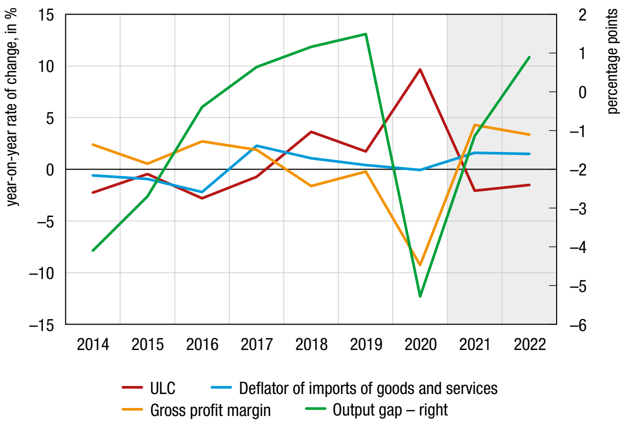
Inflationary expectations by economic analysts in 2021 were anchored in a narrow range of about 1.0% to 1.1% from mid-2020 to March this year, and then rose slightly to 1.4% (Figure 5.6). Such growth has had no impact on the expectations for the upcoming year so far, and thus the consumer price inflation projections by economic analysts for 2022 have been moving within a narrow range around 1.6% in the last eight months.

Projected developments

The projections for 2021 point to an acceleration of the average annual consumer price inflation to 1.7% (from 0.1% in 2020), which should largely be the result of the expected strong increase in the annual rate of change in the prices of energy from –5.3% in 2020 to about 5.9% in 2021. The contribution of energy prices to the overall inflation might rise from –0.9 percentage points in 2020 to about 1.0 percentage point in 2021, primarily as a result of a sharp increase in crude oil prices in the global market and a positive base effect, that is, the fading of the effect of a significant fall in the prices of petroleum products at the onset of the pandemic.

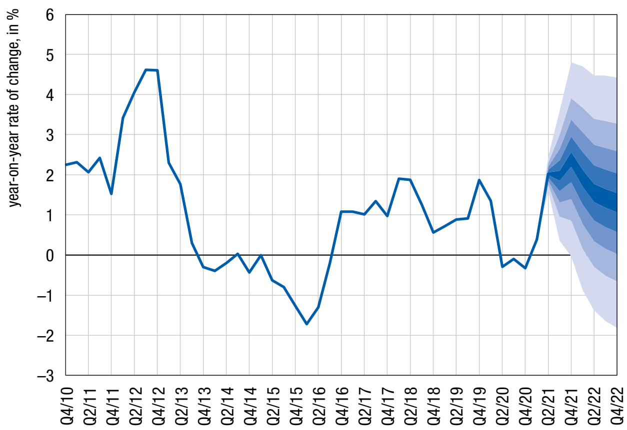
Furthermore, as a result of the recovery of demand in 2021, the annual growth rate of the consumer price index (CPI), excluding food and energy, could increase slightly to about 1.3% (from 1.0% in 2020). For instance, amid a gradual recovery of tourist demand the annual rate of growth in the prices of tourism-related services may be expected to increase. Certain inflationary pressures have been caused by the rise in the prices of raw materials in the global market, increase in freight charges and the shortage of some important products used in the production of other goods (such as semiconductors). The growth of such prices has had no significant spillover effect so far on the producer and consumer prices in Croatia. This is probably due to the relatively low share of the cost of raw materials in total costs, which largely consist of payroll costs and profit margins. The rise in the prices of raw materials is expected to be only transient, and the temporarily increased costs are expected to be alleviated by a drop in profit margins. Subdued domestic cost pressures, arising from an increase in labour productivity more pronounced than the growth in wages, resulting in a decrease in unit labour costs, should contribute to low and stable core

Figure 5.7 Domestic and foreign inflation indicators



Note: Gross profit margin is calculated as the difference between the annual rate of change of the GDP deflator and the annual rate of change of unit labour costs.
Sources: Eurostat, CBS and CNB calculations.

Figure 5.8 Projection of consumer price inflation



Sources: CBS and CNB calculations.

inflation (measured by CPI, excluding food and energy) in the current and the following year. In addition, the inflationary pressures stemming from the rise of prices in Croatia's major trading partners should be mild, having regard to a low projected core inflation, standing at 1.1% and 1.3% in 2021 and 2022 respectively at the euro area level.[12]

The average annual growth of the prices of food is expected to pick up during 2021, from –1.4% in the first quarter to 1.4% in the last quarter, as a result of a time-lagged effect of the strong rise in the prices of food raw materials (particularly cereals and oilseeds) in the global market, as well as a positive base effect (following a sharp drop in retail prices of food in the last quarter of 2020). The most prominent factors indicating that there should be no significant increase in consumer food prices are normalisation of supply chains, expectations that any rise in wages, which have a significant share in the price structure, will be only slight, as well as expectations that the rise in the prices of food raw materials in the global market should only be a temporary disruption, which will probably vanish following the high harvest yields this year on a global level.

The deceleration of projected inflation to about 1.5% in 2022 should result from the expected decrease at 0.6% in the average annual growth rate of energy prices (down from 5.9% in 2021). This should largely be the result of a drop in crude oil prices in the global market, as evident from the trends in the futures market. On the other hand, it is estimated that the average annual growth rate of food prices could increase from –0.2% in 2021 to 2.3% in 2022, with a slightly less pronounced acceleration of the average annual growth of the CPI, excluding food and energy (up from 1.3% in 2021 to 1.5% in 2022). A continued mild increase in core inflation (measured by the CPI excluding food and energy) should largely stem from further recovery of demand, and only to a limited degree be the result of a gradual spillover of the rise in the prices of industrial raw materials in the global market recorded in the previous year.

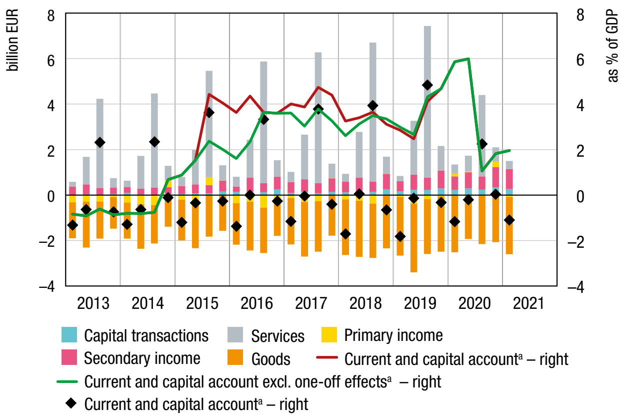
It is estimated that the risks of lower than projected or higher than projected inflation are balanced, but also higher than usual. The risks that could cause inflation to be lower lie in the possible slower than expected economic recovery in the country and abroad in the case of a slower relaxation of epidemiological measures and/or the occurrence of negative macroeconomic risks (premature lifting of monetary and fiscal measures to support the economy, increased saving, etc.). In such an event, inflationary pressures would be subdued by the weaker recovery of demand and lower prices of raw materials. By contrast, in the case of an improved epidemiological situation and consequently a stronger economic growth relative to the projection's baseline scenario, inflationary pressures could be more pronounced. Inflationary pressures from the external environment could also increase relative to the projection's baseline scenario, especially if the prices of crude oil and other raw materials in the global market continue to grow despite the expected stabilisation and in the case of higher inflation in Croatia's major trading partners. In addition, the spillover of the increase in the prices of raw materials to domestic prices could be more pronounced than expected.

6 Current and capital account

The current and capital account deficit[13] went down slightly in the first quarter of 2021 from the same period of the previous year on the back of increased use of EU funds. The opposite effect was produced by the deterioration in the primary income account balance and, to a smaller extent, by the decrease in net exports of services. At the same time, the foreign trade deficit remained unchanged. The cumulative values in the last four quarters show that the current and capital account surplus stood at 2.0% of GDP in the period up to the end of March 2021, which is a slight improvement from 1.8% of GDP in 2020 (Figure 6.1).

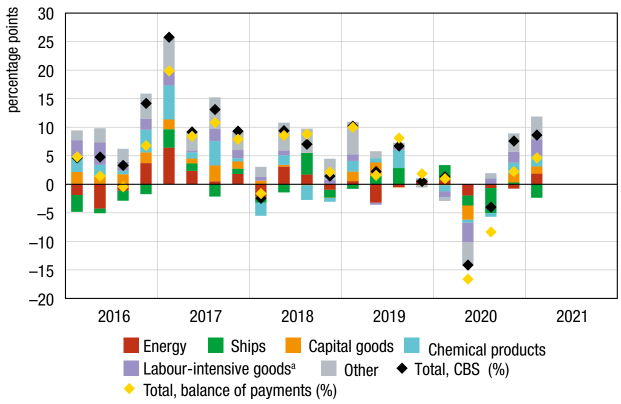
12 ECB projection, June 2021.
13 Historical balance of payments data have been revised from the previously published data. For more details, see: https://www.hnb.hr/en/-/revizija-statistike-odnosa-s-inozemstvom.

Figure 6.1 Current and capital account balance and its structure



[a] Sum of the last four quarters.
Note: One-off effects include the conversion of CHF-linked loans in 2015 and bank provisions for loans to the Agrokor Group in 2017 and 2018.
Source: CNB.

Figure 6.2 Exports of goods
year-on-year rate of change and contributions



[a] Labour-intensive goods (according to the SITC) include: textile, wearing apparel, footwear, leather, paper, cork and wood, furniture, manufactures of metals and non-metallic mineral manufactures, prefabricated buildings and manufactured articles n.e.c.
Sources: CBS and CNB.

Foreign trade and competitiveness

The recovery of global economic activity and foreign demand in the main trading partners contributed to an increase in foreign trade in goods in the first quarter of 2021 compared with the previous year's performance, which was somewhat subdued due to the measures undertaken to combat the pandemic in Croatia and all major foreign trading partners. According to the balance of payments data[14], goods exports rose by 4.6% year-on-year in the first three months of 2021, after having grown by a modest 1.0% in the same period of 2020, and goods imports grew by 2.6%, following a decrease of 0.7% in the same period of the previous year. Despite a faster growth in goods exports than in imports, the foreign trade deficit held steady in the first quarter of 2021 as a result of a higher import base, its decrease in the same period of the previous year amounting to 2.6%. In line with the cumulative values recorded in the course of the past four quarters, the goods trade deficit stood at 17.5% of GDP in the period up to the end of March 2021, which equals the value recorded in the whole of 2020. The characteristics of exports and imports in 2020 are analysed in more detail in Box 4 Trade in goods – developments during the pandemic.

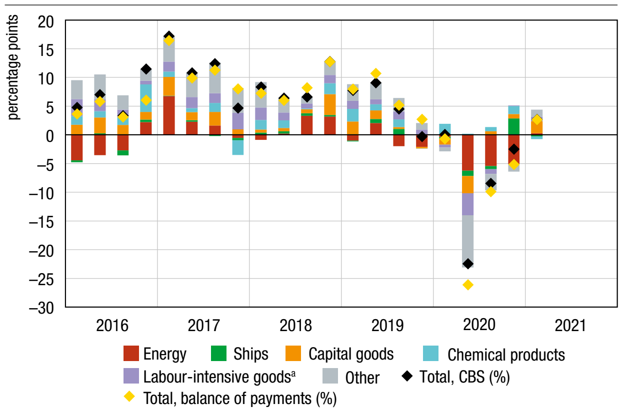
Detailed CBS data show that the annual growth in total goods exports in the first quarter of 2021 was broadly based (Figure 6.2), driven in particular by the growth in exports of medical and pharmaceutical products to the US, oil and refined petroleum products to Hungary and metal industry products to Italy and Germany. In addition, a marked increase was recorded in exports of capital goods, notably electrical machinery and apparatus to Germany and Italy, machinery specialised for particular industries to Saudi Arabia, India and Germany, and food products, mostly cereals and fish and preparations thereof, to Italy.

The major contributors to the annual growth in total goods imports (Figure 6.3) in the first quarter of 2021 included larger imports of capital goods from China (particularly electrical machinery, apparatus and appliances) and metal industry products from Italy (iron and steel, non-ferrous metals and manufactures of metals). Imports of energy products increased by only a little, with strong growth of gas imports from the US and Hungary mostly offset by the fall in imports of oil and refined petroleum products from Italy. In addition, there was a prominent decline in the imports of medical and pharmaceutical products from Belgium.

Net exports of services decreased in the first quarter of 2021 from the same period of the previous year due to the deterioration in the balance of trade in all categories of services (travel, manufacturing services on physical inputs owned by others, transport and other services). The fall in total exports of services (Figure 6.4) was for the most part due to a pronounced decrease in revenues from tourism consumption of foreign tourists (by 38.6%) in the setting of protective measures and restrictions aimed at containing the pandemic. The CBS data suggest an even more pronounced decline in volume indicators for commercial accommodation facilities, with the number of arrivals and nights stayed by foreign tourists falling by 77.1% and 63.4% respectively in the first quarter of 2021 from the same period in 2020 and amounting to only 13.4% of arrivals and 24.9% of

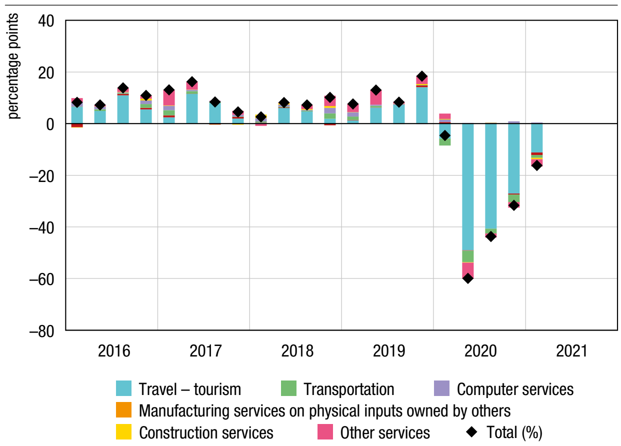
14 According to CBS data, exports and imports of goods grew by 8.6% and 2.7% respectively in the first quarter of 2021 and the goods trade deficit dropped by 6.3% from the same period in 2020. For more information on the differences in the scope of the trade in goods according to the balance of payments and CBS data, see Box 3 Foreign trade developments according to the balance of payments data, Macroeconomic Developments and Outlook No. 2, July 2017.

Figure 6.3 Imports of goods
year-on-year rate of change and contributions



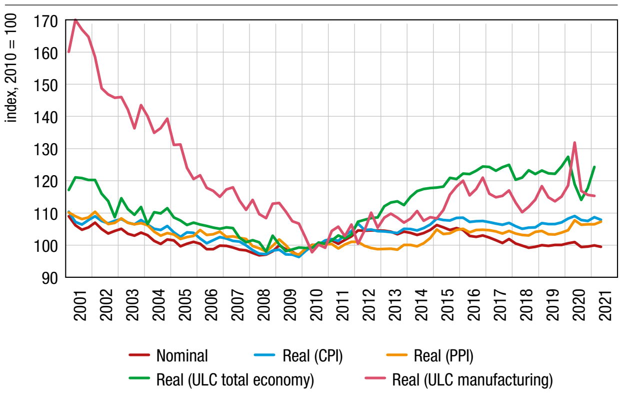
[a] Labour-intensive goods (according to the SITC) include: textile, wearing apparel, footwear, leather, paper, cork and wood, furniture, manufactures of metals and non-metallic mineral manufactures, prefabricated buildings and manufactured articles n.e.c.
Sources: CBS and CNB.

Figure 6.4 Services exports
year-on-year rate of change and contributions



Source: CNB.

Figure 6.5 Nominal and real effective exchange rates of the kuna



Notes: A fall in the index indicates an effective appreciation of the kuna. Data for the second quarter of 2021, relating to nominal and real exchange rates deflated by consumer prices refer to April and May and those relating to real exchange rates deflated by producer prices refer to April.
Source: CNB.

nights stayed in the record-setting year of 2019. At the same time, however, the impact of strong fall in revenues from tourism consumption of non-residents on the balance in services was almost completely offset by an even stronger decrease in tourism consumption of residents abroad (by 58.4%) which, due to lower import base, was only slightly less lower in absolute terms than the fall in exports. If cumulative values recorded in the course of the past four quarters are observed, the surplus in the international trade in services stood at 10.7% of GDP in the period up to the end of first quarter of 2021, decreasing only slightly from the previous year (10.8% of GDP).

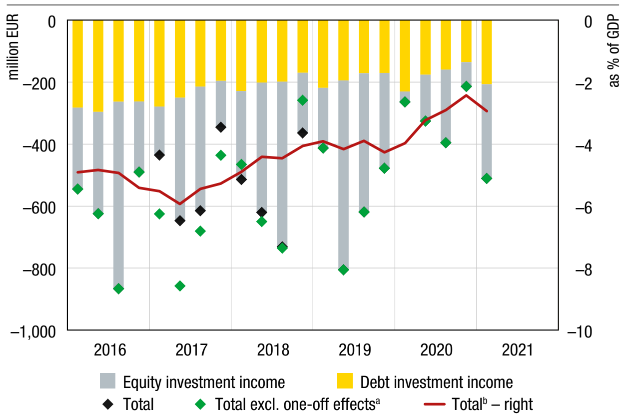
The nominal effective exchange rate remained almost unchanged in the first half of the year while the real effective exchange rate of the kuna deflated by consumer and producer prices slightly depreciated (Figure 6.6). The index of the real effective exchange rate deflated by unit labour costs in the total economy depreciated sharply in the first quarter of 2021, offsetting the deterioration in cost competitiveness from the second half of 2020. In contrast, the index of the real effective exchange rate deflated by unit labour costs in manufacturing remained almost unchanged, close to its pre-pandemic levels.

Income and transactions with the EU

The balance in the primary income account deteriorated considerably in the first quarter of 2021 from the same period of the previous year and, after a positive balance in 2020, once again posted a deficit. This was due to higher deficit in equity investment income (Figure 6.6), resulting primarily from higher profits of banks and enterprises owned by non-residents (especially in the oil industry, and trade and construction). At the same time, interest expenses on foreign borrowing by domestic sectors declined, due primarily to government expenses on issued securities, although to a smaller extent.

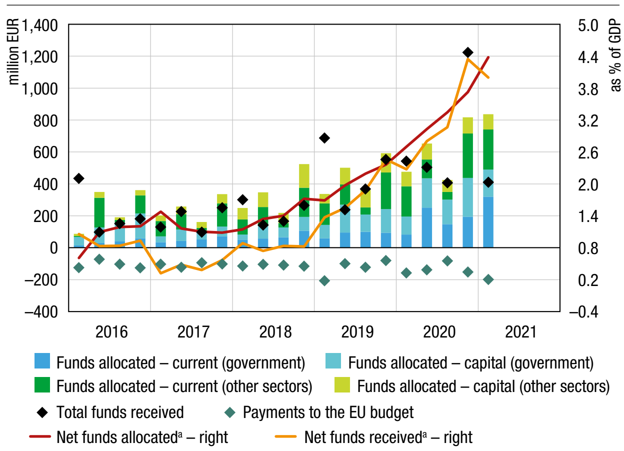
Net income from transactions with the EU budget surged in the first quarter of 2021 from the same period in 2020 owing to the continued strengthening of the uptake of EU funds and a concurrent albeit smaller increase in payments to the EU budget. As regards the structure of the use of funds, a larger share related to current than to capital revenues, with the government receiving more funds than other domestic sectors. The surplus

Figure 6.6 Investment income



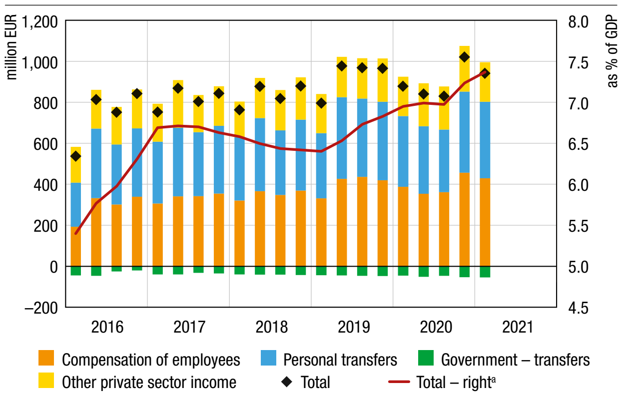
[a] One-off effects include conversion of CHF-linked loans in 2015 and bank provisions for loans to the Agrokor Group in 2017 and 2018.
[b] Sum of the last four quarters, excluding one-off effects.
Source: CNB.

Figure 6.7 Transactions with the EU budget



[a] Sum of the last four quarters.
Notes: As regards total funds received from EU funds, only funds allocated and paid out to end beneficiaries are recorded in the current and capital account of the balance of payments, while funds received but not allocated are recorded in the financial account. Payments to the EU budget carry a negative sign in the figure. The positive value of net received and net allocated funds is the surplus over the payments to the EU budget.
Sources: CNB and MoF.

Figure 6.8 Other income, excluding investment income and transactions with the EU



[a] Sum of the last four quarters.
Note: Compensation of employees is recorded in the primary income account, while other series (personal transfers, other private sector income and government transfers) are recorded in the secondary income account.
Source: CNB.

of EU funds utilised over the payments to the EU budget, reported as the sum of the last four quarters, thus increased from 3.7% of GDP at the end of 2020 to 4.4% of GDP at the end of March 2021 (Figure 6.7). The net inflow from other income, which excludes income from equity and debt investments and transactions with the EU budget, also rose, owing to a growth in net revenues from compensation of persons temporarily employed abroad and personal transfers (Figure 6.8).

Projected developments

In the whole of 2021, the current and capital account might run a surplus of 2.7% of GDP and rose markedly from the 1.8% of GDP recorded in 2020. At the same time, the current account alone might incur a small deficit (of 0.1% of GDP), improving slightly from 2020 (0.4% of GDP). The recovery of tourism revenues and, to a smaller extent, further increase in EU funds inflows stand out in terms of their positive impact on developments in the current and capital account balance. In contrast, favourable developments might be offset by the deterioration in the foreign trade balance and the primary income balance (due to higher profitability of banks and enterprises in foreign ownership) following a temporary improvement in these accounts in 2020.

Larger net exports of services, owing to the recovery in tourism revenues, could be the major contributor to the growth in the current and capital account surplus in 2021. Despite expectations of high growth rate, the overall financial result for tourism in 2021 might stand at around 70% of the level achieved in the pre-crisis and record-setting year of 2019 due to a low base stemming from the more than halved revenues in 2020. An increase in net exports of other services not related to tourism could also contribute to the growth of the surplus in the account of services, although only by a limited margin. Favourable developments in the international trade in services could be considerably counteracted by an increase in the foreign trade deficit, with a smaller deficit, however, expected to be seen in the overall trade in goods and services.

As regards trade in goods, goods exports are expected to increase noticeably in the whole of 2021 due to a relatively favourable performance in the first three months of 2021, better expectations of economic developments in the main trading partners and a continuation of the recovery in global trade. This, however, could be outweighed by the growth in goods imports supported by expectations of increased personal and investment consumption, exports of goods and services (due to import dependence of exports) and oil prices in the world market. The foreign trade deficit, temporarily halted in 2020, is thus expected to resume its upward trend. Moreover, it is anticipated that exports, imports and the foreign trade deficit might surpass their pre-crisis levels as early as in 2021.

In addition to the foreign trade in goods, favourable developments in the current and capital account could be offset by the deterioration of the primary income account balance. This deterioration reflects the assumption of the recovery in the profit of banks and enterprises in foreign ownership which could outweigh the growth in net revenues from compensation of persons temporarily employed abroad. In contrast, the surplus in the secondary income and capital transactions accounts is expected to rise further as a result of the continuation of a stronger uptake of EU funds. Specifically, it is expected that in addition to the funds from the old financial perspective the year 2021 will see the beginning of the utilisation of funds from the new financial perspective 2021-2027 and the Solidarity Fund for post-earthquake reconstruction of Zagreb and the Sisak-Moslavina County. The start of the deployment of funds in the context of the Next Generation EU plan is also expected in the current year, although its impact might remain modest. The positive balance with the EU budget could thus rise to 4.8% of GDP in 2021.

After a noticeable upswing in 2021, only a small growth in the surplus in the current and capital account is expected in 2022 (2.9% of GDP) while the recovery in net exports of services and further increase in the absorption of EU funds could be offset by larger deficits in the goods trade and primary income accounts.

The continued growth in net exports of services brought about by the further recovery in tourism revenues could have the largest favourable impact on the current and capital account balance in 2022. However, the overall financial result for tourism is not expected to reach its pre-crisis level even in 2022. Owing to the faster growth in imports than in exports, the foreign trade deficit could further widen, albeit at a slower pace than in the previous year, as the slowdown in the growth of exports could be accompanied by a stronger slowdown in the growth of imports.

The assumed worsening of the primary account balance in 2022 is attributable to the expectations of further recovery in the profit of banks and enterprises in foreign ownership. Furthermore, the surplus in the secondary income and capital accounts might continue to grow owing to increasingly larger payments of EU funds to end beneficiaries.

The projection of developments in the current and capital account of the balance of payments is exposed to significant risks and uncertainties. The key risks arise from the assumed dynamics of the recovery in tourism revenues which depends on the epidemiological situation in Croatia and the main outbound market countries as well as on EU standards on tourist migration. An additional risk comes from the possibility of a permanent change in the habits of consumers as regards travel which in turn could impact the structural characteristics of domestic tourism and the financial result. The dynamic of the economic recovery of the main foreign trading partners also poses a significant risk due to its impact on goods exports. At the same time, a higher growth in prices of energy products and other raw materials than assumed in the baseline scenario could result in higher net value of their imports and the risk of spillover on prices of other products. Finally, risks to the projection also arise from the uptake of EU funds which, on the one hand, could be larger and, on the other, weaker than currently expected due to the limited absorption capacities in the light of an abundant amount of funds available to Croatia under the overall financial envelope.

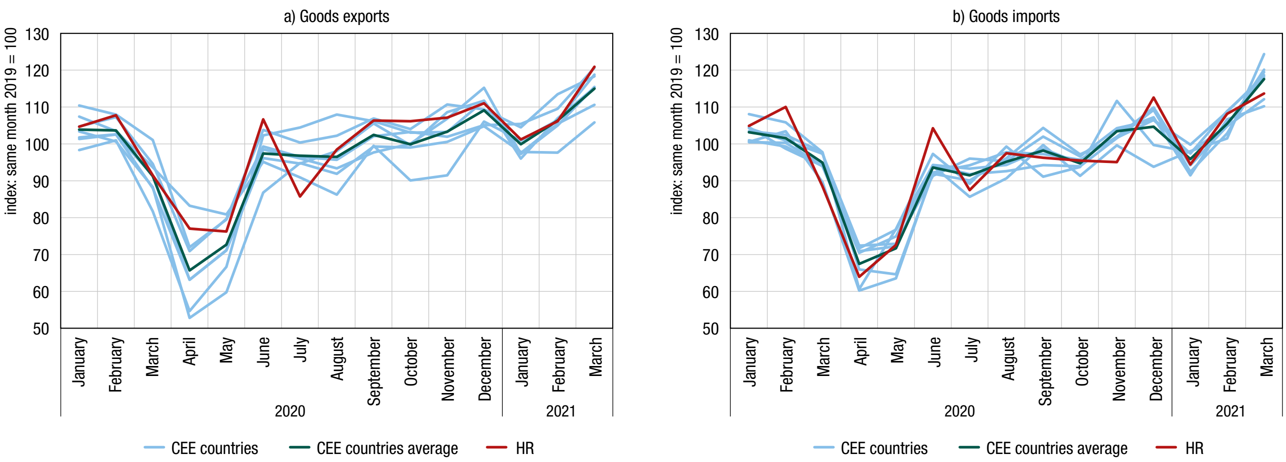
Box 4 Trade in goods – developments during the pandemic

After the initial shock of the pandemic, the foreign trade in goods in all Central and East European (CEE) countries started to show signs of quite strong recovery as early as the second half of 2020. However, the recovery in the second half of the year was insufficient to offset the adverse trends from the beginning of the year. Among the observed countries, Croatia reported the smallest fall in goods exports, due in part to the structural characteristics of the Croatian export sector, with the same trend being observed in Poland. Concurrently, owing to a substantial drop in domestic demand goods imports fell at a rather pronounced rate, contributing to a marked improvement in the goods trade balance. The trade in medical products and equipment considerably softened the contraction of trade flows, in particular imports, in the pandemic year.

A fast spread of coronavirus infections and the accompanying epidemiological measures had a strong and immediate effect on the international trade in goods, which had in fact started to gradually slow down in the years preceding the pandemic. The initial effect of the restrictive measures manifested itself primarily on the supply side, including, among other things, disturbances in supply chains, delays at border crossings and closing of a part of production and sales facilities. This contributed to a strong fall in goods exports and imports in the second quarter of 2020, and notably in April and May, in all CEE countries[15], which recorded trade in goods up to 30% smaller than the year before (Figure 1). However, after the initial shock, the recovery began as early as in June and continued until January 2021 when the trade in goods again witnessed a short-lived contraction.

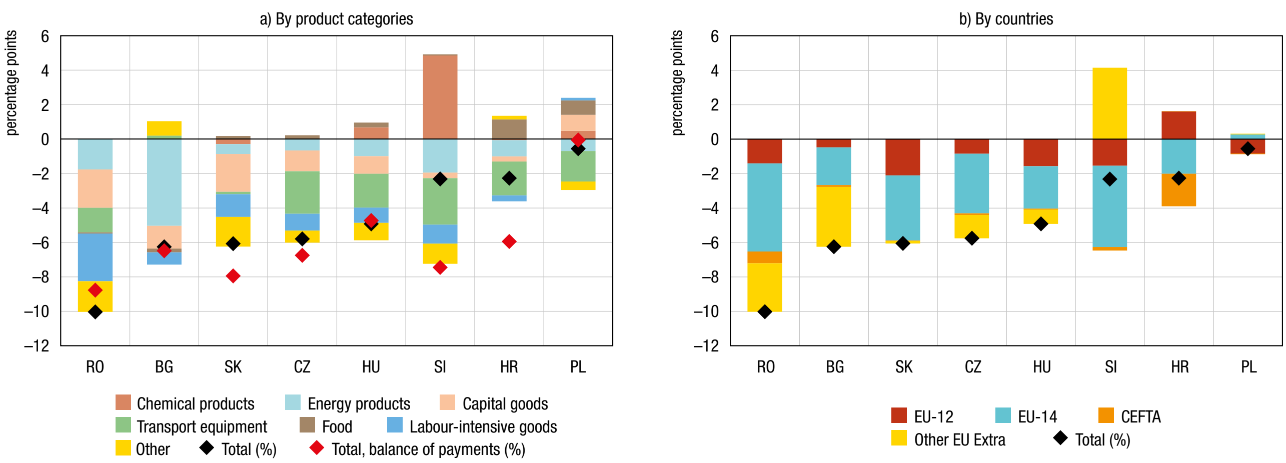
Croatia's goods exports displayed much smaller rate of decrease in April and May 2020 over the CEE countries' average

Figure 1 Trade in goods in Croatia and CEE countries during the pandemic (index: same month 2019 = 100)



Source: Eurostat.

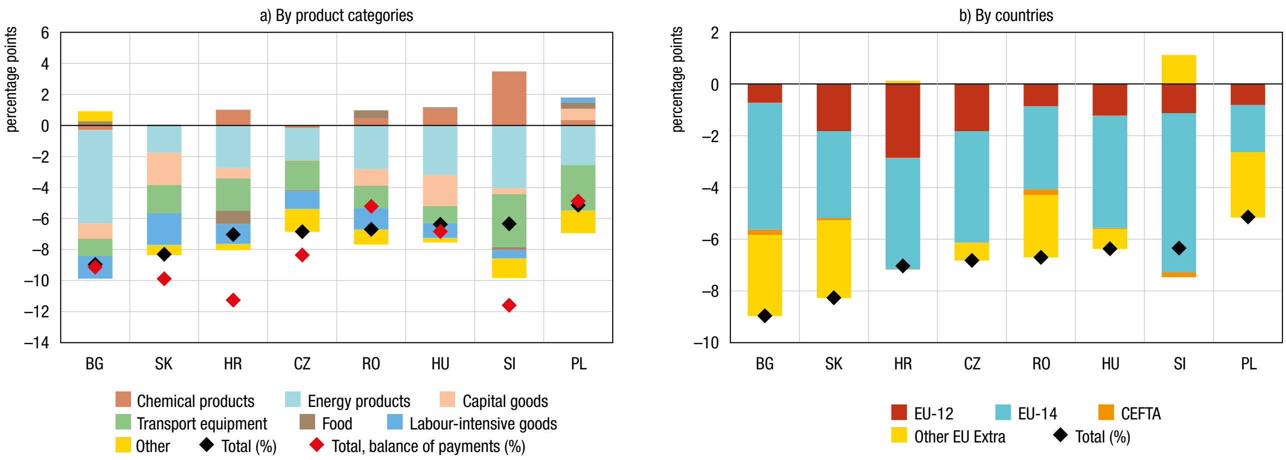
Figure 2 Contributions to changes in goods exports in Croatia and CEE countries in 2020



Source: Eurostat.

15 Central and Eastern Europe (CEE) countries analysed in this Box include, in addition to Croatia (HR), Bulgaria (BG), Czech R. (CZ), Hungary (HU), Poland (PL), Romania (RO), Slovak R. (SK) and Slovenia (SI).

Figure 3 Contributions to changes in goods imports in Croatia and CEE countries in 2020



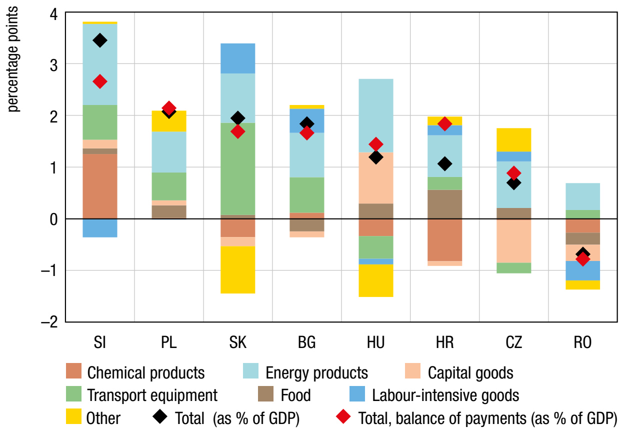
Source: Eurostat.

(Figure 1) and then in the second half of 2020 grew faster than those countries' exports, except in July when exports of ships decreased due primarily to the base effect. Although the growth reported in the second half of the year failed to fully offset the adverse trends from the beginning of the year, the contraction of goods exports was much less pronounced in Croatia (2.3%) than in all other peer countries, except for in Poland (Figure 2, according to the foreign trade statistics data).

The relative resilience of Croatia's export sector during the pandemic largely reflects its structural characteristics, which are considered relatively unfavourable in normal conditions. This primarily relates to the high share of food products and other labour-intensive goods with low value added in total exports. Specifically, food products accounted for one of the rare categories of goods that witnessed a growth in exports in most of the observed countries, with Croatia and Poland reporting the highest growth rates. The smaller fall in exports in Croatia than in other CEE countries may also be attributed to its lower participation in the global value chains, especially those related to the automobile industry. In addition to energy products, the value of whose exports declined primarily due to the fall in oil prices in the world market, exports of automobiles and automobile parts contributed the most to the fall in goods exports in most of the countries analysed. In terms of the geographic markets (Figure 2b), the fall in Croatian exports resulted from smaller exports to CEFTA member countries while exports to the EU single market fell only slightly, with the fall in exports to old EU member states (EU-14), especially Italy, largely offset by the rise in exports to new EU member states (EU-12), in particular Hungary.

The relatively favourable export performance in Croatia was in part also a result of transit operations associated with business operations of non-residents; they surged in the years after the accession to the EU and in particular in the pandemic year when they grew by almost 20%. According to the balance of payments data, which, inter alia, exclude quasi transit[16] (i.e. non-resident trade), the rate of fall in goods exports in 2020 was strong and stood at 5.9%. Although the fall did not diverge significantly from the average for other CEE countries, it was still less favourable than that reported for Poland and Hungary.

Figure 4 Change in goods trade balance in Croatia and CEE countries in 2020

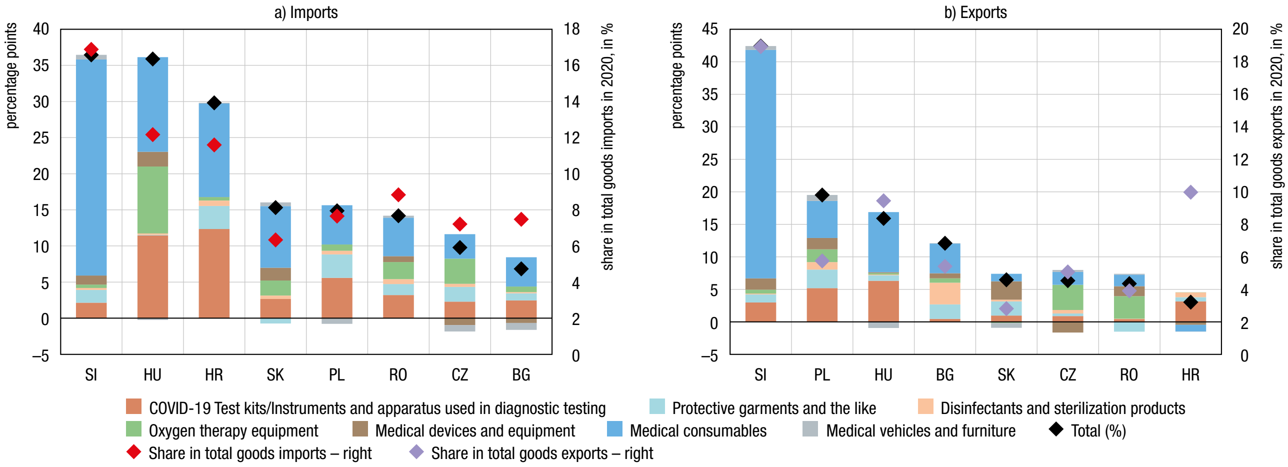


Note: The figure shows differences between the ratio of trade balance in individual product categories to GDP in 2020 and the same indicator in 2019.
Source: Eurostat.

In contrast to goods exports, which demonstrated considerable resilience, Croatia stands out among CEE countries as the country with one of the largest annual rates of fall in imports in terms of both the foreign trade statistics and balance of payments statistics data (by 7.0% and 11.3% respectively). The reported rate of decline was the consequence of the contraction in personal consumption and investment, lower oil prices and smaller exports (including exports of services, notably in tourism) due to their import dependence. As in exports, the largest drop was seen in imports of energy products which together with transport equipment accounted for more than two thirds of the total fall in imports, the trend also observed in other CEE countries. However, in contrast to exports of energy products which declined exclusively on account of the decrease in oil prices, the fall in imports, while affected by smaller import prices, was also largely determined by the decrease in imported quantities, i.e. lower demand for energy products. To a certain extent, this was the reflection of a weaker tourist season and the restrictive measures resulting in a smaller economic activity and restricted mobility as well as in the fostering of alternative forms of work organisation.

16 For more information on the differences in the scope of the trade in goods according to the balance of payments and CBS data, see Box 3 Foreign trade developments according to the balance of payments data, Macroeconomic Developments and Outlook No. 2, July 2017.

Figure 5 Contributions to pandemic-related change in trade in medical products and equipment in 2020

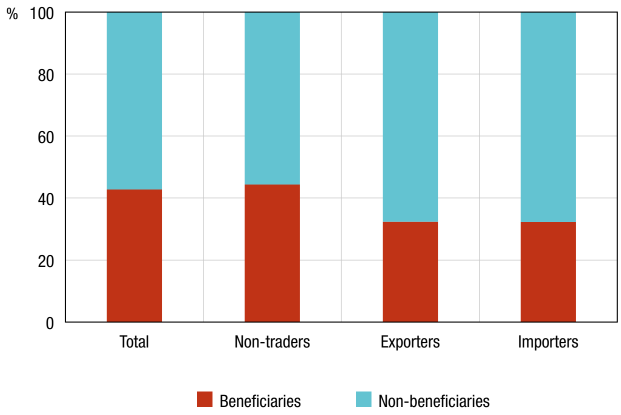


Source: Eurostat.

The aforementioned developments in exports and imports contributed to a considerable improvement in the foreign trade balance in goods in all countries except in Romania (Figure 4). The goods trade deficit in Croatia thus fell from 18.1% of GDP in 2019 to 17.0% of GDP in 2020, with the improvement in the balance being broadly based in terms of production categories, especially in trade in energy products, food and transport equipment. In contrast, a more noticeable deterioration was seen only in trade in chemical products, due to larger imports of medical and pharmaceutical products. The reported improvement in the balance was weaker than that reported by the majority of other observed countries, although Croatia is in the group of countries with the lowest fall in exports and the strongest fall in imports. This is attributable to the strong contraction in GDP, which was the largest in Croatia and contributed to a rise in all relevant indicators expressed in proportion to GDP.

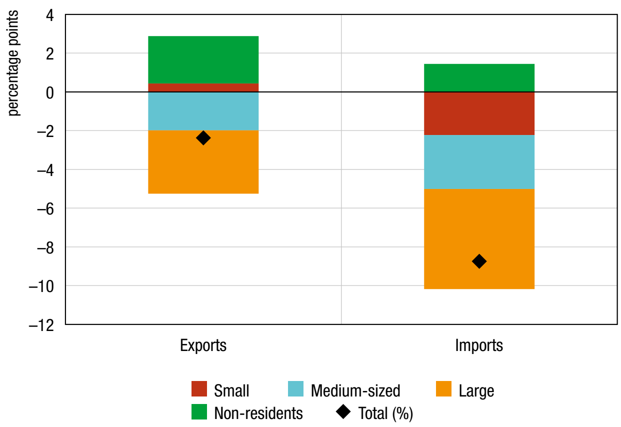
The pandemic was directly responsible for the rise in demand for medicines and other medical products and equipment, which in turn significantly lessened the contraction of total trade flows in CEE countries, in particular imports (Figure 5a). This was supported by the European Commission's decision from April 2020 on waiving VAT and customs duties on imports of about a hundred medical products as well as medical equipment from non-EU countries declared to be vital in fighting the pandemic and in the treatment of COVID-19.[17] As a result, imports of products and equipment for preventing and treating COVID-19[18] surged in 2020 in all observed countries; with the annual growth rate of about 30% Croatia ranked among the countries reporting the strongest growth, just behind Slovenia and Hungary. Increased imports of test kits, instruments and apparatus used in diagnostic testing, medicines and vaccines contributed by almost the same amount to the strong growth in imports, accompanied by a noticeable increase in imports of protective garments and the like. The share of imports of medical products and equipment accounted for almost 12% of total goods imports in Croatia in 2020 which, after Slovenia and Hungary, was the highest share among the observed countries.

Figure 6 The share of the number of enterprises in terms of job preservation grants paid out



Note: The figure shows enterprises with at least one employee.
Sources: FINA, CES and CNB calculations.

Figure 7 Contributions to change in goods trade in 2020 in terms of enterprise size



Sources: FINA, CBS and CNB calculations.

17 For further information, see: https://ec.europa.eu/taxation_customs/covid-19-taxud-response/covid-19-waiving-vat-and-customs-duties-vital-medical-equipment_en.

18 For more details on the database and the scope of data, see: https://ec.europa.eu/eurostat/documents/6842948/11003521/Corona+related+products+by+categories.pdf.

Countries with the highest shares of medical products and equipment in total imports also had the largest shares in total exports (Figure 5b) which suggests a high degree of intra-industry trade in these products. Croatian exports of medical and pharmaceutical products increased after the accession to the EU, making Croatia the second largest exporter of medical products among the observed countries in 2020 (in terms of their share in total goods exports), just behind Slovenia. In contrast, the pandemic-related growth in Croatian exports of medical products and equipment was the smallest among the observed countries in 2020, followed by a drop in exports of medicines. Although all countries witnessed a growth in exports of medical products and equipment in 2020, the reported growth rates in most of them were considerably weaker than those reported for imports. In addition to the increase in domestic demand, this may be in part attributed to the introduction of some form of restrictions on exports of medical equipment in most CEE countries or even to an absolute ban on exports in individual periods.[19]

Trade flows of individual enterprises were also facilitated by the measures taken by the Croatian Employment Service to preserve jobs. Over one half of the total number of enterprises with at least one employee that are profit tax payers received grants in 2020 (Figure 6). Hence, more than two thirds of exporters and importers were using grants for at least a month in 2020, while in enterprises not directly participating in international trade this share was only slightly higher than 50%. This was in part expected considering that enterprises active in foreign trade employ substantially larger numbers of workers than enterprises active only in the domestic market.

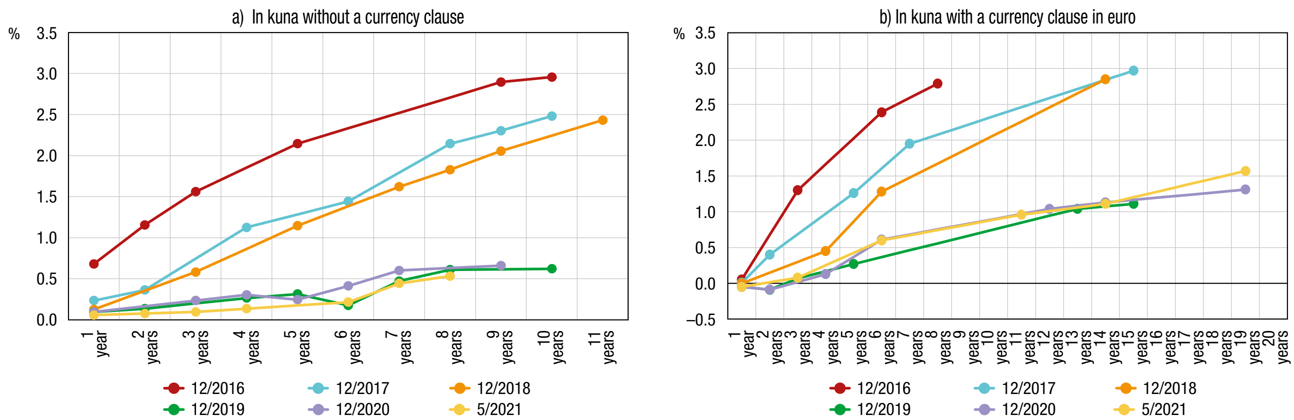
Small enterprises,[20] together with medium-sized enterprises, were the main generator of strong growth in exports in the first six years of EU membership (2013-2018) as much as they were during the recession (2008-2013) when exports recovered exclusively on the back of increased export activity of small and medium-sized enterprises while exports of large enterprises dropped significantly.[21] Small enterprises proved highly resilient even in the year of the pandemic and slightly increased their exports (Figure 7) while medium-sized and notably large enterprises were responsible for export contraction and stood out as a group with the highest decrease in total goods exports.

7 Private sector financing

The financing costs of domestic sectors generally decreased in the first half of 2021, remaining close to historic lows. On the other hand, banks continued to tighten credit standards for corporate loans in the first quarter, though the tightening was not very widespread compared with the previous year's average, while credit standards for households were slightly eased. In such conditions, total corporate financing edged down on an annual basis, mostly as a result of external deleveraging, while domestic debt increased. After a significant slowdown in 2020, the annual growth of household placements started to recover mildly, while the rise in housing loans continued to gain momentum.

Government borrowing costs, one of the determinants of borrowing costs for other domestic sectors, mostly went down in the first half of the year, particularly yields on kuna debt without a currency clause. The already very low interest rates on short-term borrowing dropped further. The interest rate on one-year kuna T-bills in the domestic market edged down from 0.06% in late 2020 to 0.02% in May 2021 (Figure 7.2), while the interest rate on euro T-bills of the same maturity issued in the domestic market remained at –0.05% in May, the same as at the previous

Figure 7.1 Yield-to-maturity on RC bonds



Notes: The dots show the achieved yields, while other values have been interpolated. Data for a one-year yield refer to the achieved interest rate on one-year kuna T-bills without a currency clause.
Source: CNB.

Notes: The dots show the achieved yields, while other values have been interpolated. Data for a one-year yield refer to the achieved interest rate on one-year kuna T-bills with a currency clause in euro, while data for the end of 2016 refer to November, and for the end of 2017, 2019 and 2020 to October respectively.
Source: CNB.

19 For a more detailed overview of measures, see: https://www.schoenherr.eu/media/v0eatave/eu_competition-new_rules_regarding_exports_of_medical_equipment_and_medicinal_products.pdf.

20 The size of an enterprise is defined using the number of employees based on hours worked: small enterprises employ less than 50 workers, medium-sized enterprises more than 50 and less than 250 workers, and large enterprises more than 250 workers. For determining the size of enterprises, data for 2019 were used, since FINA data for 2020 are currently unavailable.

21 Šelebaj, D. (2020): *Mikroekonomski aspekti izvoza hrvatske prerađivačke industrije nakon ulaska u EU*, HNB Istraživanja, I-59.

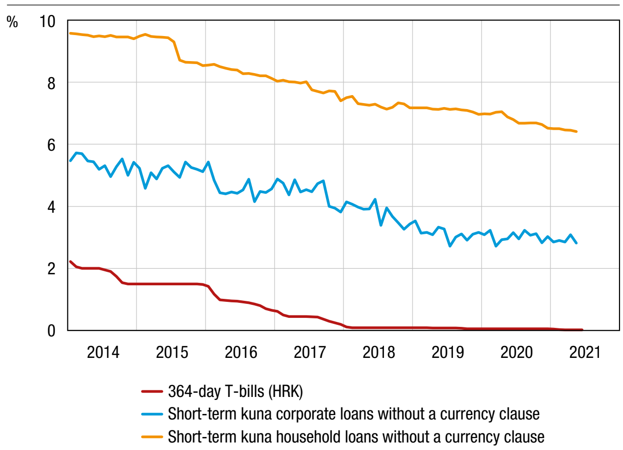
issue in October 2020. In early May, the government refinanced a large issue of one-year euro T-bills, raising the amount to EUR 1.2bn from EUR 1.0bn a year ago, while the interest rate decreased from 0.06% to 0.05%. Long-term yields on government bonds were in May close to pre-pandemic levels (Figure 7.1), whereas costs of long-term financing in kuna without a currency clause were generally more favourable. In late February, the government issued two tranches of eurobonds in the foreign capital market worth EUR 1.0bn each, with a 1.26% yield on 12-year bonds and a 1.79% yield on 20-year bonds. The maturity period for issued eurobonds was, for the first time, extended to 20 years, by which Croatia acquired funds in the foreign market for the longest term in its history. Furthermore, the government issued HRK 9bn worth of bonds with a 7-year maturity and a 0.53% yield in the domestic market at the beginning of July.

The government's foreign borrowing cost, estimated by the sum of the EMBI for Croatia and the yield on the German government bond, increased from 0.5% at the end of last year to 1.0% in June (Figure 7.3) largely due to the rise in the yield on the German government bond. Croatia's credit default swap (CDS) mostly held steady in the first half of 2021, standing at 78 basis points in late June, only 3 basis points more than at end-2020. The country's credit rating also remained unchanged in the first half of 2021. Credit rating agencies, Standard & Poor's and Fitch, maintained Croatia's BBB– investment rating with a stable outlook, while the Moody's maintained its Ba1 rating with a stable outlook, one notch below investment grade.

Corporate financing costs decreased slightly from the last quarter of 2020 to the end of May 2021. The average interest rate on short-term corporate borrowing from banks in kuna without a currency clause dropped by 0.1 percentage point (Figure 7.2), while the average interest rate on long-term loans with a currency clause fell by 0.2 percentage points (Figure 7.3). The reduction in corporate financing costs was evenly distributed by loan size; the average interest rate on loans above HRK 7.5m fell by 0.3 percentage points in the first five months of 2021 relative to the last quarter of 2020, while the average interest rate on loans of up to HRK 7.5m decreased by 0.2 percentage points (Figure 7.4). Loans ranked in terms of amounts include loans in foreign currency.

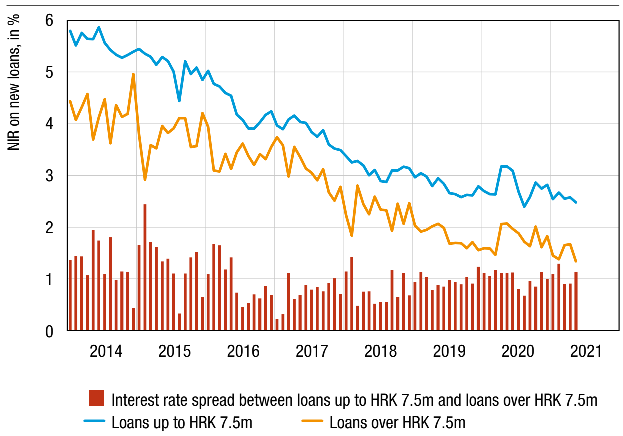
Interest rates on household loans generally trended down in the first five months of the year compared with the last quarter

Figure 7.2 Short-term financing costs
in kuna without a currency clause



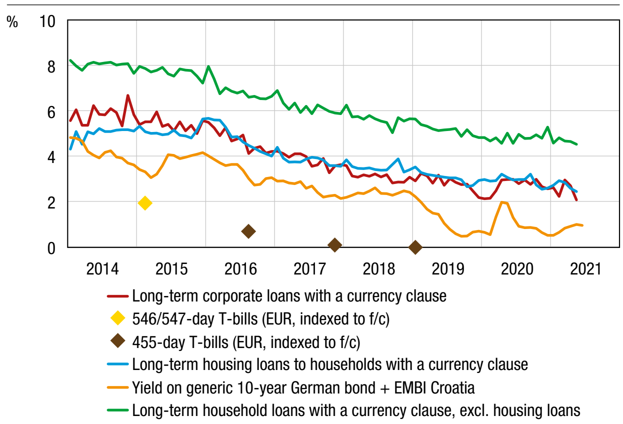
Sources: MoF and CNB.

Figure 7.4 Bank interest rates on loans to non-financial corporations by volume



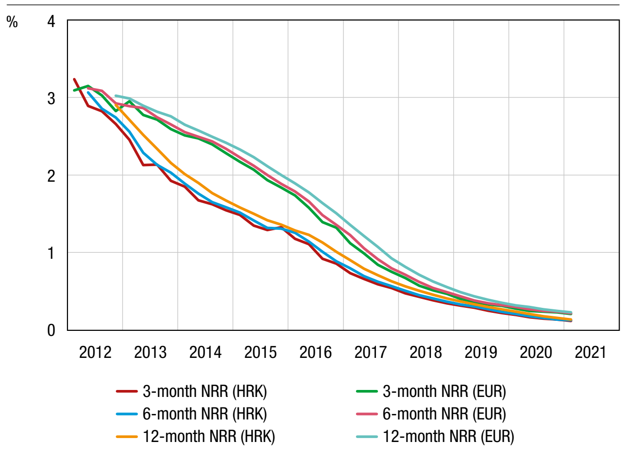
Source: CNB.

Figure 7.3 Long-term financing costs
in kuna with a currency clause and in foreign currency



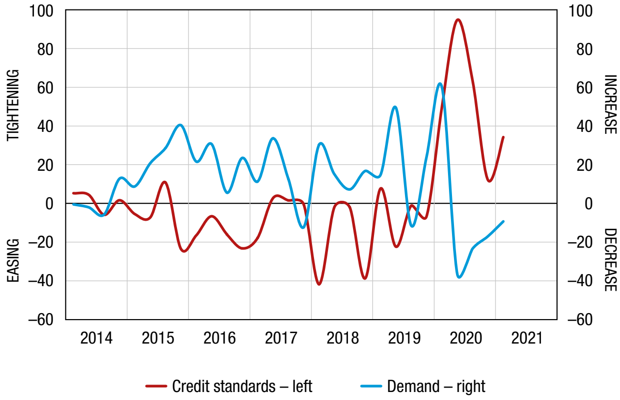
Note: EMBI, or the Emerging Market Bond Index, shows the spread between yields on government securities of emerging market economies, Croatia included, and risk-free securities issued by developed countries.
Sources: MoF, Bloomberg and CNB.

Figure 7.5 National reference rate (NRR)



Note: The rates shown are the rates for all natural and legal persons.
Sources: HUB and CNB.

Figure 7.6 Credit standards and corporate demand for loans



Note: Data show the net percentage of banks weighted by the share in total corporate loans.
Source: CNB.

of 2020. The average interest rate on short-term kuna household loans without a currency clause dropped by 0.2 percentage points (Figure 7.2), while the average interest rate on long-term household loans with a currency clause, excluding housing loans, fell by 0.4 percentage points (Figure 7.3). An increase was seen only in the average interest rate on long-term housing loans with a currency clause, of 0.1 percentage point, which is mostly attributable to the very low level of these interest rates in the last quarter of 2020 due to large amounts of housing loans granted under the APN's subsidy programme.

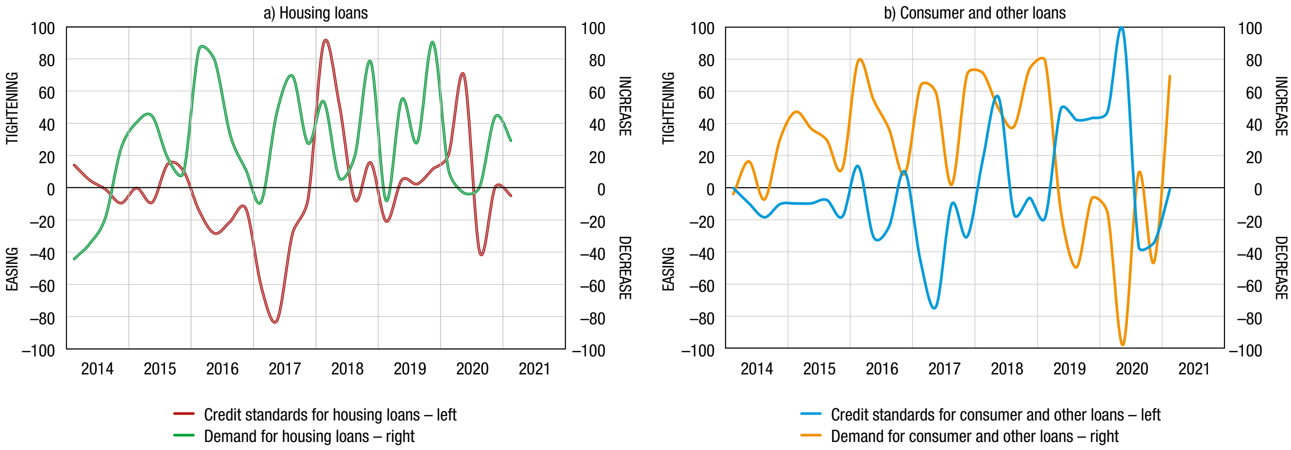
Further decrease in the funding costs of the Croatian banking system in the conditions of the exceptionally expansionary monetary policy and historically high surplus liquidity contributed to the maintenance of the favourable financing conditions of the private sector. The national reference rate (NRR)[22] (Figure 7.5) decreased slightly in the first quarter, while EURIBOR continued to decline in the first half of 2021, falling to its historical low (Figure 2.6).

According to the bank lending survey, the tightening of credit standards for corporate loans continued in the first quarter and was more widely diffused than in the quarter before (Figure 7.6), but much less pronounced than the 2020 average. The tightening was driven by negative expectations regarding overall economic trends and the worsened outlook for industries or individual enterprises, while competition among banks and abundant liquidity had the opposite effect. Overall demand for loans continued to decrease for the fourth consecutive quarter, albeit at a slower pace. Demand of large enterprises and demand for long-term loans decreased while demand by small and medium-sized enterprises and demand for short-term loans increased. According to bank responses, the slump in overall demand was a result of the fall in investments, which was, however, mitigated by the need of enterprises for debt restructuring and financing of working capital.

The credit standards for housing loans were relaxed in the first quarter of 2021 after holding steady in the quarter before, while the easing of standards for consumer and other loans almost came to a halt in the first quarter (Figure 7.7). The easing of standards for both types of loans in the first three months was influenced by competition among banks and a reduction in funding costs. The extent of the relaxation for all loans was limited by expectations regarding overall economic trends, whereas concerns about the creditworthiness of clients was a specific factor as regards consumer loans. Demand for both types of loans grew during the first quarter, particularly for consumer and other loans. Demand for housing loans was fuelled by the outlook for the real estate market, whereas stronger consumption of durable consumer goods and consumer confidence provided a boost to demand for consumer loans.

The corporate demand for loans was spurred by economic recovery, so that all types of corporate financing increased in the first quarter of 2021 (Figure 7.8), particularly external debt. On the other hand, total corporate debt was 0.2% lower in late March on an annual basis (transaction-based), largely on account of external deleveraging and, to a small extent, lower borrowing from domestic leasing companies. Other forms of

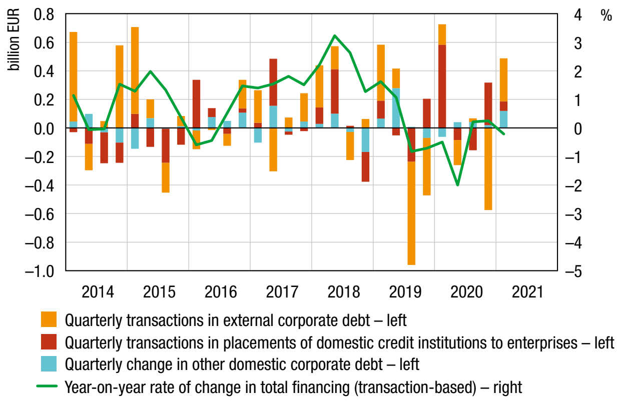
Figure 7.7 Credit standards and household demand for loans



Note: Data show the net percentage of banks weighted by the share in total household loans.
Source: CNB.

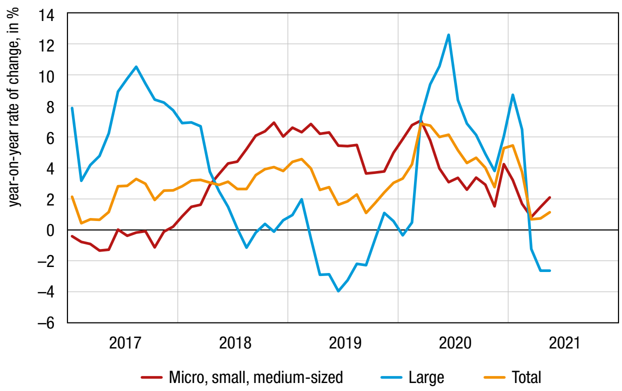
22 The national reference rate (NRR) is the average interest rate paid on deposits by the banking sector. It is used as one of the benchmark interest rates for determining the level of the variable component of variable interest rate on loans, in accordance with Article 11a of the Consumer Credit Act (pursuant to the Act on Amendments to the Consumer Credit Act, OG 143/2013).

Figure 7.8 Corporate financing



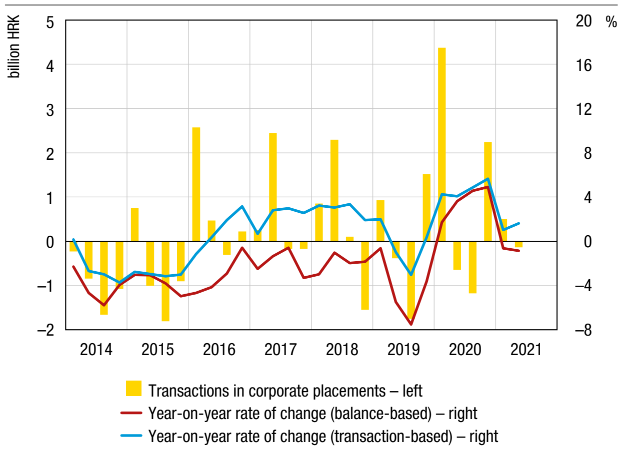
Notes: Other domestic financing includes borrowing from domestic leasing companies, the CBRD and HAMAG-BICRO. Foreign debt excludes the effect of debt-equity swaps. All changes were calculated on the basis of transactions (except for leasing companies).
Sources: HAMAG-BICRO, HANFA, CNB and CNB calculations.

Figure 7.11 Growth of corporate placements by size
transaction-based



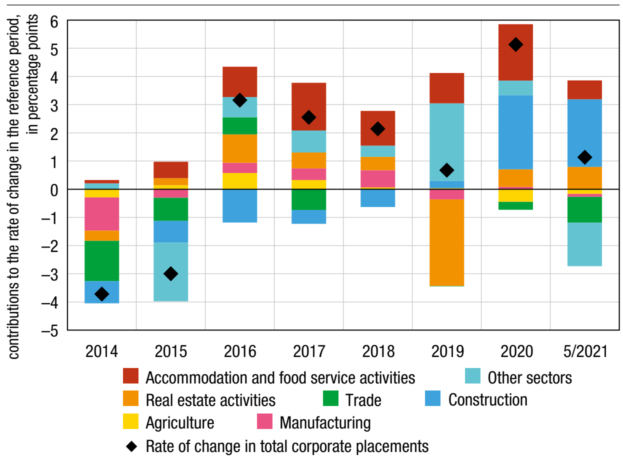
Note: The data were adjusted for the assessment of the effect of activated government guarantees for loans to particular shipyards and the decrease in the claims on the Agrokor Group linked to the operational implementation of the settlement.
Source: CNB.

Figure 7.9 Corporate domestic placements of credit institutions



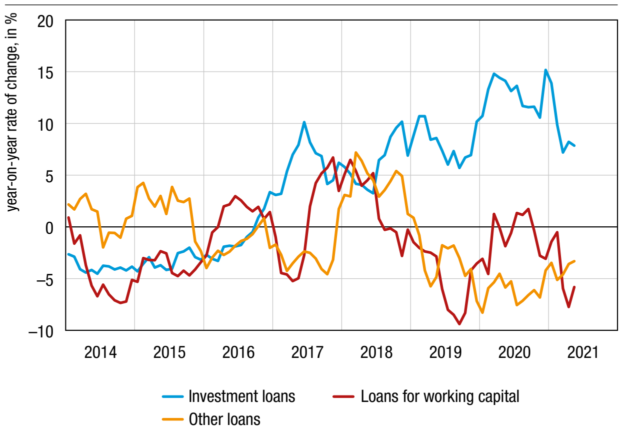
Note: Data for the second quarter of 2021 refer to April and May.
Source: CNB.

Figure 7.12 Growth of corporate placements by activity
transaction-based



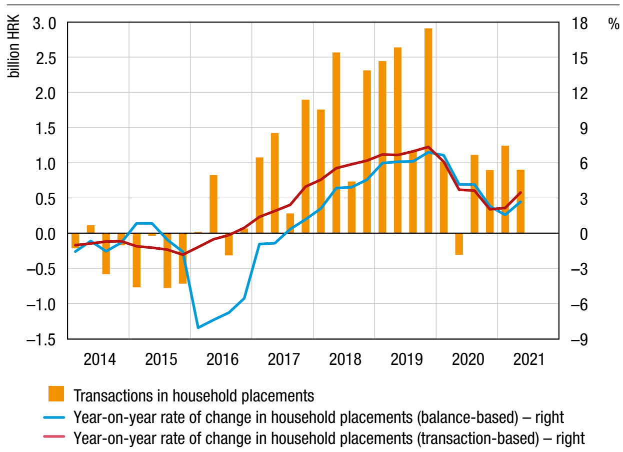
Source: CNB.

Figure 7.10 Growth of corporate loans by purpose
transaction-based



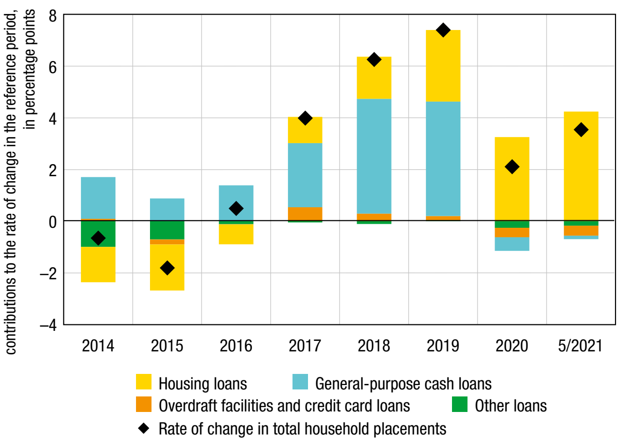
Source: CNB.

Figure 7.13 Household placements



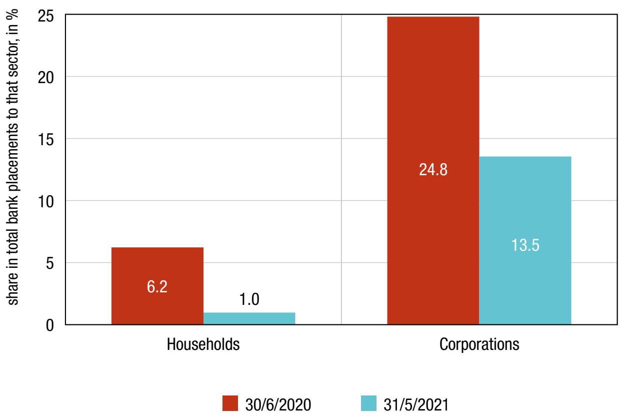
Note: Data for the second quarter of 2021 refer to April and May.
Source: CNB.

Figure 7.14 Growth of household placements by loan type
transaction-based



Source: CNB.

Figure 7.15 Loans under payment deferral or restructuring measures



Source: CNB.

domestic borrowing grew on an annual basis as well, equally from credit institutions and the CBRD, but the sharpest increase was seen in borrowing from HAMAG-BICRO due to the use of loans for maintaining liquidity during the pandemic.

After having played an important role in corporate financing in 2020, corporate placements of credit institutions grew by a mere HRK 0.4bn or 0.4% in the first five months of 2021, with their annual growth rate standing at 1.6% at end-May (transaction-based, Figure 7.9). This growth was again determined by demand for investment loans, which were 7.9% higher in late May on an annual basis (Figure 7.10), growing much less than in the previous year. Other loans dropped on an annual basis, particularly working capital loans, which fell by 5.8%, probably due indirectly to ample liquidity support provided by HAMAG-BICRO. Loans to micro, small and medium-sized enterprises increased steadily, growing by 2.1% in May, which was less than a year ago. Large enterprises started to deleverage on an annual basis in March (Figure 7.11), after having accounted for most of the growth since last March.

The bulk of the annual growth in placements in late May 2021 was seen in construction (result of a large transaction in December), the real estate activity and the activities of accommodation and food service, which were at the forefront of growth in most previous years[23] (Figure 7.12). On the other hand, placements to other activities decreased, particularly to trade and professional, scientific and technical activities.

After much slower growth in 2020, mostly due to lower demand for general-purpose cash loans, the rise in household placements started to accelerate slightly in the first half of 2021, so that their annual growth rate went up from 2.1% in late 2020 to 3.5% in May 2021 (transaction-based, Figure 7.13). The several-year upward trend in housing loans continued to gain momentum, spurred also by the implementation of the government subsidy programme. The annual growth in housing loans reached 9.7% in late May 2021, up from 7.5% in the year before. The annual decrease in general-purpose cash loans decelerated in the same period, from 1.3% in 2020 to 0.3% in May. As a result, the growth in housing loans exceeded the overall increase in household placements (Figure 7.14).

At the end of May 2021, 13.5% of total bank placements to corporates were covered by measures, substantially less than in June 2020 (Figure 7.15). However, in the household sector this share decreased sharply in the same period, amounting to only 1.0% at the end of May.

Projected developments

It is estimated that total placements (government excluded) might grow by 3.4% (transaction-based) in 2021. Credit growth might largely be driven by the more vigorous lending to households, with total placements to this sector expected to grow by 3.7% in 2021. This might be strongly driven by housing loans, which are boosted by the new round of housing loan subsidies, while general-purpose cash loans might also rise mildly on the back of stronger consumer optimism. The increase in corporate loans is expected to slow down to 2.3% this year as a result of poor performance in the year so far. Lending to non-financial corporations might be adversely affected by the tightening of credit standards for corporate loans, while it might be given a boost by a more rapid than expected economic recovery. The annual increase in corporate and household placements might pick up slightly in 2022, while total growth in placements (government excluded) might reach 3.5%.

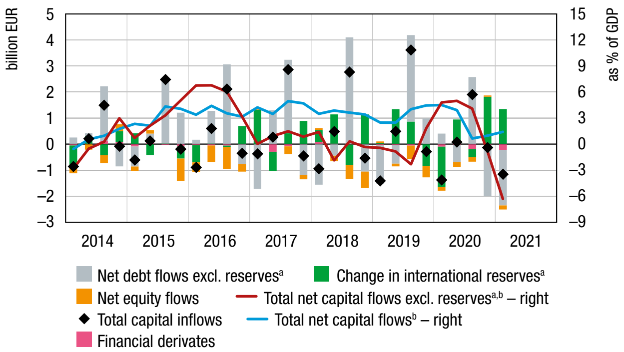
23 In October 2019, a large corporation switched from Section L (Real estate activities) to Section E (Water supply, sewerage, waste management and remediation activities). This is why a sharp decrease in placements was recorded in Real estate activities, and a substantial rise was seen in Other sectors, which include water supply in 2019.

8 Foreign capital flows

The financial account of the balance of payments[24] saw a large net inflow of capital in the first quarter of 2021. Net foreign liabilities of domestic sectors, excluding the change in gross international reserves and CNB liabilities, increased by EUR 2.5bn, mainly as a result of an increase in net debt liabilities of all domestic sectors, but mostly those of the government, while net equity liabilities rose only slightly. At the same time, international reserves rose sharply owing to an increased purchase of foreign exchange from the government and a rise in government foreign currency deposits in its account with the CNB. As a result, the total net inflow of capital in the financial account was ultimately much smaller, standing at EUR 1.2bn (Figure 8.1).

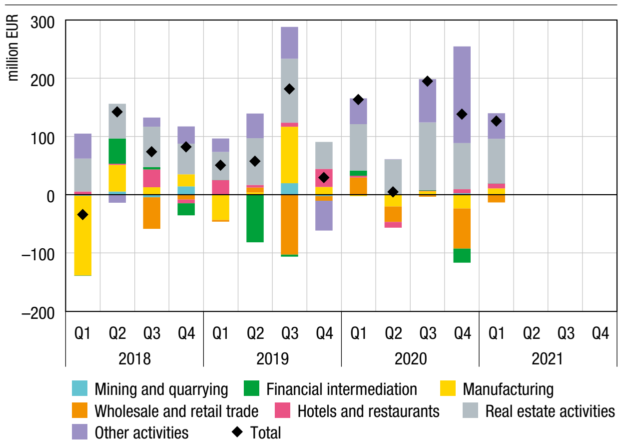
The first quarter of 2021 saw only a small net inflow of equity investment of EUR 0.2bn, as a result of a faster growth in liabilities than assets of the domestic sector. The growth in foreign assets was fuelled the most by investments of domestic institutional investors in foreign shares and equity holdings. By contrast, on the liabilities side, the reinvested earnings (defined as current profit net of the value of dividend payouts based on a decision) of banks and enterprises in foreign ownership stood out, being much bigger than in the same period of the previous year. At the same time, new direct equity investments in Croatia were smaller than in the same period of the previous year and they took place mostly in the real estate sector and computer programming activity (Figure 8.2).

Figure 8.1 Flows in the financial account of the balance of payments



[a] Changes in gross international reserves net of CNB liabilities.
[b] Sum of the previous four quarters.
Notes: Net flows are the difference between changes in assets and liabilities. Equity flows comprise changes in foreign direct equity investments, reinvested earnings and portfolio equity investment, while net borrowing from affiliated enterprises is composed of debt equity flows. Positive value means net capital outflow abroad.
Source: CNB.

Figure 8.2 Foreign direct equity investment in Croatia by activities



Note: Equity investment net of debt-to-equity transactions and round-tripping investments.
Source: CNB.

The big increase in net debt liabilities in the first quarter of 2021 of EUR 2.1bn (excluding the change in gross international reserves and CNB liabilities) was the result of an increase in foreign liabilities of all domestic sectors, which was only slightly offset by an increase in foreign assets. As regards the increase in net debt liabilities, the government stood out in particular, having increased its net debt liabilities by EUR 1.3bn, following an issue of two eurobond tranches worth EUR 2.0bn in the international capital market, using over one half of the inflow to repay the ten-year US dollar bonds due in March. The government also increased long-term credit liabilities arising from, among other things, borrowing under the European instrument for temporary support to mitigate unemployment risks in an emergency (SURE) and a loan from the International Bank for Reconstruction and Development (IBRD). The growth in government liabilities was also spurred, although to a much lesser extent, by transactions in the secondary securities market. However, the growth in government liabilities was mitigated by a noticeable growth in government receivables due to a quite wide gap between the funds distributed to end users and the funds received from the EU budget. At the same time, foreign assets of the central bank also fell by approximately the same amount, as a result of a fall in banks' funds within the TARGET2 system[25]. Net debt liabilities of banks and other domestic sectors, including direct investments, mostly those of private non-financial corporations also rose, although much less than those of the government.

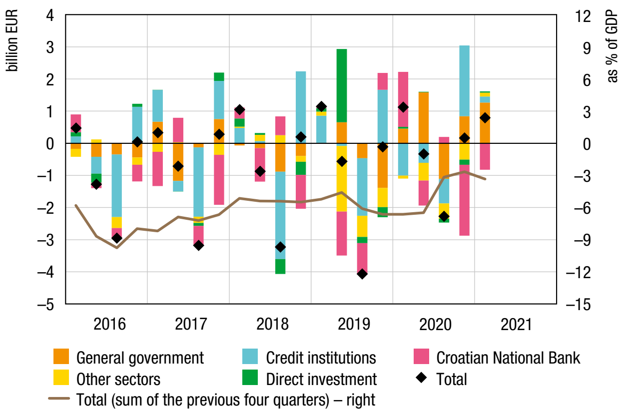
A sharp rise in international reserves can mostly be attributed to increased purchases of foreign exchange from the government and a rise in government foreign exchange deposit in its account with the CNB, attributable to increased government inflows of foreign exchange from EU funds and foreign borrowing. The growth in reserves was also partly fuelled by a bigger volume of repo transactions, which increases gross international reserves and foreign liabilities of the central bank by the same amount. Gross international reserves thus stood at EUR 21.1bn at the end of March 2021, having risen by 11.5% from the end of the previous year.

The growth in debt liabilities of the domestic sectors, particularly of the government, resulted in a deterioration of the relative indicators of external debt in early 2021. Thus, at the end of March 2021, gross external debt stood at EUR 43.4bn, or 88.1% of GDP, up by 6.9 percentage points from the end of 2020 (Figure 8.4). The noticeable growth in foreign assets that took place during the same period alleviated the deterioration in the relative indicator of net external debt. At the end of March 2021, net

24 Historical balance of payments data have been revised from the previously published data. For further information, see: https://www.hnb.hr/-/revizija-statistike-odnosa-s-inozemstvom.

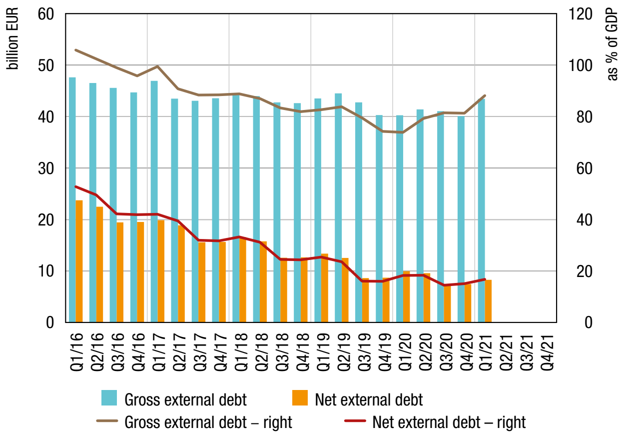
25 Bank funds within the TARGET2 system constitute central bank foreign assets but do not constitute a part of international reserves.

Figure 8.3 Net external debt transactions by sectors



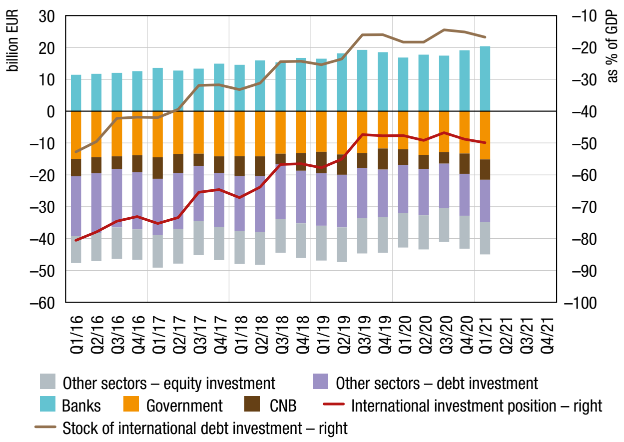
Notes: Transactions refer to the change in debt excluding cross-currency changes and other adjustments. Net external debt is calculated as the gross external debt stock net of foreign debt claims.
Source: CNB.

Figure 8.4 Stock of gross and net external debt



Note: Net external debt is calculated as the gross external debt stock net of foreign debt claims.
Source: CNB.

Figure 8.5 International investment position (net) by sectors



Note: Stock of international debt investments (net) equals the negative value of the net external debt.
Source: CNB.

external debt amounted to EUR 8.3bn or 16.8% of GDP, having risen by 1.7 percentage points from the end of 2020.

The net international investment position also worsened, mirroring an increase in net debt liabilities of the domestic sectors that was greater than the fall in net liabilities from equity investments, resulting exclusively from favourable price, exchange rate and other adjustments. As a result, the net international investment position at the end of March 2021 stood at –49.9% of GDP while at the end of December 2020 it stood at –48.8% of GDP (Figure 8.5).

Projected developments

In accordance with the projected growth in the current and capital account surplus, in 2021 the financial account of the balance of payments is expected to see a noticeably greater net capital outflow than in the year before. The estimated net capital outflow is due to a further decline in net foreign debt liabilities of the domestic sectors.

As regards equity investments, the expected recovery in the profitability of banks and foreign-owned non-financial corporations in 2021 will lead to an increase in reinvested earnings that constitute a part of foreign direct investments. Direct equity investments in Croatia are also expected to grow slightly, if debt-to-equity swaps are excluded, although they might remain relatively modest in the light of lingering risks regarding global economic developments and the caution exercised by foreign investors.

The expected fall in net debt liabilities in 2021 mainly reflects a noticeable improvement in the net external position of the central bank, i.e. an increase in international reserves. The liabilities of other domestic sectors are also expected to fall, primarily due to deleveraging by non-financial corporations. By contrast, after a considerable deterioration in the government's net debt position last year as a result of increased budget deficit financing needs amid the pandemic, in 2021 government net liabilities are expected to grow further, although at a slower pace. Net liabilities of credit institutions might also rise, although also at a slower pace.

Despite the expected growth in the gross external debt in an absolute amount, owing to a nominal GDP growth, the relative indicator might improve noticeably until end-2021 and fall to 76%. This would continue the trend of improvement, temporarily halted last year, in the relative indicator, as a result of GDP contraction. Similarly, the indicator of net external debt might improve further by the end of the year.

Net capital outflows are expected to rise further in 2022 as a result of a pronounced fall in net foreign debt liabilities of the domestic sector. The international reserves might rise further, although at a slower pace than in the year before. Other domestic sectors might also contribute to a fall in net debt. Accordingly, the relative indicators of gross and net external debt are expected to improve further.

The large foreign liabilities accumulated earlier continue to expose Croatia's external position to risks, mostly those associated with the possible deterioration in financing conditions and a more pronounced deterioration in the global investment climate. However, the trend of improvement in the country's external position present for a long time and only temporarily halted in 2020, largely mitigates these risks, particularly if the fact that the projection period is expected to see a further growth in the current and capital account surplus is taken into account.

9 Monetary policy

The first half of 2021 was marked by a further highly expansionary monetary policy. Amid stable conditions in the domestic financial markets there was no need for any extraordinary monetary policy response, as there had been in the first half of the previous year.

The first half of this year did not see any significant pressures in the foreign exchange market, which resulted in the CNB partaking in this market only sporadically. Thus, in a foreign exchange intervention in early April the CNB sold to the banks EUR 190m and in mid-June it purchased EUR 120m, and on several occasions it purchased large amounts of foreign exchange inflows from the Ministry of Finance of the Republic of Croatia, mostly associated with EU funds. If total foreign exchange transactions are observed, from the beginning of the year to end-June, the CNB purchased net EUR 1.8bn, creating HRK 13.3bn in reserve money (Figure 9.1).

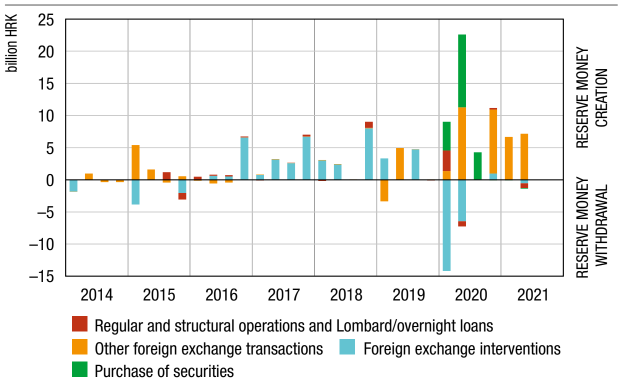
As regards other instruments, there was no need for additional purchases of government bonds in the first half of the year. Even though the CNB continued to conduct regular weekly operations at a fixed rate of 0.05%, due to the small interest shown by banks amid very high kuna liquidity surplus, the CNB has not used this instrument to place funds since the beginning of the year. No structural operations were used to create additional kuna liquidity either, however, at the end of June their stock fell by HRK 750m from the end of 2020 due to early repayments.

Monetary policy measures boosted banks' free reserves to their historical highs. Thus the average daily liquidity surplus of the domestic banking system reached HRK 72.0bn in June, up from HRK 54.7bn at the end of 2020 (Figure 9.2). The increase in surplus liquidity was driven not only by the purchase of foreign exchange from the government but also by a fall in government kuna deposits with the CNB.

The purchase of foreign exchange from the government and a higher level of repo agreements led to an increase in international reserves in the first half of 2021. They rose by EUR 2.6bn (13.7%) in gross terms from the end of the previous year, standing at HRK 21.5bn at the end of June (Figure 9.3). Net usable reserves thus rose by EUR 1.8bn (10.0%) from the end of the previous year, reaching EUR 19.5bn at the end of June. The CNB still has available to it, should a need arise, a swap line agreed in April 2020 with the European Central Bank.

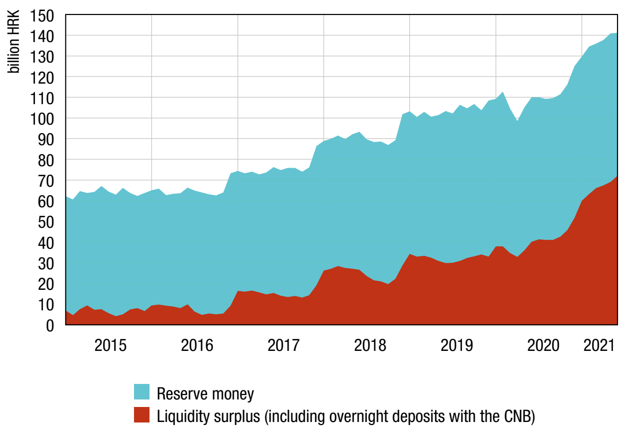
The exchange rate of the kuna against the euro depreciated slightly in the first three months of 2021, but started appreciating afterwards. The appreciation of the exchange rate intensified slightly in May, driven by the increased supply of foreign exchange from the Ministry of Finance and the banks, which, probably influenced by the expected increased inflow of foreign currency during the summer season, resorted to shorting their foreign exchange positions. The exchange rate of the kuna against the euro was EUR/HRK 7.49 at the end of June, down by 0.9% from the end of the same month of the previous year, while the average exchange rate from the beginning of the year stood at EUR/HRK 7.55, up 0.3% from the average exchange rate in the same period of the previous year (Figure 9.4). If developments in the exchange rate of the kuna against the euro

Figure 9.1 Flows of reserve money (M0) creation



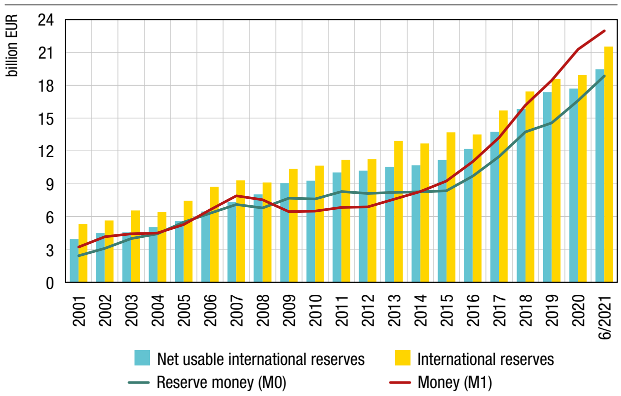
Notes: The Lombard facility cancelled on 28 September 2017 was replaced by the overnight facility. Other foreign exchange transactions include the purchase of foreign exchange from and the sale of foreign exchange to the MoF and the EC and foreign currency swaps with banks, where the positive values refer to the purchase of foreign exchange by the CNB.
Source: CNB.

Figure 9.2 Bank liquidity and reserve money



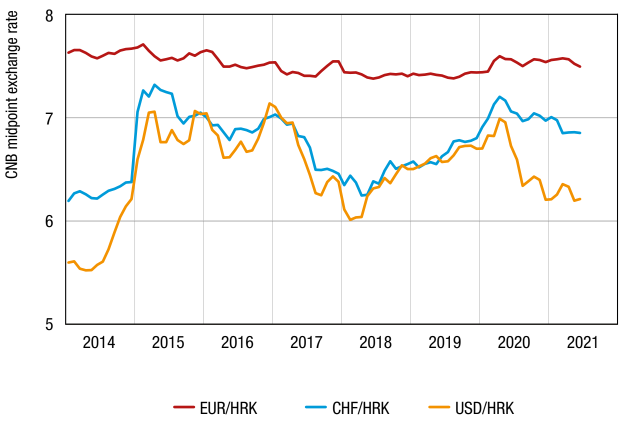
Source: CNB.

Figure 9.3 International reserves of the CNB and monetary aggregates



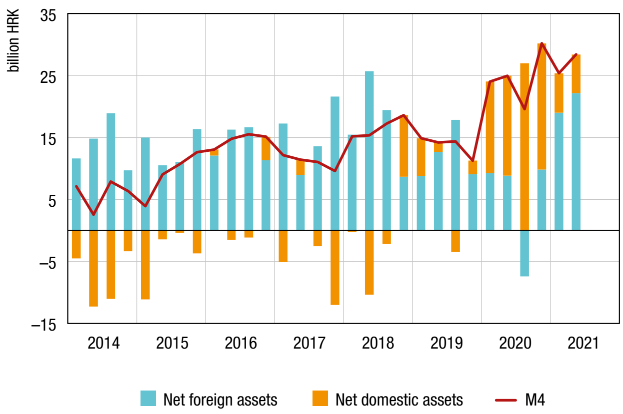
Notes: Net usable international reserves are defined as international reserves net of CNB foreign liabilities, reserve requirements in f/c, government foreign currency deposits and off-balance sheet liabilities (swaps). The most recent data available for M1 in 2021 refers to May.
Source: CNB.

Figure 9.4 Nominal exchange rates of the kuna against selected currencies



Source: CNB.

Figure 9.5 Net foreign assets, net domestic assets and total liquid assets (M4)
absolute changes in the last 12 months



Notes: Absolute changes exclude the exchange rate effect. Data for the second quarter of 2021 refer to end-May.
Source: CNB.

since joining the ERM II to the end of the first half of 2021 are observed compared to the central rate[26], the average exchange rate moved within a very narrow range of –1.0% do +0.7%. At the end of June 2021, the exchange rate of the kuna against the US dollar fell from the end of the same period of 2020, reflecting the weakening of the US dollar against the euro. The exchange rate of the kuna against the Swiss franc also recorded a lower level during the same period, mirroring the effect of kuna strengthening against the euro and euro strengthening against the Swiss franc.

Monetary aggregates continued to grow in the first half of 2021, although somewhat slower than at the end of the previous year. Total liquid assets (M4) slowed down on an annual level, from 9.1% at the end of 2020 to 8.1% at the end of May 2021 (transaction-based) (Figure 9.6), reflecting a much slower growth in net domestic assets (NDA). Slower NDA growth reflects a slowdown in the growth of net claims on the central government. At the same time, the growth in net foreign assets (NFA) accelerated, driven by an inflow of foreign exchange to the MoF then purchased by the CNB.

The CNB will support economic activity recovery by continuing to pursue an expansionary monetary policy and by maintaining the stability of the exchange rate of the kuna against the euro and by ensuring sufficient kuna and foreign exchange liquidity. Stable conditions in the domestic financial market will help maintain favourable domestic sectors' financing conditions and boost credit activity.

26 In July 2020, Croatia entered the Exchange Rate Mechanism II, with the central rate of the kuna being set at 1 euro = 7.5345 and the standard fluctuation band at ±15% around this rate.

10 Public finance

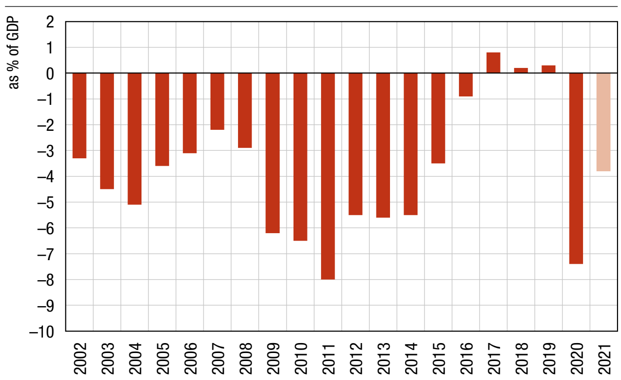
General government budget balance

Following a surplus between 2017 and 2019, in 2020 the consolidated general government recorded a considerable deficit (ESA 2010). The crisis brought about by the coronavirus pandemic resulted in a deficit of HRK 27.5bn or 7.4% of GDP, with the absolute deterioration from 2019 (surplus of HRK 1.2bn) reflecting a simultaneous sharp fall in revenues and a growth in budget expenditures. As regards the year 2021, the revised budget adopted in June 2021, according to the ESA methodology, envisages that the general government deficit will fall by almost one half from that in the previous year, and that it will stand at HRK 15.3bn or 3.8% of GDP, primarily mirroring the favourable impact of economic activity recovery on budget revenues.

The decomposition of the change in the nominal general government balance shows that the change in the nominal balance in 2020 was negatively influenced almost equally by one-off and temporary measures and the cyclical component. The contribution of structural factors was also negative, although to a much smaller extent. Interest expenditures alone made a favourable impact, owing to improved conditions of refinancing of the liabilities that fell due previously.

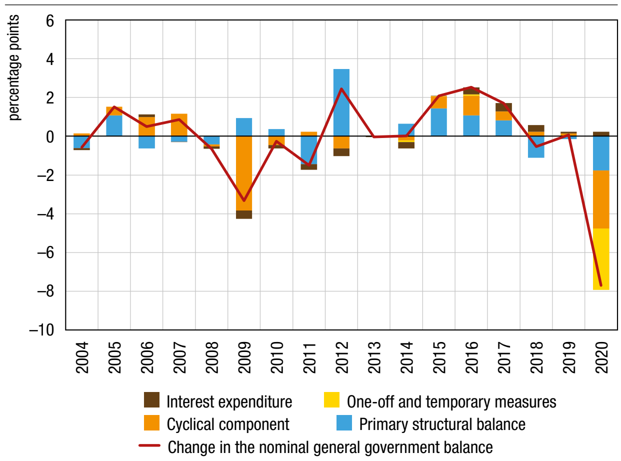
The revenue side of the budget shows a fall in total general government revenues of 6.5% (ESA 2010) in 2020, which declined strongly from the growth in 2019 (7.0%). The fall in total revenues was mostly driven by revenues from indirect taxes due to the impacts of the pandemic and the high level of uncertainty on economic activity and personal consumption. The developments in revenues were also influenced by tax reliefs in the VAT system, i.e. a cut from 25% to 13% in the tax rate for food and desserts preparation and serving in and outside catering establishments. Although to a lesser extent, revenues from direct taxes also contributed to the annual fall in total revenues. Coupled with the impact of a fall in economic activity, this also reflects the tax changes introduced as well as the impact of some of the measures of support provided to entrepreneurs. As regards tax changes, which have a structural impact on the budget balance, a change was introduced to the system of profit taxation, raising the threshold subject to profit tax of 12% from HRK 3m to HRK 7.5m. Also, entrepreneurs that recorded a fall in revenues were provided a one-off interest-free deferral and payment of direct taxes and contributions in instalments, depending on the intensity of fall in their operating income, with entrepreneurs recording a fall greater than 50% or those with revenues below HRK 7.5m being granted a one-off tax relief on direct tax and contributions payments falling due in the second quarter of 2020. Under the Convergence Programme of the Republic of Croatia, a total of HRK 3.1bn worth of direct taxes and contributions were written off in 2020, with fiscal support measures being provided to some 130,000 tax payers. These measures, coupled with unfavourable developments in the labour market led to a negative contribution of revenues from social contributions to developments in total general government revenues. Unlike the mentioned categories of budget revenues, other revenues recorded annual growth in 2020, alleviating the fall in total revenues and reflecting the favourable impact of greater inflows from EU

Figure 10.1 General government deficit (ESA 2010)



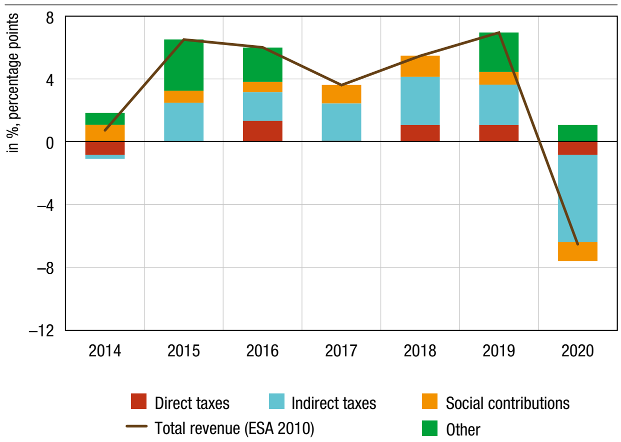
Sources: Eurostat and MoF.

Figure 10.2 Decomposition of the change in the nominal general government balance (ESA 2010)



Source: CNB.

Figure 10.3 Consolidated general government revenue
ESA 2010, year-on-year rate of change and contributions



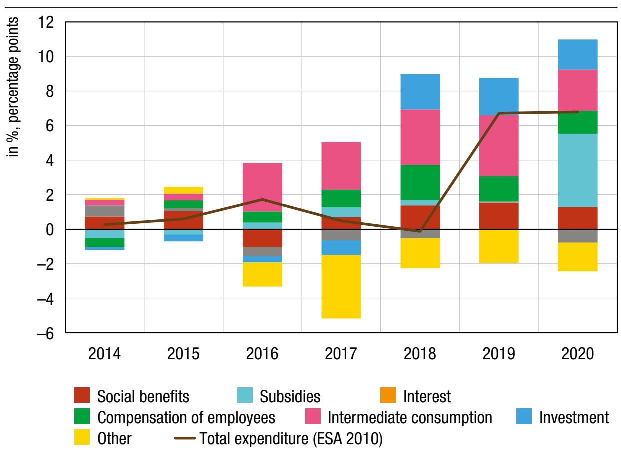
Source: Eurostat (CNB calculations).

funds, one-off exceptional aid from the EU to fight the pandemic and EU Solidarity Fund payments to earthquake-hit areas.

On the expenditure side of the budget (ESA 2010), the annual growth in total expenditures in 2020 stood at 8.6%, up from 6.8% in 2019. Although all expenditure categories recorded an increase, the growth in total expenditures was mostly fuelled by subsidies provided in the form of support to employers for job preservation. General government investments also grew, their annual growth being attributed to faster investment activity associated with the construction of transport and public utility infrastructure, increasingly financed with EU funds. Intermediate consumption saw a similar increase, driven by increased materials expenses of state-owned health institutions for medicines, medical devices and supplies and additional coronavirus-related expenses. Expenditures for employee compensations saw a somewhat slower annual growth, resulting from the increase in the wage calculation base of 2% from 1 January 2020 for civil servants and government employees. The increase in expenditures for social benefits mirrors increased unemployment benefits, increased compensations for parent-caregiver and caregiver for persons with disabilities and maternity benefits. This is due to an increase in the maximum amount of compensation paid to employed and self-employed parents during maternity leave which has been set at HRK 5,654.20 per month since 1 April 2020 as well as regular pension indexation costs. Other expenditures and interest expenditures fell slightly on an annual level, reflecting in the case of the latter favourable terms of refinancing of liabilities falling due before the crisis, which continued into the pandemic period.

As regards the fiscal results in 2021, according to Ministry of Finance of the Republic of Croatia data[27], the central government budget deficit fell by HRK 2.2bn in the January to April 2021 period, from the same period of the previous year. Better budget results are due to a faster annual growth in revenues than expenditures. The available data suggest an increase in the amount of fiscalised receipts in trade (which generates approximately 70% of the total amount of such receipts) in May and

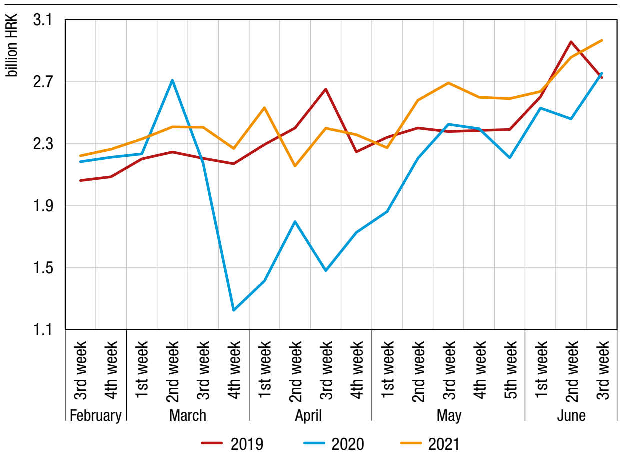
Figure 10.4 Consolidated general government expenditure
ESA 2010, year-on-year rate of change and contributions



Source: Eurostat (CNB calculations).

27 Monthly data for the central government, state government and social security sub-sectors, which are required, under Council Directive 2011/85/EU, to be published before the end of the following month. The published data refer to general government units according to the scope of ESA 2010 statistical methodology, except for data pertaining to local government, which are published on a quarterly basis.

Figure 10.5 The amounts of fiscalised receipts in wholesale and retail trade, repair of motor vehicles and motorcycles (G)



Sources: MoF and Tax Administration (CNB calculations).

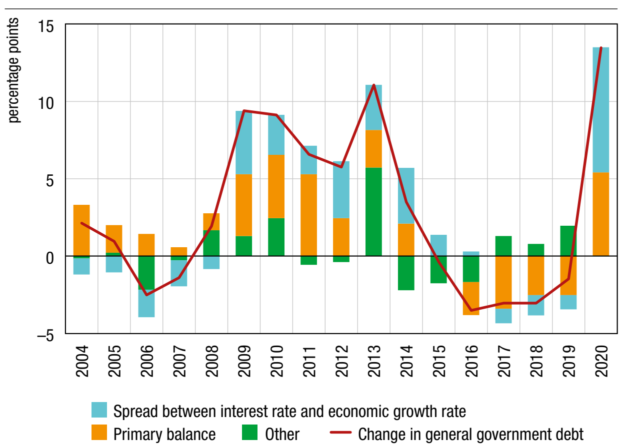
June 2021 from their average amount in March and April. Towards the end of this period, the amount of fiscalised receipts, after weeks of better results, approached their level in 2019, probably starting to reflect decreased current consumption of non-residents.

Public debt

The budget deficit, coupled with a simultaneous sharp fall in economic activity in 2020, resulted in an increase in the public debt to GDP ratio from 72.8% at the end of 2019 to 88.7% of GDP at the end of 2020, mirroring the unfavourable effect of the rate of fall in economic activity and, to a lesser extent, the primary deficit. According to the revised budget, the public debt to GDP ratio might amount to 86.6% of GDP at the end of 2021.

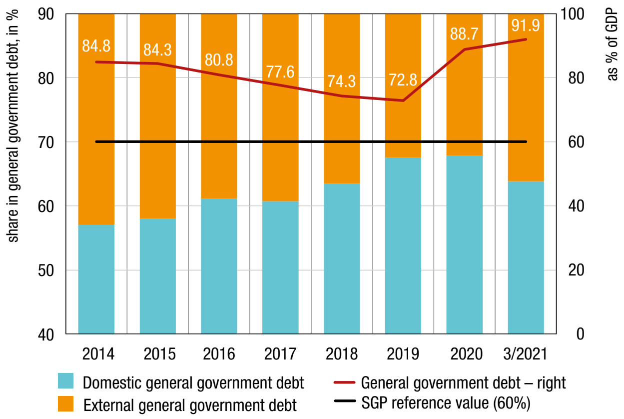
As regards the issues of public debt instruments thus far in 2021, at the end of February the government issued two tranches of eurobonds on the foreign capital market totalling EUR 2bn (12-year eurobonds falling due in 2033 worth nominally EUR 1bn and 20-year eurobonds falling due in 2041 worth nominally EUR 1bn). The new eurobond issue falling due in 2033

Figure 10.6 Decomposition of the change in general government debt



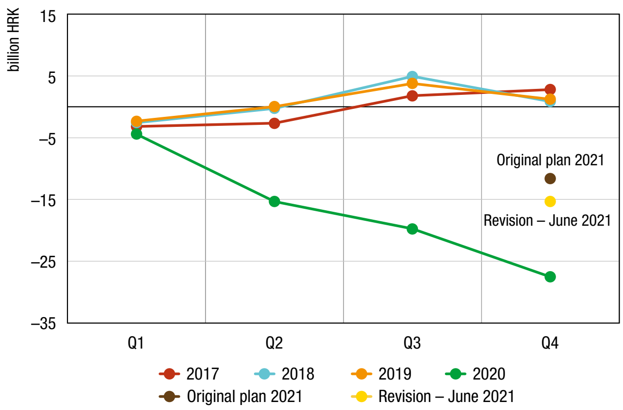
Sources: Eurostat and MoF (CNB calculations).

Figure 10.7 General government debt
end-period stock



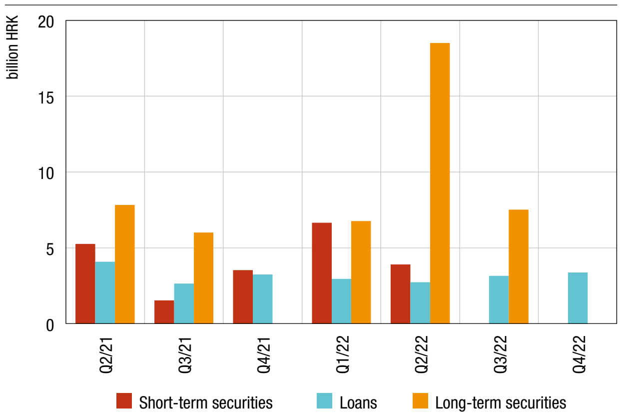
Note: Nominal GDP calculated as the sum of GDP for the first quarter of 2021 and the last three quarters was used for the calculation of the relative indicator at the end of March 2021.
Source: CNB.

Figure 10.9 General government cumulative balance
ESA 2010



Note: The plan of the general government balance for 2021 is based on the 2021 State Budget and the Convergence Programme of the Republic of Croatia for the period 2022-2024.
Sources: Eurostat and MoF (CNB calculations).

Figure 10.8 General government debt maturity



Note: Projection of the repayment of short-term and long-term securities is based on the balances as at 23 June 2021 and projection of the repayment of loans on the balance as at 31 March 2021.
Sources: MoF and CNB.

has a yield to maturity of 1.257%, while the longest maturity eurobond ever issued, falling due in 2041, has a yield to maturity of 1.788%. The funds derived from these bond issues were partly used to repay the USD 1.5bn worth bonds that fell due in March 2021 and partly to finance the budget deficit in 2021. Given the favourable borrowing terms, the savings generated on interest expenses for refinancing might stand at approximately HRK 460m on an annual level.

Estimates and projections of fiscal figures under the Convergence Programme of the Republic of Croatia

Under this year's Convergence Programme, following a considerable budget deficit in 2020 (7.4% of GDP), the Government of the Republic of Croatia expects that the general government deficit will stand at 3.8% of GDP in 2021, and to fall additionally to 2.6% of GDP in 2022.

According to this source, the developments on the revenue side of the budget in 2021 will reflect recovery in economic activity, the fiscal impacts of changes in profit and income tax, value added tax and excise duty regulations and also to a large extent inflows from the EU funds (multiannual financial framework and Next Generation EU with a special emphasis on the Recovery and Resilience Facility). As regards the expenditure side of the budget in 2021, the planned increase in compensation of employees reflects the 4% increase in the wage base of civil servants and government employees, the previous 2% increase in the coefficient in primary and secondary education and in police services, in addition to a regular increase for years of service of 0.5% and the expected small increase in the number of employed persons, particularly in the education and health sectors. Also, the increase in expenditures for intermediate consumption reflects the allocation of additional funds for medicines and medical devices and supplies of hospitals and health institutions in state ownership, as well as additional costs related to the fight against the coronavirus pandemic, vaccine costs included. The rise in expenditures is also fuelled by material costs for the reconstruction of areas hit by earthquakes in Zagreb and Petrinja. With persisting adverse impacts of the crisis, expenditures for subsidies will rise, due to job preservation support paid to employers, support provided to agriculture, maritime and air transport, as well as measures of active labour market policy.

Sources: Eurostat and MoF (CNB calculations).

In its spring forecasts, the European Commission estimated that the general government balance in Croatia in 2021 might be somewhat more unfavourable (–4.6% of GDP) than envisaged under the Convergence Programme of the Republic of Croatia, partly due to a somewhat slower than expected economic growth. The Commission's projection of the general government balance in 2022 is also more unfavourable (–3.2%) than that projected under the Convergence Programme of the Republic of Croatia.

11 Deviations from the previous projection

As regards the international environment, the estimates of real developments in most of the countries for 2021 are more favourable than those under the December 2020 projection. According to the latest IMF projection, global economic growth in 2021 might be 0.9 percentage points faster than in the previous projection cycle. Nevertheless, the expected growth in Croatia's main trading partner countries might be somewhat slower than under the previous projection, primarily as a result of the base effect of improved results in the previous year on the projected growth rates in 2021. As regards the monetary policy, major central banks are expected to pursue again an exceptionally expansionary monetary policy in 2021, although the raising of the key interest rates might take place sooner than previously expected.

Total economic activity in 2021 might grow by 6.8% in 2021, faster than expected in December when the annual growth rate was projected at 4.9%. The upward revised growth rate can be attributed to better expectations regarding personal consumption and gross fixed capital formation. Thus personal consumption in 2021 might rise by 6.3% in 2021, an increase compared to the previous projection (4.5%). The correction in relation to the previous official projection reflects more favourable results in the first quarter than expected, as well as more favourable conditions in the labour market in the first half of 2021 than those earlier expected. Gross fixed capital formation might also grow faster than expected in December 2020, i.e. by 8.4% as opposed to the previously projected 7.2%. This correction is the result of a faster growth in capital investments in the first three months of 2021 than earlier expected and reflects more favourable expectations regarding general government investment activity. Government consumption might rise by 1.9% in 2021 as opposed to the previously projected 2.2%. As regards foreign demand, total exports might grow slightly slower than expected in January, i.e. by 15.0% (earlier projection put this growth rate at 19.3%), owing to a possibly worse outcome of tourist demand recovery in 2021, while the expectations regarding goods exports are better. Goods and services imports might grow by 13.8%. The downward correction of imports growth (previous projection put this growth rate at 15%) mirrors worse expectations regarding total exports. The downward correction of exports is more pronounced than the correction of imports, with the contribution of net foreign demand to total growth being neutral (a positive contribution 0.8 percentage points was expected in January).

The average annual consumer price growth rate in 2021 is projected at 1.7%, an increase of 0.7 percentage points from the December 2020 projection. This can mostly be attributed to a much more pronounced annual growth in the prices of refined petroleum products, which fuelled the estimated average growth in energy prices throughout the entire 2021, up from 0.5% under the previous projection to 5.9% under the current one. The increase in the projected inflation in 2021 was to a smaller extent also the result of a somewhat faster projected annual growth in the CPI excluding food and energy (1.3% as opposed to 1.1% under the previous projection), largely owing to higher excise duties on tobacco products introduced in March 2021, a development that was not known towards the end of the last year. By contrast, although the projected annual growth rate of food prices at the end of 2021 is slightly slower (1.9%, as opposed to 2.1% under the previous projection) as a result of not as good results as anticipated in the first five months of 2021, the average annual growth rate of food prices in 2021 has been revised downwards considerably under the current projection and now stands at –0.2% (as opposed to 1.1% under the previous projection). This is the result of a considerable fall in food prices towards the end of 2020 and in turn a smaller food prices inflation carry-over into 2021, compared to the previous projection.[28]

The estimate of the current and capital account surplus in

Table 11.1 Basic assumptions, deviations from the previous projection

	2021		
	Previous projection (12/2020)	Current projection	Deviation
GDP (real rate of change, in %)			
Rest of the world	5.2	6.0	0.9
Euro area	5.2	4.4	–0.7
USA	3.1	6.4	3.3
Developing countries and emerging market countries	6.0	6.7	0.6
Central and Eastern European countries	3.9	4.4	0.6
Main trading partners of the Republic of Croatia	3.9	3.7	–0.2
Prices			
Euro area HICP[a]	1.0	1.5	0.5
Oil prices (USD/barrel)[b]	43.1	66.1	23.0
Key interest rates			
EURIBOR 3M (end of year)[c]	–0.45	–0.50	–0.1
ECB main refinancing rate[c]	0.00	0.00	0.0
US federal funds target rate[c]	0.30	0.30	0.0

[a] ECB, June 2021. [b] Bloomberg, Brent crude oil futures. [c] Bloomberg.
Source: IMF (WEO, April 2021).

28 The carry-over of food prices inflation into 2021 under the current projection stands at –2.0 percentage points (as opposed to –1.0 percentage point under the previous projection).

Table 11.2 Domestic indicators, deviations from the previous projection

	2020			2021		
	Previous projection (12/2020)	Outturn	Deviation	Previous projection (12/2020)	Current projection	Deviation
National accounts (real rate of change, in %)						
GDP	–8.9	–8.0	0.9	4.9	6.8	1.8
Personal consumption	–6.6	–6.4	0.3	4.5	6.3	1.8
Government consumption	2.0	3.4	1.4	2.2	1.9	–0.2
Gross fixed capital formation	–5.2	–2.9	2.2	7.2	8.4	1.2
Exports of goods and services	–26.4	–25.0	1.5	19.3	15.0	–4.3
Imports of goods and services	–16.3	–13.8	2.5	15.0	12.8	–2.2
Labour market						
Number of employed persons (average rate of change, in %)	–1.5	–1.2	0.3	0.7	1.6	0.9
Registered unemployment rate	9.1	8.9	–0.2	8.5	8.2	–0.3
ILO unemployment rate	7.5	7.5	0.0	7.0	6.9	–0.1
Prices						
Consumer price index (rate of change, in %)	0.2	0.1	–0.1	1.0	1.7	0.7
External sector						
Current account balance (as % of GDP)	–1.0	–0.4	0.6	0.1	–0.1	–0.2
Current and capital account balance (as % of GDP)	1.4	1.8	0.4	3.0	2.7	–0.3
Gross external debt (as % of GDP)	82.2	81.3	–0.9	76.2	76.0	–0.2
Monetary developments (rate of change, in %)						
Total liquid assets – M4	8.9	9.3	0.5	3.2	4.9	1.7
Total liquid assets – M4[a]	8.4	9.1	0.7	3.4	4.9	1.5
Placements (excl. central government)	3.2	3.9	0.7	3.0	2.9	–0.1
Placements (excl. central government)[a]	2.8	3.9	1.0	3.3	3.4	0.1

[a] Rates of change are calculated on the basis of data on transactions (see Annex 1 Introduction of data on transactions in monetary developments analysis in the CNB Bulletin No. 221).
Source: CNB.

2021 was reduced from that under the previous projection by 0.3 percentage points. This correction is mostly the result of a bigger foreign trade deficit. Namely, despite the expectation of a faster growth in goods exports and imports than that under the previous projection cycle, due to a noticeably bigger import base, the projected growth in imports was noticeably bigger in absolute amounts than that of exports, which ultimately translates into an unfavourable trade balance. Although to a much lesser extent, the reduction in the projected surplus in the current and capital account was also due to a worsening in the projected net services exports, particularly in tourism. By contrast, the secondary income and capital transaction accounts are expected to see a considerably bigger surplus as a result of a more pronounced growth in the use of EU funds, and the balance in the primary income account might also improve, particularly owing to a bigger estimate of revenues from compensation of persons temporarily employed abroad, supporting better results in 2020. As regards the external debt, although a higher level of gross external debt is expected until end-2021 than that under the December projection, the favourable estimates of GDP developments might lead to a somewhat lower relative indicator of the gross external debt than earlier anticipated. Domestic sectors are expected to continue to deleverage and relative indicators of external debt are likely to improve until the end of the projection period.

The projection of growth in placements of credit institutions (excluding the government) in 2021 has been slightly revised upwards from the earlier projections (3.4%, as opposed to 3.3% under the previous projection). A small pick-up in bank lending is the result of stronger lending to households and other financial institutions, while lending to non-financial corporations in the previous part of the year rose slower than previously expected. Household lending was mostly influenced by a growth in housing loans, driven by a further implementation of the government's housing loans subsidy programme, while the fall in general-purpose cash loans slowed down slightly.

The projected growth in total liquid assets (M4) in 2021 stands at 4.9% and has been revised upwards from 3.4% (transaction-based) under the previous projection. As regards the structure of this broadest monetary aggregate, particularly noticeable is a considerably bigger accumulation of monetary assets in transaction accounts than initially expected. By contrast, quasi-money and foreign exchange deposits fell, influenced also by a further fall in interest rates on deposits.

12 Annex A: Macroeconomic projections of other institutions

Table A.1 Macroeconomic projections of other institutions
change in %

	GDP		Household consumption		Gross fixed capital formation		Exports of goods and services		Imports of goods and services		Industrial production		Consumer prices	
	2021	2022	2021	2022	2021	2022	2021	2022	2021	2022	2021	2022	2021	2022
Croatian National Bank (July 2021)	**6.8**	**4.4**	**6.3**	**2.9**	**8.4**	**6.9**	**15.0**	**11.0**	**12.8**	**9.5**	**–**	**–**	**1.7**	**1.5**
World Bank (June 2021)	5.5	6.2	–	–	–	–	–	–	–	–	–	–	–	–
Eastern Europe Consensus Forecasts (June 2021)	4.9	4.5	4.4	4.0	7.0	7.3	–	–	–	–	4.4	3.7	1.4	1.6
European Bank for Reconstruction and Development (June 2021)	6.0	4.5	–	–	–	–	–	–	–	–	–	–	–	–
European Commission (May 2021)	5.0	6.1	4.9	3.4	7.3	10.2	16.3	12.2	11.0	8.2	–	–	1.3	1.3
International Monetary Fund (April 2021)	4.7	5.0	–	–	–	–	–	–	–	–	–	–	0.7	1.2
Raiffeisen Research[a] (April 2021)	5.1	3.0	–	–	–	–	21.4	14.5	13.9	9.0	3.5	4.2	1.0	1.5
Ministry of Finance (April 2021)	5.2	6.6	5.1	4.0	9.9	18.0	12.5	15.8	12.3	14.7	–	–	1.9	1.7

[a] Rates of change in exports and imports of goods and services refer to the change in the nominal value.
Note: Projection of the Ministry of Finance was taken from the Convergence Programme of the Republic of Croatia for 2021 and 2022.
Sources: Publications of the respective institutions.

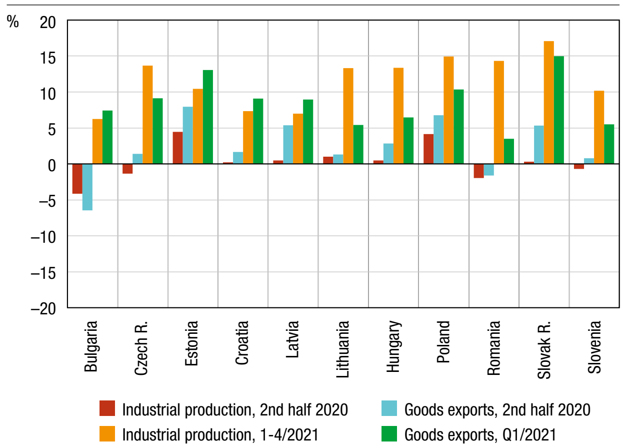
13 Annex B: Comparison of Croatia and selected countries

Table 13.1 Gross domestic product

	Year-on-year rate of change, original data			Quarter-on-quarter rate of change, seasonally adjusted data			
	2018	2019	2020	Q2/ 2020	Q3/ 2020	Q4/ 2020	Q1/ 2021
Bulgaria	3.1	3.7	–4.2	–10.1	4.3	2.2	2.5
Czech R.	3.2	2.3	–5.6	–8.7	6.9	0.6	–0.3
Estonia	4.4	5.0	–2.9	–5.1	2.7	2.8	4.8
Croatia	2.8	2.9	–8.0	–15.1	5.9	4.1	5.8
Latvia	4.0	2.0	–3.6	–7.0	6.9	1.1	–1.7
Lithuania	3.9	4.3	–0.9	–6.2	6.1	–0.3	2.0
Hungary	5.4	4.6	–5.0	–14.5	9.7	2.8	2.0
Poland	5.4	4.7	–2.7	–8.9	7.5	–0.5	1.1
Romania	4.5	4.1	–3.9	–11.8	5.5	4.6	2.8
Slovak R.[a]	3.7	2.5	–4.8	–7.5	9.9	0.8	–2.0
Slovenia	4.4	3.2	–5.5	–9.9	12.6	–0.6	1.4
Average[b]	**4.1**	**3.6**	**–4.3**	**–9.5**	**7.1**	**1.6**	**1.7**

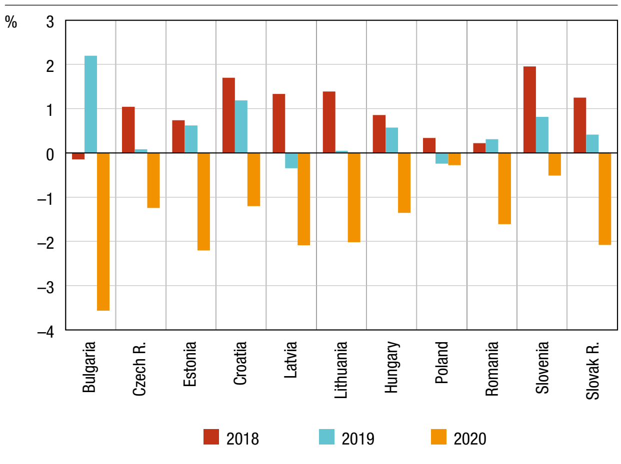
[a] Slovak R.: seasonally adjusted data. [b] Simple average.
Sources: Eurostat, EC, CBS and CNB.

Figure 13.1 Industrial production and goods exports
year-on-year rate of change



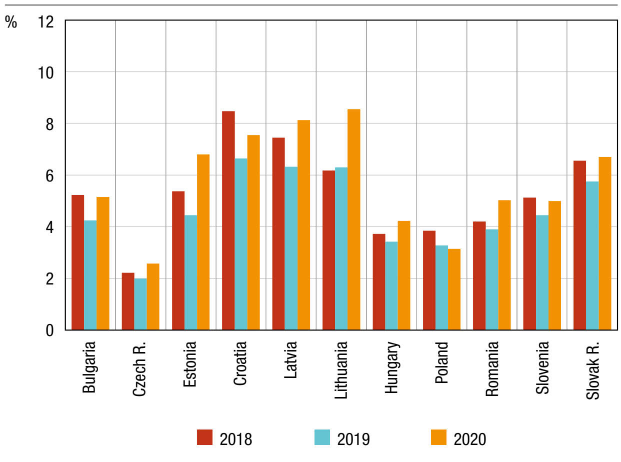
Sources: Eurostat and CBS.

Figure 13.2 Labour Force Survey employment rate
year-on-year rate of change



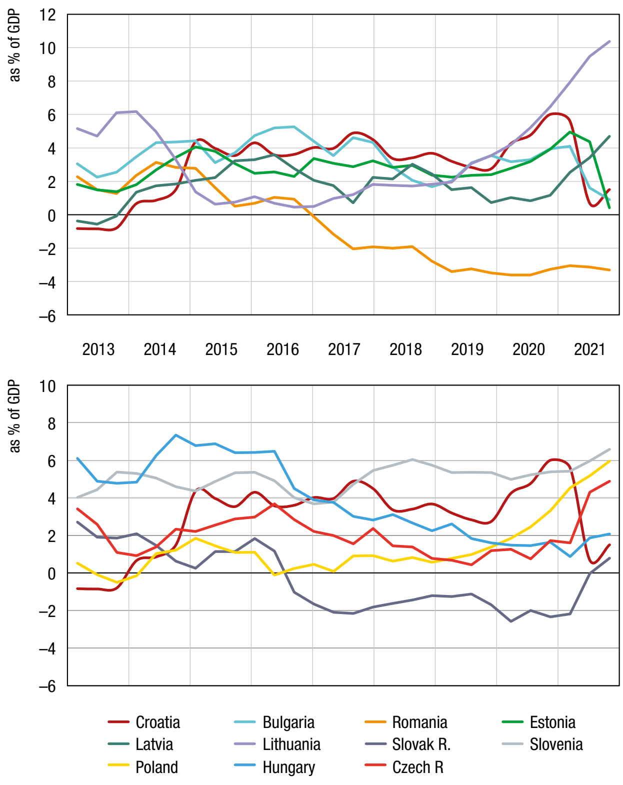
Source: Eurostat.

Figure 13.3 Labour Force Survey unemployment rate



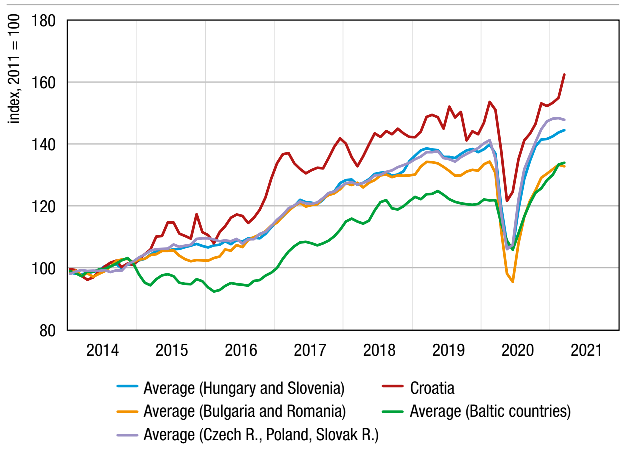
Source: Eurostat.

Figure 13.4 Current and capital account balance
sum of the last four quarters



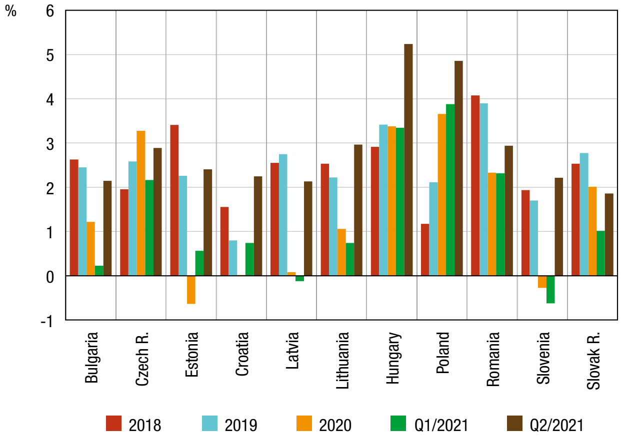
Sources: Eurostat and CNB.

Figure 13.5 Goods exports
quarterly moving average, seasonally adjusted data



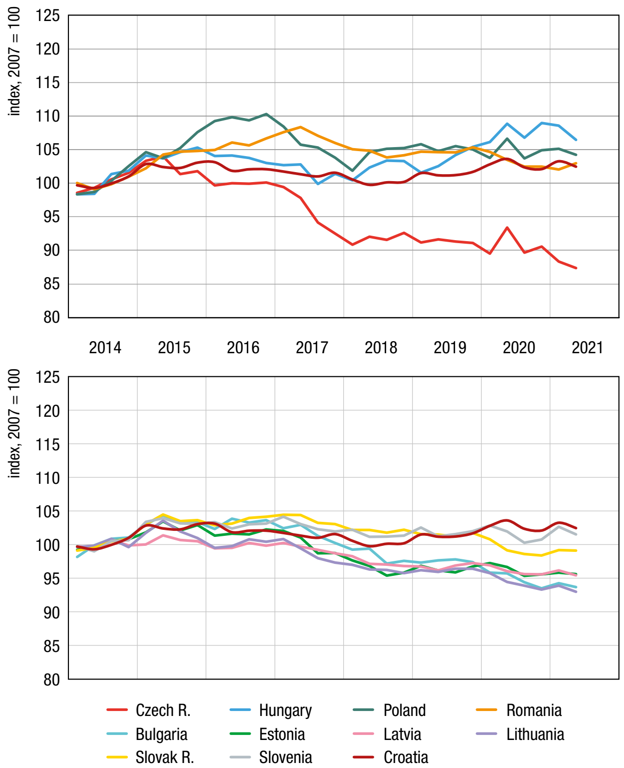
Sources: Eurostat and CNB.

Figure 13.6 Consumer price inflation
average year-on-year rate of change



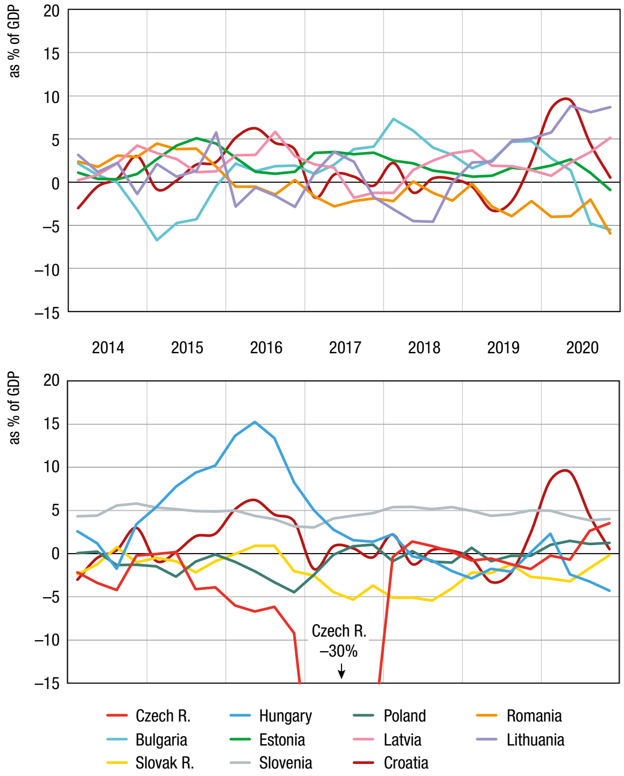
Note: Data for the second quarter of 2021 refer to April and May.
Source: Eurostat.

Figure 13.7 Real effective exchange rate (deflated by consumer prices) in selected countries



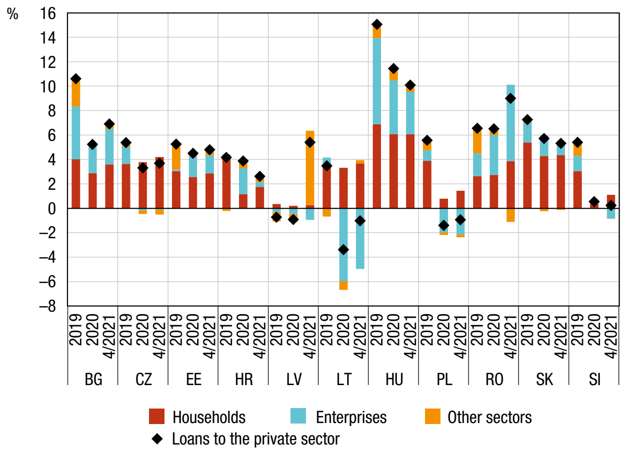
Notes: Data for 2021 refer to the January-May period. A fall in the index indicates a real effective appreciation.
Sources: BIS and CNB.

Figure 13.8 Balance of payments financial account balance, excluding the change in international reserves
sum of the last four quarters



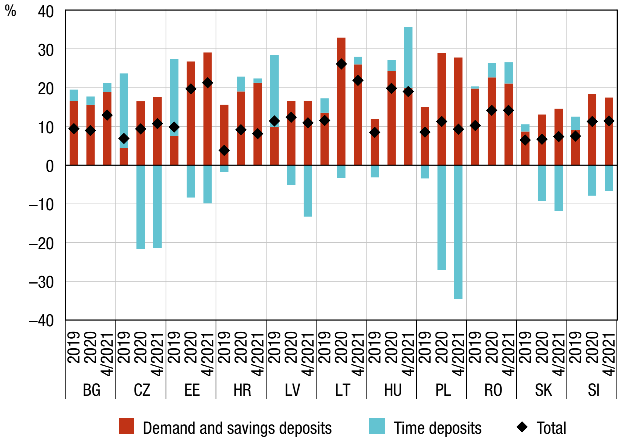
Sources: Eurostat and CNB.

Figure 13.9 Bank loans to the private sector
contributions to the year-on-year rate of change, transaction-based



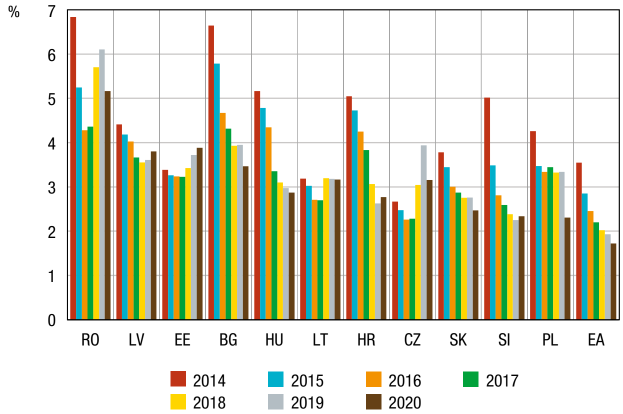
Sources: ECB and CNB.

Figure 13.10 Private sector deposits
year-on-year rate of change, excluding the exchange rate effect



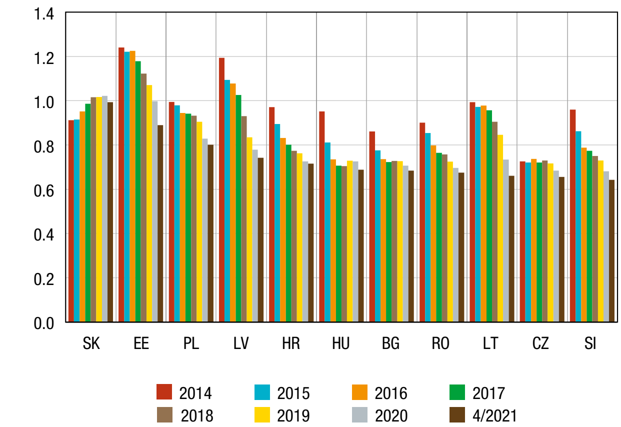
Sources: ECB and CNB.

Figure 13.13 Short-term interest rates on corporate loans



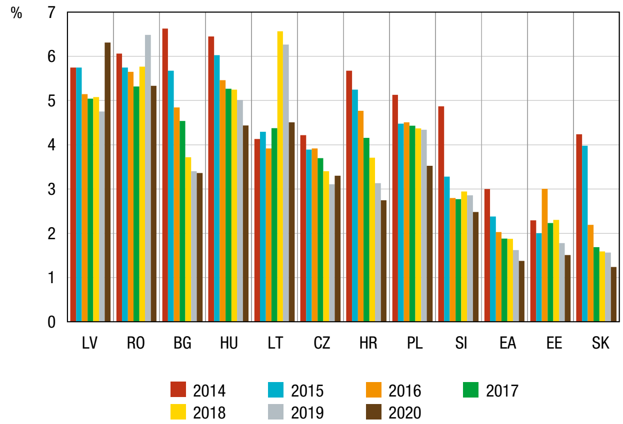
Note: Includes average interest rates on corporate loans up to EUR 1m and with a maturity of up to 1 year.
Source: ECB.

Figure 13.11 Placement to deposit ratio of the private sector



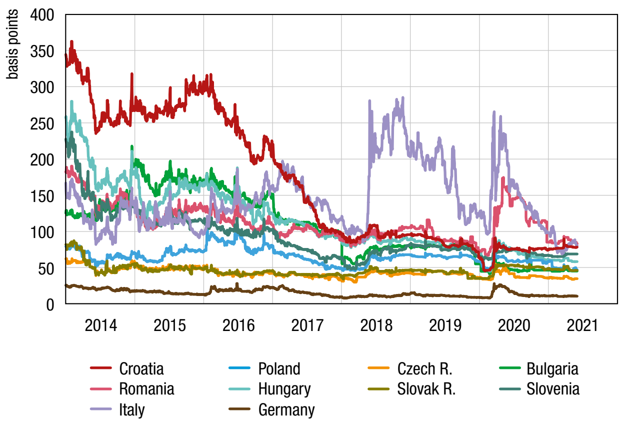
Sources: ECB and CNB.

Figure 13.14 Interest rates on housing loans



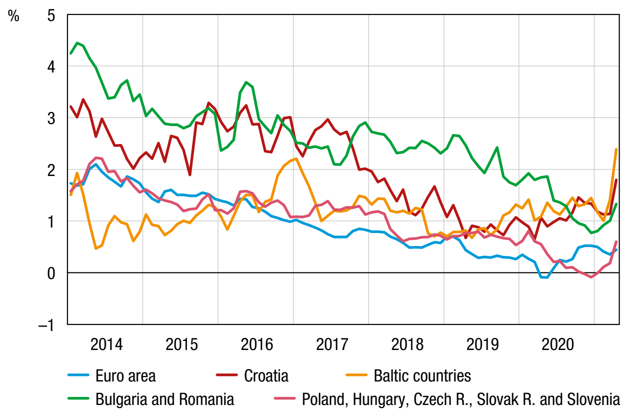
Sources: ECB and NCBs.

Figure 13.12 CDS spreads for 5-year government bonds of selected countries



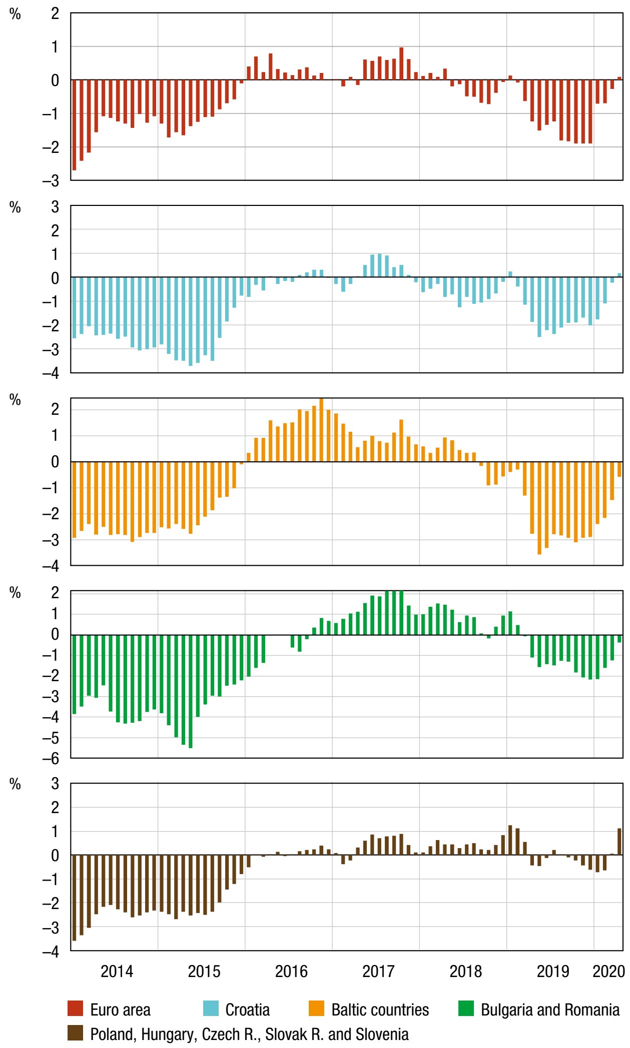
Note: Credit default swaps (CDS) spread is an annual premium that a CDS buyer pays for protection against credit risk associated with an issuer of an instrument.
Source: S&P Capital IQ.

Figure 13.15 Expected real interest rate on corporate loans
up to EUR 1m and with maturity up to 1 year



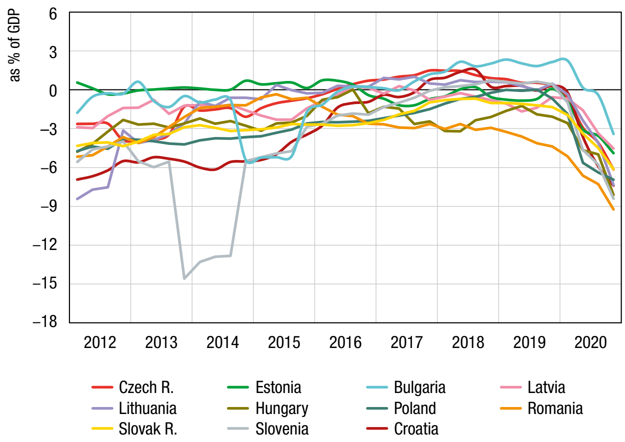
Notes: The expected real interest rate equals the nominal interest rate deflated by inflation projected for the next year from the Consensus Forecasts. Country group averages are not weighted.
Sources: ECB and Consensus Forecasts.

Figure 13.16 Spread between expected and achieved real interest rate on corporate loans
up to EUR 1 and with maturity up to 1 year



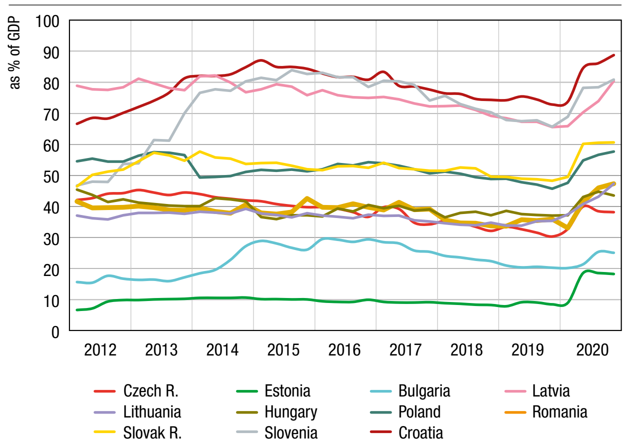
Notes: The expected real interest rate equals the nominal interest rate deflated by inflation projected for the next year from the Consensus Forecasts and the achieved real interest rate equals the nominal interest rate deflated by inflation achieved. Country group averages are not weighted.
Sources: ECB and Consensus Forecasts.

Figure 13.17 Consolidated general government balance
four-quarter moving sums



Sources: Eurostat and CNB.

Figure 13.18 General government debt
end-quarter stock



Sources: Eurostat and CNB.

Abbreviations and symbols

Abbreviations

APN – Agency for Transactions and Mediation in Immovable Properties
ARZ – Rijeka-Zagreb Motorway
BIS – Bank for International Settlements
bn – billion
b.p. – basis points
BEA – U. S. Bureau of Economic Analysis
BOP – balance of payments
c.i.f. – cost, insurance and freight
CBRD – Croatian Bank for Reconstruction and Development
CBS – Central Bureau of Statistics
CCI – consumer confidence index
CDCC – Central Depository and Clearing Company Inc.
CDS – credit default swap
CEE – Central and Eastern European
CEFTA – Central European Free Trade Agreement
CEI – consumer expectations index
CES – Croatian Employment Service
CHIF – Croatian Health Insurance Fund
CM – Croatian Motorways
CLVPS – Croatian Large Value Payment System
CNB – Croatian National Bank
CPF – Croatian Privatisation Fund
CPI – consumer price index
CPII – Croatian Pension Insurance Institute
CR – Croatian Roads
CSI – consumer sentiment index
DAB – State Agency for Deposit Insurance and Bank Resolution
dep. – deposit
DVP – delivery versus payment
EC – European Commission
ECB – European Central Bank
EFTA – European Free Trade Association
EMU – Economic and Monetary Union
ESI – economic sentiment index
EU – European Union
excl. – excluding
f/c – foreign currency
FDI – foreign direct investment
Fed – Federal Reserve System
FINA – Financial Agency
FISIM – financial intermediation services indirectly measured
f.o.b. – free on board
GDP – gross domestic product
GVA – gross value added
HANFA – Croatian Financial Services Supervisory Agency
HICP – harmonised index of consumer prices
HUB – Croatian Banking Association
ILO – International Labour Organization
IMF – International Monetary Fund
incl. – including
IPO – initial public offering
m – million
MIGs – main industrial groupings
MM – monthly maturity
MoF – Ministry of Finance
NA – national accounts
NBS – National Bureau of Statistics of China
NCA – National Classification of Activities
NCB – national central bank
NCS – National Clearing System
n.e.c. – not elsewhere classified
OECD – Organisation for Economic Co-Operation and Development
OG – Official Gazette
R – Republic
o/w – of which
PPI – producer price index
RTGS – Real-Time Gross Settlement
Q – quarterly
RR – reserve requirement
SDR – special drawing rights
SE – South-East
SITC – Standard International Trade Classification
SGP – Stability and Growth Pact
ULC – unit labour cost
VAT – value added tax
WTO – World Trade Organization
ZMM – Zagreb Money Market
ZSE – Zagreb Stock Exchange

Three-letter currency codes

ATS – Austrian schilling
CHF – Swiss franc
CNY – Yuan Renminbi
DEM – German mark
EUR – euro
FRF – French franc
GBP – pound sterling
HRK – Croatian kuna
ITL – Italian lira
JPY – Japanese yen
USD – US dollar
XDR – special drawing rights

Two-letter country codes

AT – Austria
BE – Belgium
BG – Bulgaria
CY – Cyprus
CZ – Czech Republic
DE – Germany
DK – Denmark
EE – Estonia
ES – Spain
FI – Finland
FR – France
GB – Great Britain
GR – Greece
HR – Croatia
HU – Hungary
IE – Ireland
IT – Italy
LT – Lithuania
LV – Latvia
MT – Malta
NL – Netherlands
PL – Poland
PT – Portugal
RO – Romania
SI – Slovenia

SK – Slovak Republic

UK – United Kingdom

Symbols

– – no entry

.... – data not available

0 – value is less than 0.5 of the unit of measure being used

∅ – average

a, b, c,... – indicates a note beneath the table and figure

* – corrected data

( ) – incomplete or insufficiently verified data

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