

CROATIA

Table 1 **2023**

Population, million	3.8
GDP, current US\$ billion	82.0
GDP per capita, current US\$	21401.9
International poverty rate (\$2.15) ^a	0.3
Lower middle-income poverty rate (\$3.65) ^a	0.4
Upper middle-income poverty rate (\$6.85) ^a	1.8
Gini index ^a	28.9
School enrollment, primary (% gross) ^b	95.9
Life expectancy at birth, years ^b	76.4
Total GHG emissions (mtCO2e)	17.5

Source: WDI, Macro Poverty Outlook, and official data.
 a/ Most recent value (2021), 2017 PPPs.
 b/ Most recent WDI value (2021).

Croatia's economic growth at 2.8 percent remained well above EU average in 2023, supporting income convergence. Poverty has likely stayed stagnant at 1.4 percent in 2023. The medium-term outlook is relatively favorable due to robust domestic demand, underpinned by a tight labor market, a strong inflow of EU funds, and slowly improving external demand. Fiscal policy is set to be expansionary with significant increase in spending in 2024, but public debt will remain on a declining path.

Key conditions and challenges

Croatia's economic activity continues to show resilience, which is reflected in an accelerated convergence with average EU incomes over the last three years. The country's GDP per capita is set to exceed 75 percent of the EU average in 2023, up by 9 p.p. compared to 2019. The recent GDP growth acceleration is largely due to the booming tourism sector and the strong inflow of EU funds. Economic activity was also underpinned by supportive fiscal policy, strong labor market, and large inflows of workers' remittances, which fostered robust personal consumption growth. Over the last year, Croatia was, however, not spared from the adverse effects of inflationary pressures and tighter monetary policy that weighed on business investments and external demand. The medium-term outlook remains relatively favorable on the back of robust domestic demand, an improved external environment, and substantial EU funding.

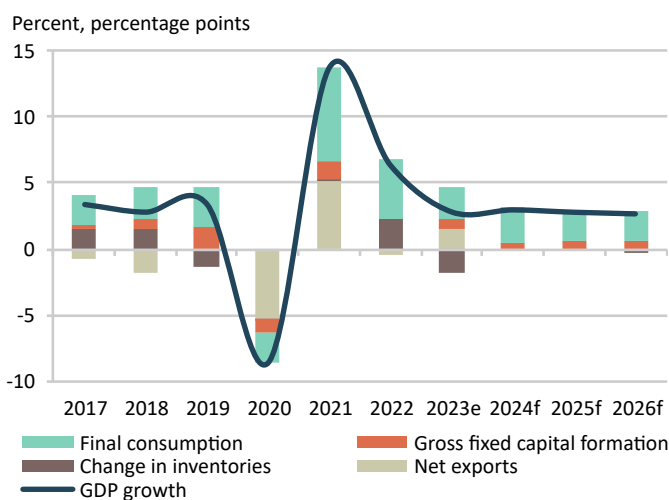
Notwithstanding the significant economic progress, there remains ample room to improve the quality of the institutional framework and to address shortcomings in the business environment, two of Croatia's long-standing issues. Lifting potential growth through structural reforms that augment productivity over the next couple of years will be especially important in the context of possible reduction in EU funds available to Croatia in

the post-2030 period and still relatively low labor market participation and adverse demographic trends. The uncertain external outlook and geopolitical tensions still pose downside risks to growth but are partially mitigated by Croatia's improved economic resilience. Risks to fiscal sustainability are moderate: despite the short-term deterioration of the fiscal balance in 2024, the downward trajectory of the debt-to-GDP ratio is expected to continue over the medium term. Moreover, the banking sector remains resilient, with private sector debt and NPLs staying relatively low, while external vulnerabilities appear manageable, given the high positive current and capital account balance.

Recent developments

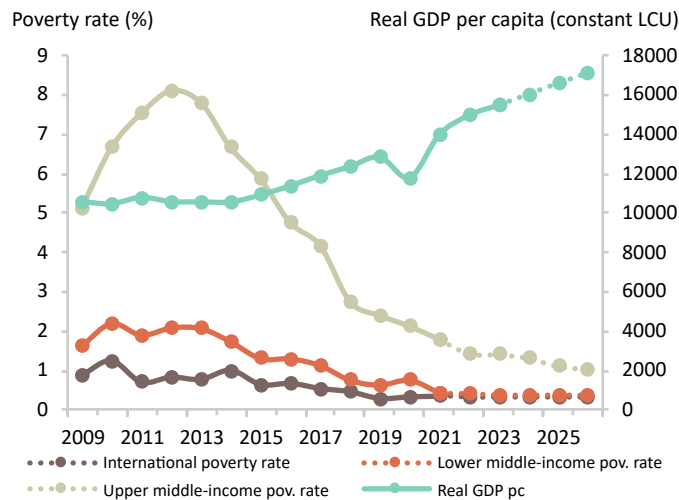
Croatia ended 2023 on a strong note. After a modest expansion in the third quarter (in q-o-q terms), real GDP growth accelerated in the last quarter with an annual growth rate surpassing 4 percent, primarily reflecting strong domestic demand. Overall, real GDP growth in 2023 stood at 2.8 percent and was one of the highest in the EU. The largest contribution came from private consumption, which was supported by favorable labor market developments and falling inflation, leading to an improvement in real disposable incomes. Investment activity, primarily supported by public sector investments financed by EU funds, also contributed positively. On the other hand, business investments remain stubbornly low compared to EU peers.

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



Sources: CROSTAT and World Bank.

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



Source: World Bank. Notes: see Table 2.

Services exports continued to provide strong support to growth, whereas goods exports declined. The trade balance improved following the decline in imports which in part seems to have been linked to a relatively strong fall in inventories. On the supply side, growth was primarily supported by the services sector and construction, while manufacturing activity was suppressed, consistent with sluggish growth in Croatia's main trading partners. Net inflow of FDI remained significant but a large share of investments in real estate makes it less relevant for raising the country's growth potential. The labor market remained strong throughout 2023, with the strongest employment growth observed in sectors linked to tourism and construction. At the same time, nominal wage growth picked up, which, amid falling inflation, resulted in a strong rise in real wages. Despite robust growth and high inflation having a favorable impact on revenue performance, the significant rise in the government wage bill led to deterioration of the general government budget balance. Inflation steadily declined throughout 2023, and in January 2024 reached 4.8 percent. The slowdown has been consistent across major components, except

for services price inflation, which remains elevated. Despite falling inflation, the World Bank 2023 Rapid Assessment Survey reports that most Croatians (78 percent) expected the increase in their total household income would not catch up with inflation. Poverty is expected to remain at 1.4 percent in 2023.

Outlook

Over the medium term, the country's growth rate, at around 2.8 percent, is expected to exceed the average for the EU. In 2024, growth is projected to accelerate to 3.0 percent reflecting positive carry-over effects from 2023, strengthening external demand, as well as expansionary fiscal policy. In addition, a strong labor market, which is reflected in a relatively high share of companies reporting shortages of labor and a strong rise in public sector wages, will further support increase in real incomes. Against this backdrop, personal consumption growth is expected to accelerate in 2024 and be the main driver of growth. The dynamics of goods exports could also strengthen in response to the

improved external environment, while growth in services exports is expected to slow down given the strong performance in recent years and the reduced price-competitiveness of the Croatian tourism sector. Investment growth is expected to decelerate but remain relatively strong, supported by EU funds and improved private sector investments. While personal consumption growth is expected to decelerate following less expansionary fiscal policy in 2025, improvements in the external environment, less restrictive monetary policy, as well as an ample amount of EU funds will continue to support economic activity. Inflation is set to continue its declining trend and gradually narrow towards the ECB target of close to 2 percent by the beginning of 2025, but risks remain given upward wage pressures. At the same time, fiscal balance is expected to worsen significantly in 2024, largely reflecting rise in wage bill and social benefits, but it is set to remain relatively contained over the forecast horizon. Together with continued nominal economic growth, this will allow for a further decline in the public debt-to-GDP ratio that is forecast to reach 56 percent at the end of 2026. Poverty is expected to gradually fall to 1.0 percent by 2026.

TABLE 2 Croatia / Macro poverty outlook indicators

(annual percent change unless indicated otherwise)

	2021	2022	2023e	2024f	2025f	2026f
Real GDP growth, at constant market prices	13.8	6.3	2.8	3.0	2.8	2.7
Private consumption	10.6	6.7	3.0	3.7	2.8	2.7
Government consumption	3.0	2.7	2.8	2.9	2.9	2.8
Gross fixed capital investment	6.6	0.1	4.2	2.1	3.3	3.4
Exports, goods and services	32.7	27.0	-2.9	2.8	3.2	3.3
Imports, goods and services	17.3	26.5	-5.3	3.1	3.3	3.5
Real GDP growth, at constant factor prices	12.2	7.9	2.3	3.0	2.8	2.7
Agriculture	9.6	-4.3	0.4	0.9	1.0	1.0
Industry	12.4	2.7	-0.5	1.7	2.2	2.2
Services	12.3	10.5	3.4	3.6	3.1	2.9
Inflation (consumer price index)	2.7	10.7	8.4	3.9	2.3	2.2
Current account balance (% of GDP)	1.0	-2.8	1.0	1.6	1.6	2.4
Net foreign direct investment inflow (% of GDP)	5.2	5.4	3.5	3.4	3.4	3.2
Fiscal balance (% of GDP)	-2.5	0.1	-0.3	-2.3	-1.8	-1.6
Revenues (% of GDP)	46.1	45.0	46.6	45.4	45.5	45.8
Debt (% of GDP)	78.1	68.2	60.7	58.2	56.9	56.0
Primary balance (% of GDP)	-1.0	1.5	0.9	-1.2	-0.6	-0.5
International poverty rate (\$2.15 in 2017 PPP)^{a,b}	0.3	0.3	0.3	0.3	0.3	0.3
Lower middle-income poverty rate (\$3.65 in 2017 PPP)^{a,b}	0.4	0.4	0.4	0.4	0.4	0.4
Upper middle-income poverty rate (\$6.85 in 2017 PPP)^{a,b}	1.8	1.4	1.4	1.3	1.1	1.0
GHG emissions growth (mtCO₂e)	4.2	-1.1	-0.1	0.7	0.4	0.3
Energy related GHG emissions (% of total)	87.5	86.8	86.6	86.2	85.8	85.4

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

Notes: e = estimate, f = forecast.

a/ Calculations based on ECAPOV harmonization, using 2022-EU-SILC. Actual data: 2021. Nowcast: 2022-2023. Forecasts are from 2024 to 2026.

b/ Projection using neutral distribution (2021) with pass-through = 0.87 (Med (0.87)) based on GDP per capita in constant LCU.