HNB

Macroeconomic Developments and Outlook

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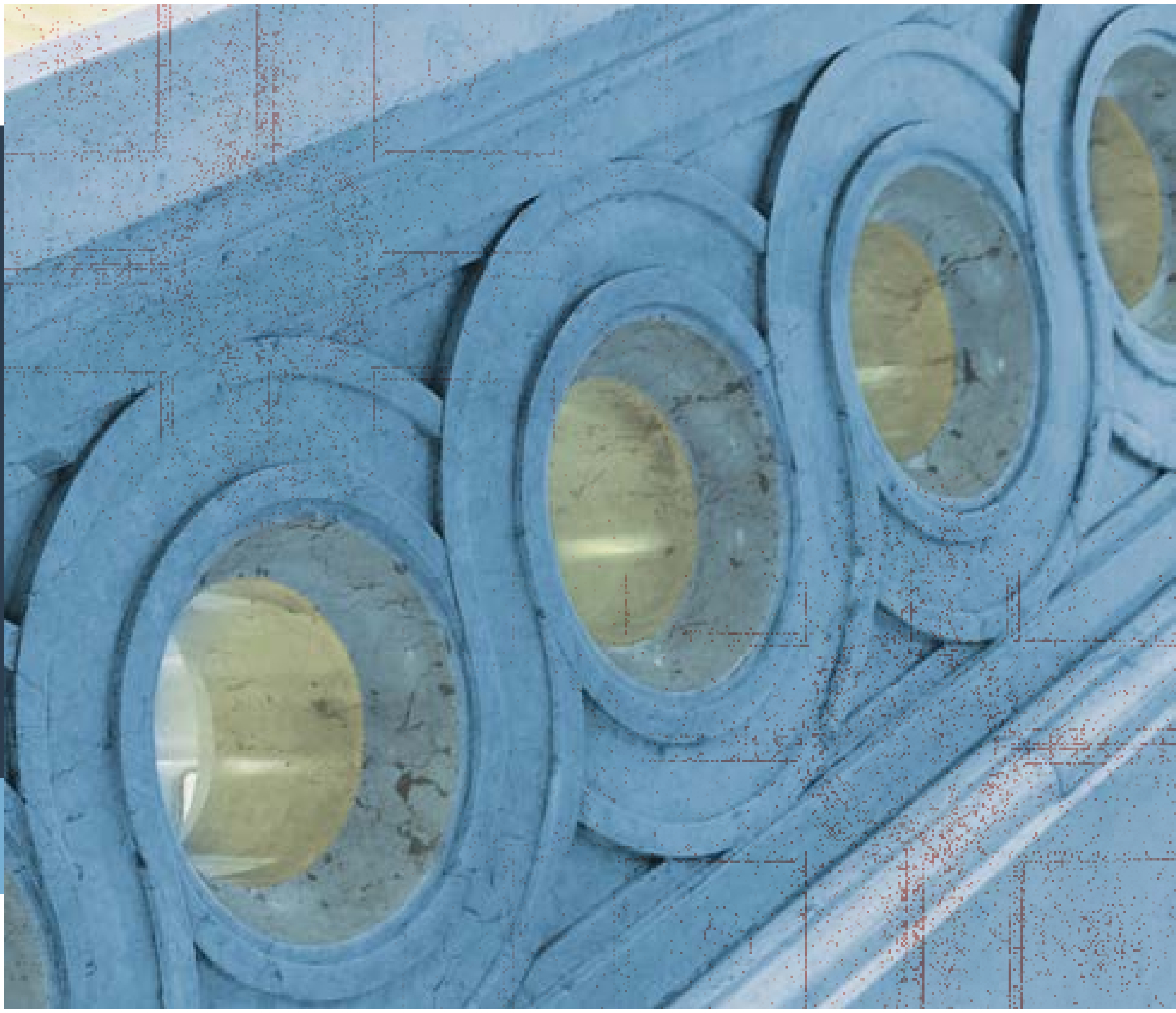

CROATIAN NATIONAL BANK

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

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Contents

General information on Croatia

Economic indicators

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
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]	4.281	4.268	4.256	4.238	4.204	4.174	4.125	4.088	4.065	4.048	3.889
GDP (million HRK, current prices) [b]	337,572	334,592	335,955	335,292	344,034	355,920	372,355	390,856	412,228	378,341	430,621
GDP (million EUR, current prices)	45,408	44,509	44,359	43,944	45,211	47,271	49,913	52,718	55,604	50,224	57,232
GDP per capita (in EUR)	10,608	10,430	10,423	10,368	10,755	11,324	12,101	12,896	13,678	12,408	14,718
GDP - real year-on-year rate of growth (in %)	-0.1	-2.3	-0.4	-0.3	2.5	3.5	3.4	2.9	3.5	-8.1	10.2
Average year-on-year CPI inflation rate	2.3	3.4	2.2	-0.2	-0.5	-1.1	1.1	1.5	0.8	0.1	2.6
Average year-on-year HICP inflation rate	2.2	3.4	2.3	0.2	-0.3	-0.6	1.3	1.6	0.8	0.0	2.7
Current account balance (million EUR) [c]	-764	-788	-453	153	1,524	1,091	1,767	994	1,686	-56	1,945
Current account balance (as % of GDP)	-1.7	-1.8	-1.0	0.3	3.4	2.3	3.5	1.9	3.0	-0.1	3.4
Exports of goods and services (as % of GDP)	38.4	39.1	39.9	42.8	45.8	47.1	49.3	49.5	50.8	42.1	52.5
Imports of goods and services (as % of GDP)	40.1	40.7	41.9	43.2	45.5	45.9	48.6	50.3	51.1	48.8	53.5
External debt (million EUR, end of year) [c]	49,198	47,624	48,622	49,468	48,340	44,675	43,548	42,583	40,278	40,074	44,610
External debt (as % of GDP)	108.3	107.0	109.6	112.6	106.9	94.5	87.2	80.8	72.4	79.8	77.9
External debt (as % of exports of goods and services)	282.5	273.7	274.5	262.9	233.2	200.8	176.9	163.1	142.6	189.7	148.4
External debt service (as % of exports of goods and services) [d]	42.5	46.1	43.4	46.3	44.0	35.7	33.0	27.0	37.7	34.9	21.0
Gross international reserves (million EUR, end of year)	11,195	11,236	12,908	12,688	13,707	13,514	15,706	17,438	18,560	18,943	25,022
Gross international reserves (in terms of months of imports of goods and services, end of year)	7.4	7.5	8.3	8.0	8.0	7.5	7.8	7.9	7.8	9.3	9.8
National currency: kuna (HRK)											
Exchange rate on 31 December (HRK : 1 EUR)	7.5304	7.5456	7.6376	7.6615	7.6350	7.5578	7.5136	7.4176	7.4426	7.5369	7.5172
Exchange rate on 31 December (HRK : 1 USD)	5.8199	5.7268	5.5490	6.3021	6.9918	7.1685	6.2697	6.4692	6.6499	6.1390	6.6435
Average exchange rate (HRK : 1 EUR)	7.4342	7.5173	7.5735	7.6300	7.6096	7.5294	7.4601	7.4141	7.4136	7.5331	7.5242
Average exchange rate (HRK : 1 USD)	5.3435	5.8509	5.7059	5.7493	6.8623	6.8037	6.6224	6.2784	6.6223	6.6108	6.3636
Consolidated general government net lending (+)/borrowing (-) (million HRK) [e]	-26,584	-18,236	-18,436	-18,354	-11,736	-3,296	2,804	-116	969	-27,710	-12,438
Consolidated general government net lending (+)/borrowing (-) (as % of GDP) [e]	-7.9	-5.5	-5.5	-5.5	-3.4	-0.9	0.8	0.0	0.2	-7.3	-2.9
General government debt (as % of GDP) [e]	63.7	69.4	80.3	83.9	83.3	79.8	76.7	73.3	71.1	87.3	79.8
Long-term interest rates (annual, in %) [f]	6.54	6.13	4.68	4.05	3.53	3.47	2.77	2.17	1.28	0.83	0.45
Unemployment rate (ILO, persons above 15 years of age) [g]	13.7	15.9	17.3	17.3	16.2	13.1	11.2	8.4	6.6	7.5	7.6
Employment rate (ILO, persons above 15 years of age) [g]	44.8	43.2	42.1	43.3	44.2	44.6	45.8	46.9	47.7	47.2	47.8

[a] The population estimate of the Republic of Croatia for 2000 is based on the 2001 Census and that for the 2001 – 2020 period on the 2011 Census. Data for 2021 are preliminary.
[b] The GDP data are presented according to the ESA 2010 methodology. Data for 2020 and 2021 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 first quarter of 2022 and data on the gross external debt position as at the end of March 2022.
[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.
[f] Average long-term government bond yield with a remaining maturity of about 10 years.
[f] Data for the 2007 – 2013 period are revised and therefore no longer comparable to data for the 2000 – 2006 period.

Sources: CBS, MoF and CNB.

Macroeconomic Developments and Outlook

1 Introduction

The economic fallout from the Russian invasion of Ukraine, accompanied by the leap in the prices of energy and raw materials and further disruptions in global supply chains, have had no serious impact on Croatia's economic outlook so far. Negative external shocks have had more of an impact on the manufacturing sector, but in the services sector the difficulties have been surmounted owing to the lifting of most remaining containment measures and the redirecting of demand towards consumption of services rather than goods, backed by savings accumulated during the pandemic, which generally had a favourable effect on economies more oriented towards the service sector and less reliant on global production chains. In such a setting, domestic economic activity was 2.7% higher in the first quarter of 2022 than in the previous quarter, on the back of growth in total exports and investment activities. Available high-frequency economic indicators point to a similar economic growth dynamics in the second quarter, while booking data suggest that a very good tourist pre-season could be followed by favourable results in peak tourist season. Thus, real GDP could increase by 5.5% in the whole of 2022. Unfavourable global circumstances, coupled with elevated inflation pressures, could be reflected more in the domestic economy in 2023, when growth in domestic real activity is expected to fall to 2.5%. Risks remained elevated in the projection period, dominated by those that might be reflected negatively in economic growth. Consumer price inflation might accelerate considerably in 2022 (to 9.4%), primarily due to noticeably higher global prices of energy and raw materials, with clear signs of spillover of higher input costs onto a broader set of goods and services. In the domestic market, the strongest growth continues to be recorded in the prices of energy and food, with a gradual increase in the prices of other inflation subcomponents, i.e. other goods and services. Growth in all the main subcomponents is projected to slow down in 2023, and consequently total inflation is projected to trend down to 4.6%. However, such a projection rests on the assumption that, among other things, the prices of energy and other raw materials in the global market will stabilise and gradually decrease towards the end of this year. Risks to inflation projections are thus also elevated, predominantly those concerning the possibility of higher than foreseen inflation. The surplus in the current and capital account of the balance of payments might edge down in 2022 (to 5.2% of GDP), largely fuelled by the widening of the foreign trade deficit under the influence of growing import prices, largely counteracted by the rise in net exports of services. A sizeable drop in the surplus is expected in the following year (to 3.8% of GDP), as a result of further growth in the foreign trade deficit, accompanied by a noticeably slower increase in net exports of services than last year. Heightened uncertainty caused by the war in Ukraine, strong inflationary pressures and the expected reversal of monetary policies, backed by the first steps taken in that direction and the announcements regarding future measures, have triggered a substantial tightening of global financial conditions. Against this backdrop, the CNB continued to maintain exchange rate stability in the first half of 2022. Participation in the ERM II has helped to anchor expectations, and the CNB managed to stabilise the exchange rate with only a few interventions in the foreign exchange market, while the liquidity of the monetary system remained ample. The rise in market yields on government debt securities has not yet spilled over to the financing costs of the private sector. Interest rates on corporate loans remained close to historic lows, while the costs of household financing dropped to their record low in April. The rise in corporate placements picked up noticeably, which is largely associated with the financial needs of corporates operating in the energy sector, while household lending continued to edge up. Public finance developments should remain relatively favourable, given the continued growth in economic activity and the acceleration of consumer price inflation, which will have a positive effect on budget revenues. More pronounced fiscal adjustments will be curbed by the introduction of measures on both the revenue and the expenditure side, aimed at alleviating adverse economic and social effects of the growing inflation, as well by the relatively sharp growth in certain expenditure categories, largely associated with the costs generated in the health sector. In accordance with the amendments to the state budget of the Government of the Republic of Croatia from May, the general government budget deficit might be 2.8% of GDP in 2022 and decrease additionally to 1.6% of GDP in the following year. Following a one-off increase in 2020, general government debt-to-GDP ratio is expected to resume its downward path during the current year and in the following year.

Although the Russian invasion of Ukraine has resulted in considerable geopolitical tensions on a global level, with a continued rise in the prices of energy and raw materials that started as early as last year, these factors have had no adverse impact on the growth of Croatia's economy so far. The stabilisation of the pandemic and lifting of the remaining containment measures enabled the recovery of the services sector, while the increase in demand, especially for services, was supported by the savings accumulated during the pandemic. Economic activity intensified in the first three months this year, while real GDP rose by 2.7% from the previous quarter. With regard to GDP components, the exports of goods and services and gross fixed capital formation rose on a quarterly level, while personal consumption held steady at the levels recorded in the previous quarter, with a decrease in government consumption. The available high-frequency data point to a similar growth dynamics in the second quarter, while data on tourist bookings suggest that a very good tourist pre-season could be followed by favourable results in peak tourist season. Total GDP in the whole of 2022 might increase by 5.5%, having grown by 10.2% in 2021, with the expected rise in all components of both domestic and foreign demand. As regards domestic demand components, household consumption and investments could provide the strongest boost to total growth. An unfavourable global environment, coupled with persisting inflationary pressures, could have a significant impact on domestic economic activity and its growth could slow down to 2.5%. In light of such a central projection, risks are tilted to the downside, mostly arising from geopolitical instability. Increasing inflation, especially as far as the prices of food and energy are concerned, could cause an additional decrease in real disposable income, resulting in an even more pronounced impact on domestic and foreign demand. Real economic activity could be further exacerbated by a potential faster and sharper tightening of financing conditions, aimed at curbing such inflationary pressures. In addition, there is still a threat of new waves of the pandemic and new virus variants that could be resistant to the existing vaccines. Withdrawal of EU funds available to Croatia is expected to gain pace considerably in the projection period. Withdrawal dynamics and the amounts of withdrawn EU funds pose both a positive risk (more intensive use than expected) and a negative risk (insufficient absorption capacities). A positive risk also stems from the potential de-escalation of the conflict in Ukraine, which could to some extent cushion the supply chain disruptions. The adverse scenario involving a prolonged conflict in Ukraine and a full cut-off in Russian energy supply to the European market could be partly reflected in economic growth as early as this year, with broader potential repercussions in the following year.

The labour market has been under the influence of the still very favourable real developments. Following the increase in employment of 2.2% in 2021, the number of employed persons could grow by 2.6% in 2022. The major part of the increase in employment comes from a stronger employment growth in the private sector, which is to a considerable extent probably due to hiring of workers from third countries (non-EU countries). In 2023, in light of a slower growth in economic activity, employment growth is expected to decelerate to 1.1%. The ILO unemployment rate could come down to 6.1% of the labour force in 2022 (from 7.6% in 2021), and drop further to 5.6% in 2023. Increased demand for workers and inflationary pressures fuel a faster growth in wages, and the average nominal gross wage is expected to increase by 7.5% this year (from 4.1% in 2021). However, the real value of gross wages could trend down in 2022, and increase again in 2023.

The increase in the prices of energy and raw materials, which intensified even more following the outbreak of the war in Ukraine, steadily surpassed market expectations. This growth, coupled with more pronounced spillover of the rise in the input costs to a wider set of goods and services, was behind the rise in the projected average annual consumer price inflation, measured by the harmonised index of consumer prices (HICP), to 9.4% in 2022 (from 2.7% in 2021). The considerable pick-up in inflation in 2022 was the result of numerous factors. On the one hand, the waning of the coronavirus pandemic gave a boost to demand for a large number of products and services, especially those that were partly or completely unavailable during the pandemic, with a rise in the global prices of raw materials. On the other hand, disruptions on the supply side during the pandemic led to shortages of some semi-finished and finished products. Problems on the supply side became even more acute following the Russian invasion of Ukraine, especially taking into account the significance of the two countries in the supply of energy and other raw materials, with sanctions imposed against Russia further contributing to unfavourable inflation trends. The prices of a growing number of products and services started increasing over time, with the prices of energy and food rising strongly for

Table 1.1 Summary table of projected macroeconomic measures

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
National accounts (real rate of change, in %)												
GDP	–2.3	–0.4	–0.3	2.5	3.5	3.4	2.9	3.5	–8.1	10.2	5.5	2.5
Personal consumption	–2.4	–1.6	–2.5	0.2	3.1	3.2	3.3	4.0	–5.3	10.1	5.3	2.5
Government consumption	–0.9	0.7	1.3	–0.9	1.0	2.2	2.5	3.3	4.1	3.1	3.3	2.5
Gross fixed capital formation	–4.6	1.0	–2.3	8.4	5.0	1.5	3.8	9.8	–6.1	7.6	6.4	4.1
Exports of goods and services	–1.5	2.5	7.4	10.3	7.0	6.9	3.7	6.8	–22.7	33.3	11.3	6.2
Imports of goods and services	–2.4	3.2	3.5	9.4	6.5	8.4	7.5	6.5	–12.3	14.7	9.9	7.5
Labour market												
Number of employed persons (average rate of change, in %)	–1.2	–1.5	–2.0	0.7	1.9	1.9	2.3	2.3	–1.2	2.2	2.6	1.1
Registered unemployment rate	18.9	20.2	19.6	17.0	14.4	11.6	9.2	7.6	8.9	8.0	6.4	5.9
ILO unemployment rate	15.9	17.2	17.3	16.2	13.1	11.2	8.4	6.6	7.5	7.6	6.1	5.6
Prices												
Consumer price index (average rate of change, in %)	3.4	2.2	–0.2	–0.5	–1.1	1.1	1.5	0.8	0.1	2.6	9.4	4.6
Harmonised index of consumer prices (average rate of change, in %)	3.4	2.3	0.2	–0.3	–0.6	1.3	1.6	0.8	0.0	2.7	9.4	4.6
External sector												
Current account balance (as % of GDP)	–1.8	–1.0	0.3	3.4	2.3	3.5	1.9	3.0	–0.1	3.4	2.1	1.0
Current and capital account balance (as % of GDP)	–1.5	–0.8	0.8	4.1	3.7	4.5	3.2	4.6	2.0	5.8	5.2	3.8
Gross external debt (as % of GDP)	107.0	109.6	112.6	106.9	94.5	87.2	80.8	72.4	79.8	77.9	69.8	64.1
Monetary developments (rate of change, in %)												
Total liquid assets – M4	3.6	4.0	3.2	5.2	4.7	2.1	5.5	2.9	9.3	10.7	9.9	
Total liquid assets – M4[a]	3.5	3.8	2.4	4.6	5.3	3.2	6.1	3.5	9.1	10.4	9.6	
Credit institution placements to the private sector	–5.9	–0.5	–1.6	–3.0	–3.7	–1.2	2.0	2.8	3.9	3.0	7.4	
Credit institution placements to the private sector[a]	–1.2	0.8	–1.5	–2.3	1.1	2.9	4.4	4.2	3.9	3.9	7.4	
Credit institution placements to corporates[a]	–1.5	1.8	–3.7	–3.0	3.2	2.5	1.9	0.4	5.6	2.3	13.6	
Credit institution placements to households[a]	–1.1	–1.2	–0.7	–1.8	0.5	4.0	6.2	7.4	2.1	4.5	5.0	

[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.

some time already, followed by recent increases in the prices of other goods and services. As a result, the annual consumer price inflation surpassed 10% in May, for the first time ever since the stabilisation programme in 1990s. It is expected to stabilise in the remainder of the year and might start decelerating slightly towards the end of the year. Inflation is expected to slow down noticeably to 4.6% in 2023, largely due to the negative effect of the base period (the waning effect of the sharp increase in the prices of numerous goods and services in early 2022) and owing to the anticipated stabilisation and gradual fall in the prices of crude oil and other raw materials in the futures markets towards the end of the projection horizon. However, risks to the inflation projection remain pronounced, with prevailing risks that could push inflation higher than anticipated. Higher inflation could also stem from elevated inflation in Croatia's main trading partners, as well as from the potential build-up of domestic inflationary pressures in the case of a faster growth in wages. Inflation trends will also largely depend on the further development of the Russian invasion of Ukraine, as well as on the stringency and duration of containment measures that are being periodically introduced in some Chinese cities that are also major global ports, which could lead to new mismatches between supply and demand.

The pronounced widening of the foreign trade deficit, mainly caused by the deterioration in the terms of trade due to a hike in the prices of energy and other raw materials in the global market, should contribute the most to the slight decrease in the current and capital account surplus in 2022 (from 5.8% in 2021 to 5.2% of GDP). However, a noticeable recovery in the demand for services, especially tourism, could largely alleviate unfavourable foreign trade developments. In addition, a somewhat more intensified use of EU funds is expected. The foreign trade deficit and interest expenses on foreign liabilities are expected to grow further next year, while net exports of services could also rise, albeit noticeably slower than last year. As a result, the decrease in the current and capital account surplus might be more pronounced in 2023 (standing at 3.8% of GDP). As regards foreign capital flows, net capital outflows are expected to continue in the projection period, with the steady improvement in relative indicators of external debt.

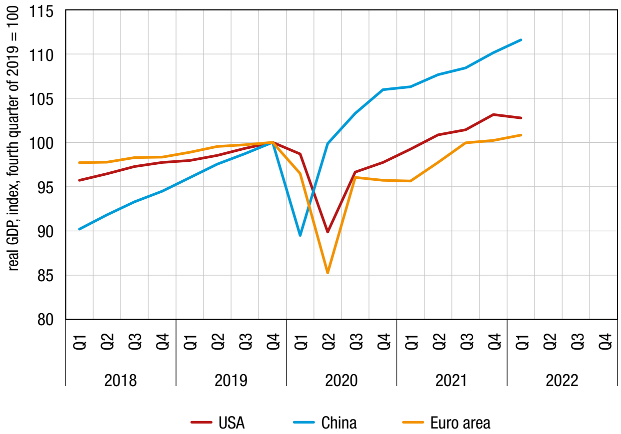
The first half of 2022 was marked by mounting inflationary pressures and expectations of a faster and sharper tightening of the monetary policies of many central banks, including those in the most developed economic areas. The expected reversal of monetary policies, backed by the first steps taken in that direction and announcements regarding future measures, triggered a substantial tightening of global financial conditions. In such conditions, the exchange rate of the kuna against the euro remained stable, while monetary system liquidity held steady at a very high level. Though the rise in geopolitical tensions spurred by the Russian aggression against Ukraine created some pressures in the foreign exchange market in March, their intensity was relatively limited as market expectations were further anchored by Croatia's participation in the exchange rate mechanism ERM II and the expected introduction of the euro. The CNB intervened three times by selling only smaller amounts of foreign currency to commercial banks, after which the pressures subsided. Banks' free reserves edged down from the end of 2021, even though they remained at very high levels, which contributed to maintaining the favourable costs of corporate and household financing, despite the tightening of global and European financing conditions. Individual interest rates dropped to their historic lows. The growth in corporate placements, particularly in loans for working capital, accelerated considerably, under the influence of elevated costs caused by higher prices of energy and raw materials, especially for corporates operating in the energy sector, as well as due to the anticipated potential increase in borrowing costs. Household lending continued to edge up, with the sharpest growth seen in housing loans, but also with a rise in general-purpose cash loans. A record-high number of applications for the new round of housing loan subsidies was reached, which will accelerate the increase in these loans in the upcoming months. In the forthcoming period, monetary policy will be gradually adjusted to the instruments and orientation of the common monetary policy in the euro area, which will lead to a significant easing of monetary conditions. This will somewhat alleviate the expected impact of tighter global and European financing conditions on the domestic economy.

In light of favourable economic developments and heightened inflation, reflected in the rise in budget revenues, the general government deficit could continue to improve. Nevertheless, fiscal intervention aimed at alleviating the negative economic and social effects of the rise in the prices of energy and a sharp rise in health care expenditures have curbed a more marked improvement in fiscal indicators in 2022. Consequently, in accordance with the amendments to the state budget from May 2022, the general government budget deficit is anticipated to improve only slightly and amount to 2.8% of GDP (from 2.9% of GDP last year). The Ministry of Finance expects a noticeable improvement in the fiscal deficit in 2023, perhaps by as much as 1.6% of GDP. In its spring forecast from May 2022, the European Commission estimated that the deficit might be more favourable in 2022 and slightly more unfavourable in 2023. In accordance with these general government balance indicators, the public debt-to-GDP ratio should continue its downward trend this year and in 2023, following its sharp increase in 2020, while the general government debt-to-GDP ratio could almost reach its pre-pandemic levels at the end of the following year, according to the projections of the Ministry of Finance.

2 Global developments

The recovery of the global economy from the coronavirus crisis edged down at the turn of 2021, and was further weakened following the Russian invasion of Ukraine in late February. The Russian aggression against Ukraine triggered the imposition of trade and financial sanctions on Russia, spurred uncertainty over the supply of energy and other raw materials, contributing to a sharp rise in their prices. The operations in the manufacturing sector have been noticeably impaired amid the pronounced growth in the costs of energy and raw materials, heightened uncertainty and additional disruptions in supply chains caused by the war. In addition, certain segments of China's economy, including important trade and production zones, endured weeks of lockdown as a result of a very restrictive containment policy, additionally hindering global trade. In

Figure 2.1 Economic activity in selected markets



Sources: Eurostat, BEA and NBS.

contrast with China, containment measures in the majority of other countries were eased considerably following their short-lived tightening at the beginning of the year in response to the new Omicron variant, which contributed to the recovery of the services sector. In response to the mounting inflationary pressures, a growing number of central banks started tightening monetary policy or decreasing the degree of its accommodativeness. Coupled with heightened uncertainty and the rise in risk aversion, this contributed to the worsening of global financing conditions, especially in emerging market economies.

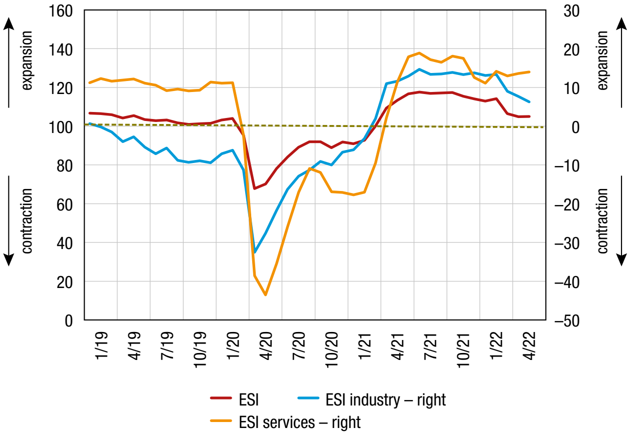
The annual growth of the US economy slowed down perceptibly in the first quarter of 2022 to 3.6%, with a quarterly contraction of 0.4%, following its steady growth for a year and a half (Figure 2.1). The export sector recorded the sharpest fall, with a slowdown in investments. Fiscal spending has been trending down for the second successive quarter, while only personal consumption and imports continued to grow at a similar pace as in the previous quarter. Nevertheless, labour market developments continued to improve, with the unemployment rate down to 3.6% of the labour force at the end of May, standing around the pre-pandemic level. The rise in the energy and raw materials prices and disruptions in the global supply chains boosted US inflation, reaching 8.6% in May, its highest rate in the past four decades. Core inflation, excluding the prices of energy and food, stood at 6% on an annual basis.

Economic activity in the euro area increased by 0.6% in the first quarter of 2022 from the previous quarter, with its annual growth accelerating to 5.4%. As for larger member states, the French economy contracted on the quarterly level, while the Italian and German economies recorded some minor growth. Despite a brief tightening of containment measures in some countries, the services sector continued to recover, while the operations in the manufacturing sector were still hindered by disturbances in global supply chains. In addition to the decrease in the exports to Russia and Ukraine felt by some corporations, the implications of the war in Ukraine soon started to be reflected in the entire euro area economy, in the form of elevated prices of energy and raw materials and the growing uncertainty, especially due to the significant dependence of certain member states on Russian gas. Early economic indicators suggest that such negative implications became even more noticeable at the beginning of the second quarter with the further decline in confidence in the manufacturing sector (Figure 2.2). Inflation in the euro area has surged since the beginning of the year, reaching as much as 8.1% in May. Although energy and food prices were the biggest contributors, the annual rise in other consumer prices accelerated to 4.4% in May.

Croatia's main trading partners

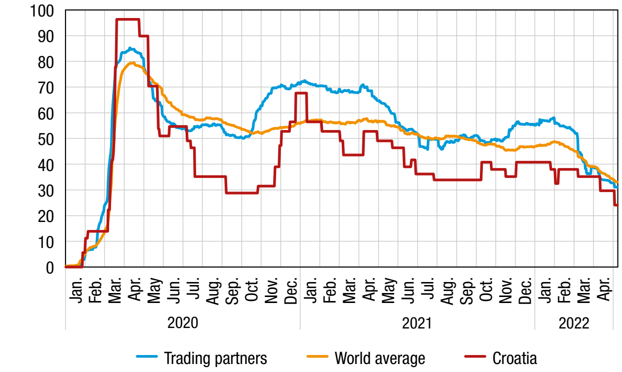
Economic recovery in the majority of Croatia's main trading partners in the euro area edged down in the first quarter of 2022. Such trends were influenced by containment measures, which were tightened in late 2021, only to be considerably relaxed soon after (Figure 2.3). Following the Russian invasion of Ukraine, the manufacturing sectors in the majority of countries, especially in the neighbouring area, started recording a rather marked decline in confidence due to insecurities related to energy supply. Southeastern European trading partners witnessed a relatively strong recovery from the pandemic that continued in early 2022. However, the increasingly prominent rise in prices of energy and food started weighing noticeably on domestic consumption. Somewhat stronger economic links between Russia and some of these countries were also reflected adversely in foreign trade and investments.

Figure 2.2 Euro area confidence indicators



Note: Data are up to May 2022.
Source: Eurostat.

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



Notes: Data are up to 30 April 2022. 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 growth in the prices of energy and raw materials accelerated again at the beginning of 2022, only to further intensify following the outbreak of the war in Ukraine in late February. At the very beginning of 2022, oil prices rose moderately, mostly due to eased uncertainty concerning the effect of the Omicron variant on the global economy and limited supply from OPEC countries, but spiked in the first days of the war, periodically exceeding USD 130 per barrel. Oil prices were extremely volatile afterwards, although moving at slightly lower levels, only to again exceed USD 120 per barrel in late May following the European Union's partial embargo on Russian oil. Supply fears had an even bigger effect on the prices of natural gas, especially in the European market, where the prices more than doubled in only a few days following the onset of the aggression against Ukraine, reaching their record highs (EUR 230/MWh). However, in mid-March it became likely that the European Union would not impose sanctions on Russian gas due to the heavy reliance of some member states on Russian energy supplies, and the price went down again to approximately EUR 100/MWh and held steady at this level until the end of May.

The war in Ukraine also triggered a further rise in the prices of other raw materials, especially of certain agricultural raw materials and metals largely produced in Russia and Ukraine. This reflected the most in the prices of cereals (particularly of wheat) that rose by around 50%, and in the prices of oilseeds (especially of sunflower) which doubled from the outbreak of war. Apart from potential shortages caused by the conflict in Ukraine, the increase in the prices of food raw materials was also spurred by the growth in energy prices, adding to their production and transportation costs. The already elevated prices of metal increased further as a result of the war, primarily those of some rare raw materials such as palladium, which is an important input in the automobile industry and produced in Russia. However, it should be noted that the prices of most industrial raw materials, excluding food raw material, peaked in March, which was followed by their moderate correction.

The mounting of inflationary pressures since the beginning of 2022 was followed by an intensified reduction of monetary stimuli introduced during the pandemic, leading to the gradual tightening of monetary policy. The fastest tightening of monetary policy was kicked off by the Fed, lifting the benchmark interest rate by 0.25 percentage points in March, followed by a further rise of 0.5 percentage points in May and 0.75 percentage points in June, which is the largest increase in several decades. Apart from the scaling back of the central bank's balance sheet, a further increase in interest rates has been announced for as early as in July, at a similar rate. The ECB also sped up the discontinuation of monetary stimuli. In March, it abolished the pandemic emergency purchase programme (PEPP) and further decreased purchases made within the scope of its asset purchase programme (APP) during the second quarter, announcing its discontinuation in July, with an increase in the benchmark interest rate by 0.25 percentage points.

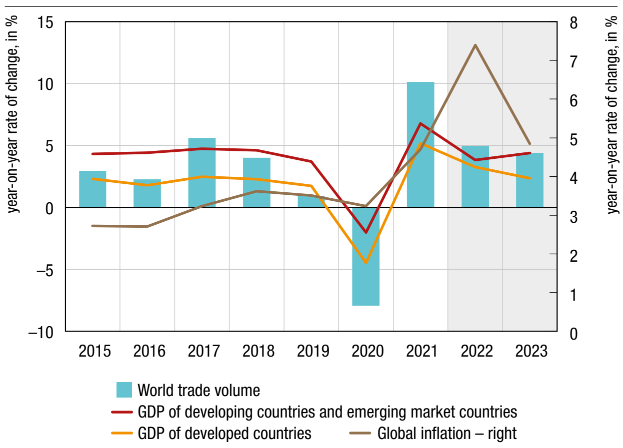
Developments in the world's foreign exchange market in the first five months of 2022 mostly reflected heightened uncertainty regarding the recovery of the euro area economy relative to other markets and the slower pace in the normalisation of the ECB's monetary policy. Against such a backdrop, the US dollar strengthened against the euro by 5.3% from the beginning of the year, standing at EUR/USD 1.07 in late May. The exchange rate of the Swiss franc against the euro also strengthened, although to a considerably lesser degree, amounting to EUR/CHF 1.03 at the end of May.

Projected developments

Before the outbreak of the war in Ukraine, the majority of international financial institutions expected that the global economy would continue to rebound in 2022, owing to the improved epidemiological prospects on a global scale and further alleviation of disruptions in global supply chains. However, these expectations suddenly deteriorated as the negative effects of the Russian invasion of Ukraine started to spill over to the global economy, reflected in mounting uncertainty, a rise in the prices of energy and raw materials and new supply chain disturbances (see also Box 1 The impact of the war in Ukraine on the Croatian economy). Given the increase in inflationary pressures against such a background, large central banks are expected to normalise their monetary policies at a significantly faster pace, while global financing conditions are expected to worsen, which will put additional strain on real economic activity.

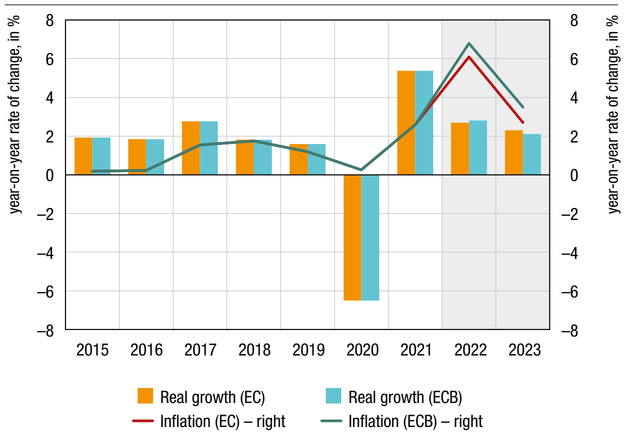
With regard to the global economy, in its April projections the IMF decreased the projected growth in 2022 by as much as 1.3 percentage points from its December projections (standing at 3.6%) (Figure 2.4). By country groups, the IMF noticeably decreased expectations for emerging market economies due to

Figure 2.4 Global economic developments



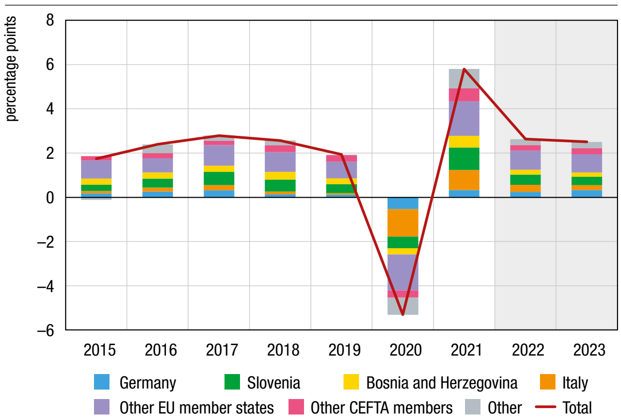
Source: IMF (WEO, April 2022).

Figure 2.5 Economic growth and inflation in the euro area



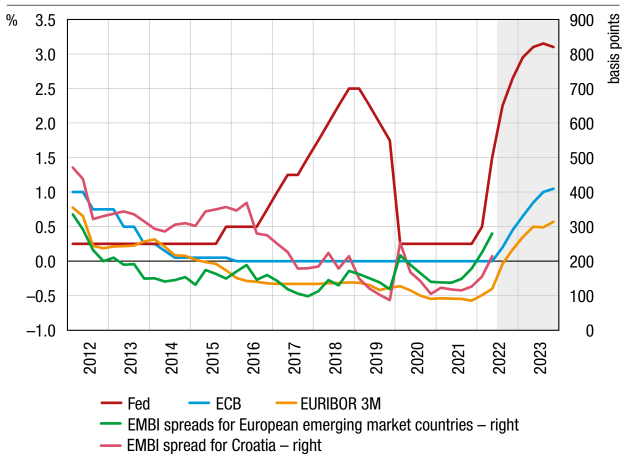
Sources: ECB (June 2022) and EC (May 2022).

Figure 2.6 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 2022).

Figure 2.8 Benchmark interest rates and the average yield spread on bonds of European emerging market countries
end of period

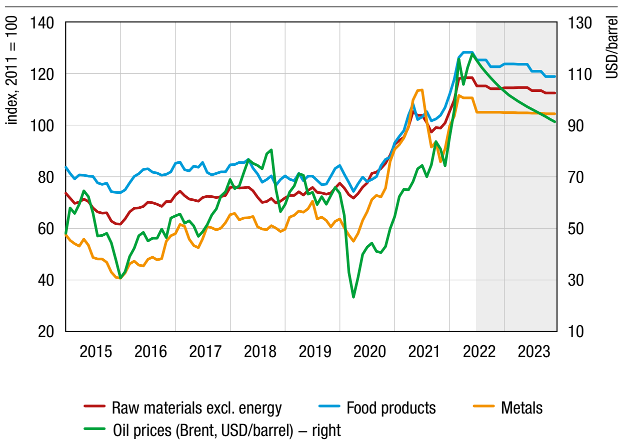


Source: Bloomberg.

their greater sensitivity to surging inflationary pressures, tightened financing conditions and the shrinking of fiscal space for stimulating domestic demand. Expectations for the Chinese economy were also lowered due to the economic fallout from a very stringent policy to fight coronavirus. Among developed countries, expectations decreased the most for the euro area, given that it is most exposed to the negative effects of the conflict in Ukraine, owing to much deeper trade and financial ties with the two countries, and its reliance on the Russian energy. Expectations regarding the USA have also been revised downwards, mostly due to recent weak performance and the decrease in foreign demand, while domestic consumption, backed by a strong labour market, remained the main economic driver. The IMF also expects that global inflation will come to an average of 7.4% this year, which is almost three times more than at the end of last year, and might remain elevated during 2023 as well.

Economic projections in the euro area published by the European Central Bank and the European Commission support IMF expectations (Figure 2.5). In its latest June projections, the ECB expects the economic growth in the euro area to stand at only 2.8% and 2.1% in 2022 and 2023 respectively. The disturbances in the manufacturing sector caused by the increase in the prices of energy and raw materials and impeded supply of some inputs used in the production of final goods will significantly offset the positive impact of the eased containment measures on the recovery of the services sector. Apart from the weaker foreign demand, in the upcoming period domestic demand will be hampered by a drop in real income of households, a decline in the propensity to consume and a decrease in investments amid heightened uncertainty and worsened financing conditions. According to the ECB projections, the average inflation rate in the euro area could come to an elevated 6.8% in 2022, and could significantly exceed the ECB's medium-term target level, reaching 3.5% in 2023.

Figure 2.7 Prices of raw materials on the international market



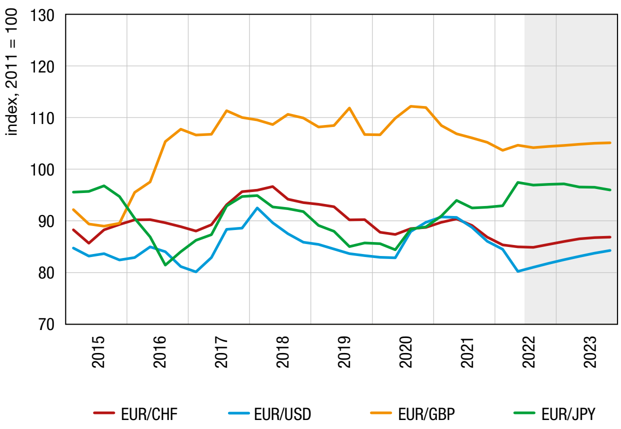
Sources: IMF, oil prices: Bloomberg (Brent crude oil futures, 26 May 2022) and CNB estimates.

In accordance with the described trends in the global environment, demand for Croatian export goods and services is expected to grow at a weaker pace in the remaining part of 2022 and in 2023 (Figure 2.6). The slump in foreign demand could be more conspicuous in goods exports, given that the manufacturing sector has been more burdened by the high costs of energy and raw materials and disruptions in supply chains. The slowdown of demand in the services segment, including tourism, could be less pronounced due to the shifting of a portion of demand from durable consumer goods to services that were extremely limited during the pandemic, which could be favourable to countries such as Croatia with a large share of tourism revenues in GDP.

As regards the global prices of raw materials, crude oil prices are expected to remain relatively high until the end of this year and in 2023 and to decrease gradually towards the end of the projection horizon (Figure 2.7). The gradual decline in these prices should be helped by the increase in production in OPEC+ countries, which would compensate for the structural deficit in the market caused by the sudden opening of the global economy, further deepened by the embargo on Russian oil imposed by some large countries. The prices of food raw materials, especially those of which Russia and Ukraine are large producers in the global market, such as cereals and oilseeds, could also remain elevated for a longer period of time. The same goes for the prices of some metals such as nickel or copper, which might be in limited supply due to sanctions imposed against Russia. However, the prices of most other metals are expected to normalise faster due to the weakening of global demand.

The process of monetary policy normalisation is expected to

Figure 2.9 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 (May 2022).

further accelerate given the scorching inflation in a number of countries, reaching levels not seen for decades. In some countries, the key interest rates could exceed their pre-pandemic levels. Having remained at zero-levels last year, the interest rate set by the Fed could exceed 3% as early as at the beginning of 2023 (Figure 2.8). Following the end of the asset purchase programme and the raising of the benchmark interest rate in July, the ECB is expected to gradually and moderately tighten its monetary policy. The markets are currently expecting that the ECB will lift the benchmark interest rate by 1 percentage point by the end of 2023.

According to the May Foreign Exchange Consensus Forecasts, the exchange rate of the euro against the US dollar is expected to recover slightly on the foreign exchange market by the end of the projection horizon (Figure 2.9). Some market participants are expecting further weakening of the euro over the short term, influenced by the growing divergence between the monetary policies of the ECB and the Fed. The euro is expected to strengthen against the Swiss franc by the end of the projection horizon, while its exchange rate against the Japanese yen and the British pound should remain generally unchanged.

Risks related to the global economy have remained mainly negative, largely stemming from geopolitical instability. Further deepening and prolongation of the conflict in Ukraine might result in even more negative effects on global economic activity, in the form of further weakening of trade, a rise in the prices of energy and raw materials and prolonged uncertainty. More pronounced limitations in the supply of Russian gas could cause a decline in industrial production in European countries, given the limited possibility of its being replaced by other sources over the short term. Surging inflation increases the risk of further tightening of financing conditions, having negative effects on domestic demand and putting pressure on public finances and the banking sector. Although pandemic-related risks have receded, their presence is still felt given the potential emergence of new coronavirus variants requiring the re-introduction of tighter containment measures. There is still a risk that some production inputs or intermediate goods might be unavailable over the long term, due to either the war or other factors. On the other hand, global growth could be spurred by a faster pace in the reduction of savings accumulated during the pandemic and by a stronger rebound of the services sector.

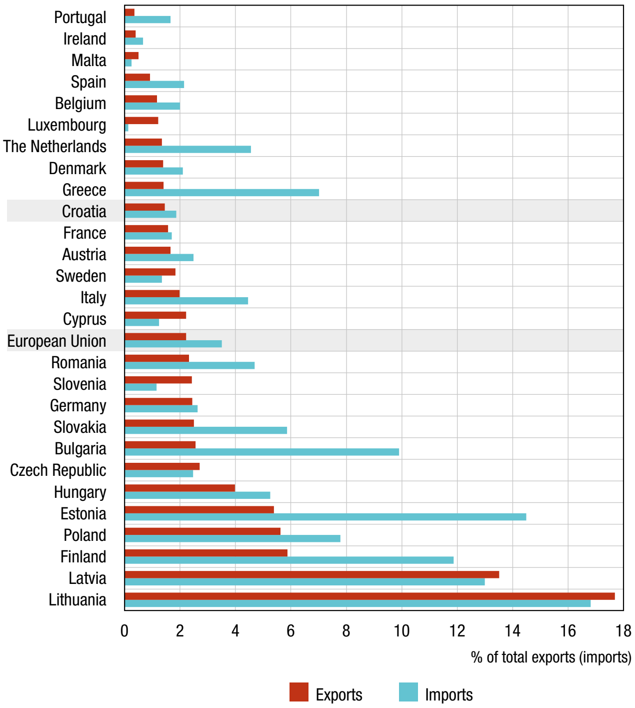
Box 1 The impact of the war in Ukraine on the Croatian economy

Given the relatively limited trading and financial links between Croatia on the one hand and Russia and Ukraine on the other, the war in Ukraine should not have any significant direct effects on the Croatian economy, except for some enterprises that have been more exposed to the Russian and Ukrainian markets. However, the Croatian economy will not remain isolated from the indirect effects of the conflict, which have already started to spill over from the global market, reflected in the increased prices of energy and raw materials caused by disruptions in supply from the areas hit by the war and the imposed sanctions. In addition, uncertainty in many European countries over Russian and Ukrainian energy and raw material supplies and the possibility of alternatives available from third markets being rapidly substituted for them, as well as the slip in consumer and producer confidence, have been weighing down on their economic recovery, which will be reflected negatively in foreign demand for Croatian products and services. Against the backdrop of elevated global inflationary pressures, monetary policy in the environment is expected to normalise faster, having a negative impact on the borrowing costs of domestic business entities.

For the majority of Croatian corporations, Russian and Ukrainian markets are not among the top export markets. In the last ten years, the average exports of goods to Russia came to around EUR 250m annually, accounting for only 1% of total Croatian goods exports or 5% of exports to non-EU countries. The exports have been trending down, especially after the imposition of sanctions in 2014. Exports to Ukraine are several-fold lower and mostly do not exceed EUR 50m annually. By comparison, the average trade exposure of other European Union member states is somewhat larger, especially when it comes to Baltic countries (Figure 1). Exports from Croatia to these markets is highly concentrated in only a few activities, and almost half of such exports are accounted for by medical and pharmaceutical products, while the remaining portion concerns exports of oilseeds and fruits, essential oils and cosmetics. Although these industries have mostly not been hit by sanctions imposed following the Russian invasion in late February 2022[1], they are still bound to face a sharp fall in demand from the two markets, while the materialisation of negative effects will depend on how fast corporations will be able to shift their exports towards third markets. According to the latest IMF projections, Russian and Ukrainian economic activities are expected to fall by 8.5% and by as much as 35% respectively. In addition, domestic corporations linked with natural persons and legal entities through either

1 The EU had introduced six packages of sanctions against Russia by mid-June 2022. The most important trade sanctions imposed include a ban on exports of cutting-edge technology, electronics, software and transportation equipment that could be used for military purposes. As for imports, the ban includes wood, cement, fertilisers, seafood and liquor. With regard to energy products, the embargo on coal and other solid fossil fuels will apply from August 2022. The ban on imports of Russian oil will be imposed gradually by the end of this year, while a temporary exception is foreseen for imports of crude oil by pipeline into those member states that have no viable alternative options. Croatia and Bulgaria will be able to benefit from temporary derogations concerning the imports of Russian seaborne crude oil.

Figure 1 Share of Russia and Ukraine in foreign trade in 2021

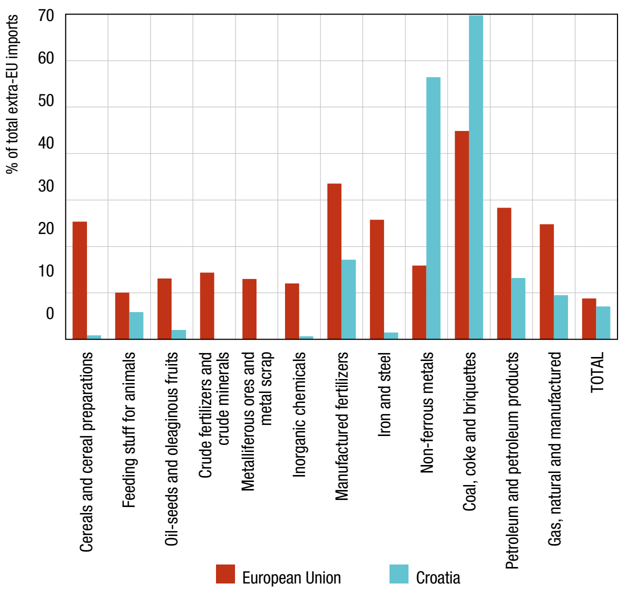


Source: Eurostat.

ownership or loans are already facing operational difficulties due to the imposed sanctions.

With regard to the import dependence of the domestic economy, Russia and Ukraine account for around 2% of total direct Croatian goods imports, somewhat below the EU average. Imports structure is dominated by energy products (petroleum and petroleum products, natural gas and coal), followed by artificial fertilisers and various metals and food raw materials.

Figure 2 Imports from Russia and Ukraine by chosen type of goods in 2021



Note: Products grouped at the second level of SITC.
Source: Eurostat.

Broken down by products, most groups show that Croatia is less dependent than the EU average (Figure 2). According to statistical data on Croatia's direct imports from Russia, Croatia's import dependence is not as high when it comes to energy products, especially natural gas, but also petroleum and petroleum products (Croatia imports a part of these energy products indirectly, via neighbouring countries. For more information on Croatia's total real (direct and indirect) import dependency on Russia, see Box 3 Croatia's energy dependence). On the other hand, Croatia has been relying much more on the imports of coal from Russia, which will be banned starting from August this year. Croatia's imports of cereals, seeds, artificial fertilisers and feedstuffs from the Russian and Ukrainian markets have been relatively lower than in other EU member states, with relatively higher imports of some metal raw materials such as aluminium.

In the present conditions, the supply of Russian and Ukrainian products has been strained, with limited possibilities with regard to alternatives available from third markets substituting for them, given the leading roles of Russia and Ukraine in some global market segments (Table 1). Shortages of these raw materials in the global market in the case of further widening of sanctions against Russia and a sharper decline in production in Ukraine would deepen and prolong the current strains in global supply chains caused by the pandemic and disrupting the operations in the production sector.

Given that some of Croatia's main trading partners have stronger trade and financial links with Russia or rely more on Russian energy, which makes them more exposed to difficulties in the supply of raw materials and production inputs, the weakening of industrial production in these countries will be unfavourably reflected in the domestic exports sector. In this context, the fact that the Croatian economy is less integrated in global value chains could be a mitigating factor, as was the case during the pandemic.

With regard to trade in services, some difficulties may be expected in tourism as well, even though Russian and Ukrainian tourists account for less than 1% of Croatia's total tourism revenues. Namely, in the absence of tourist arrivals from Russia and Ukraine and amid the decline in the disposable income of guests from key European markets due to elevated inflation, tourists from remote markets might be unwilling to travel to the region due to a feeling of uncertainty, which could affect tourism revenues.

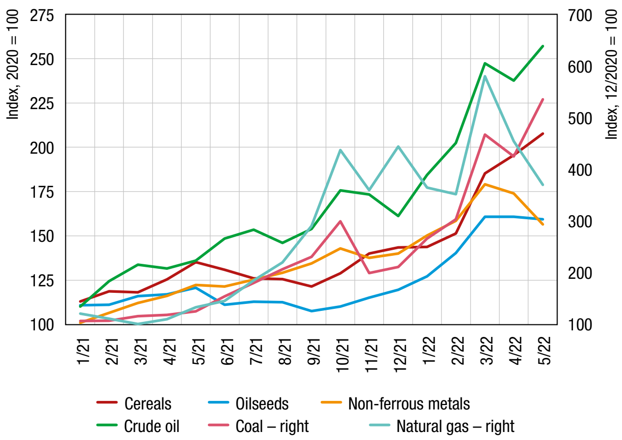
The negative effects of the war in Ukraine on domestic

Table 1 Share of Russia and Ukraine in global market in 2020, in %

HS	Product name	Russia	Ukraine
1001	Wheat	20.6	9.2
1003	Barley	9.9	10.0
1005	Maize (corn)	14.3	1.8
1512	Sunflower oil	18.3	37.5
2701	Coal	16.3	0.1
2709	Petroleum oils, refined	10.5	0.0
3102	Manufactured fertilizers	13.2	0.9
7110	Palladium	20.9	0.0
7502	Nickel	24.3	0.0
7601	Aluminium	11.9	0.1
8108	Titanium	13.7	1.4

Source: Atlas of Global Complexity, Harvard University.

Figure 3 Prices of selected raw materials and energy products in the global market



Source: HWWI.

economic activity are reflected not only in trade, but also in the heightened uncertainty that deters investment and increases the propensity to save. However, the majority of the negative impacts will be felt through the rise in prices of energy and other raw materials, creating inflationary pressures and causing a drop in household disposable income. The Russian invasion of Ukraine has already delivered a large shock to goods markets, including the market in energy, certain metals and food raw materials (Figure 3). In addition to the spike in energy prices, the price of wheat rose by one-third, and the price of oilseeds by 15%, putting additional pressure on the growth in the prices of food, accounting for a large share in the consumer basket.

Russia's aggression against Ukraine has had a negative impact on financial markets as well, increasing risk aversion, which is mirrored in the costs of borrowing, as seen from the example of Croatia. Following its steady decline until the beginning of 2022, the kuna yield on long-term government bonds surged in February 2022, only to hold steady at 2.1% in March. However, the latest government borrowing in the European market in April 2022 was made at an even higher rate (a 10-year eurobond was issued with a yield of 2.975%). In view of inflationary pressures fuelled by the Russian invasion, even faster monetary policy response may be expected, which will contribute to further deterioration in financing conditions.

Operational difficulties faced by corporations exposed to Russian and Ukrainian markets could also affect the banking sector through an increase in credit risk. The Russian aggression against Ukraine has had a limited effect on the Croatian financial system so far. Nevertheless, due to reputational issues, a domestic bank in Russian ownership faced a sharp deposit outflow, but was soon acquired by another domestic bank.

Overall, the impact of the war in Ukraine on Croatia's real growth will remain relatively subdued only if the war shock is short-lived and if the prices of raw materials normalise in the forthcoming quarters, and the exports sector reorients to third markets. However, if the prices of energy and raw materials remain elevated over a longer period of time and uncertainty persists, and especially in the case of shortage of gas supply that would entail rationing of industrial production in Europe, the impact on the economy of the Russian aggression will be a lot more pronounced. Against such a background, the effects of the spillover onto domestic real activity and inflation would be much larger.

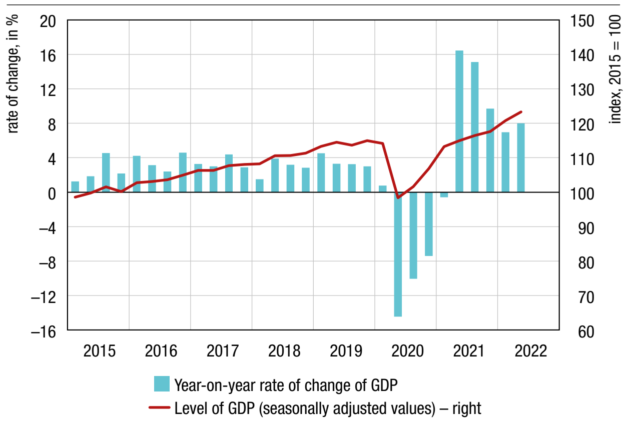
3 Aggregate supply and demand

Early 2022 was marked by geopolitical uncertainties on a global scale due to Russia's invasion of Ukraine, with a continued rise in the prices of energy and raw materials that had begun in the previous year. However, the domestic economy resisted these negative impacts. Foreign demand and investment activity increased on a quarterly level, as evident from a much stronger corporate than household optimism. The quarterly increase in capital investments was also the result of the absorption of EU funds. Economic activity was also probably supported by the lifting of the remaining containment measures, as well as by the strengthening of demand in services (partly owing to savings accumulated during the pandemic) which were less affected by global supply chain chokeholds. Consequently, the growth of the Croatian economy accelerated in the first quarter of 2022 relative to the previous quarter (from 1.0% to 2.7%).

Broken down by GDP components, the quarterly growth was due to favourable trends in foreign trade and the increase in capital investments. Personal consumption held steady at the level recorded in the previous quarter, while government consumption decreased. A sharper increase in capital investments and further growth in total exports triggered a pick-up in total imports. The production side of the GDP calculation shows that gross value added grew by 2.8% in the first quarter of 2022 from the last quarter, with the largest growth recorded in services. The strongest quarterly growth was seen in wholesale and retail trade, transportation and storage, accommodation and food service activities.

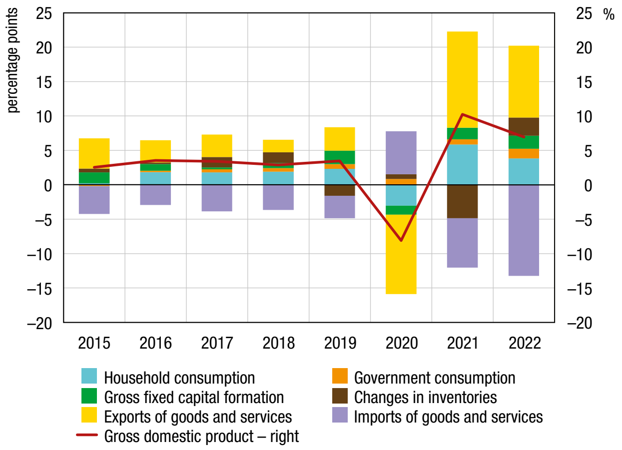
Real GDP increased by 7.0% in the first quarter of 2022 from the same period last year, mostly due to a leap in the exports of goods and services, although positive contributions to

Figure 3.1 Gross domestic product (GDP)
real values



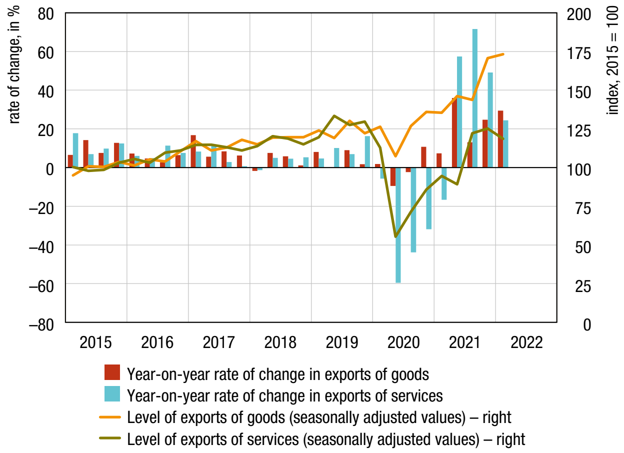
Note: Data for the second quarter of 2022 refers to the CNB's monthly indicator of real economic activity, estimated on the basis of data published until 29 June 2022.
Source: CBS (seasonally adjusted by the CNB).

Figure 3.2 GDP rate of change
contributions by components



Note: Data for 2022 refer to the first quarter of 2022.
Source: CBS.

Figure 3.4 Exports of goods and services
real values



Source: CBS (seasonally adjusted by the CNB).

economic growth were made by all the components of domestic demand. Available high-frequency economic indicators suggest that the economic growth continued into the second quarter of 2022, while its pace on a quarterly level could be similar to that at the beginning of the year, which could result in an annual growth rate similar to that in the first quarter.

Aggregate demand

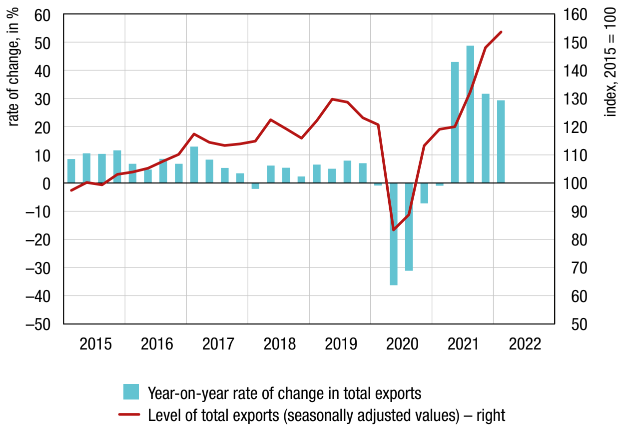
Despite the slowdown in the growth of real exports of goods and services in early 2022, a very high growth rate of 29.4% was recorded on an annual basis. Nominal CBS data show that exports increased in all main industrial groupings (MIGs) on an annual level, with the highest increase recorded in the exports of energy due to the spike in energy prices. Even though the importance of real exports of services was less pronounced in the first quarter, it should be noted that they nevertheless rose sharply (by 24.5%), almost reaching their pre-pandemic levels.

In the period from January to March 2022, household consumption held steady at the level recorded in the previous three months. Stagnant household consumption reflects the negative effect of rising inflation on real income, which has probably contributed to the decline in consumer optimism. This may be primarily attributed to negative expectations concerning the financial situation in the household sector and the overall economic situation in Croatia over a period of 12 months compared with the current state of affairs, which may be linked with heightened uncertainty and growing inflationary expectations for the current year. Despite a quarterly stagnation, personal consumption was 6.3% higher in the first quarter than in the same period last year.

Investment activity rose in the first three months of 2022 from the end of the previous year (from 1.5% to 8.3%). A sharp rise in capital investments was fuelled by the continued increase in the volume of construction works, with the volume of civil engineering works climbing at a somewhat faster pace than construction works on buildings. Such trends suggest that general government investments might witness a slightly stronger increase than private sector investments in the first quarter. If viewed on an annual level, capital investments grew by 7.9% from the same period last year.

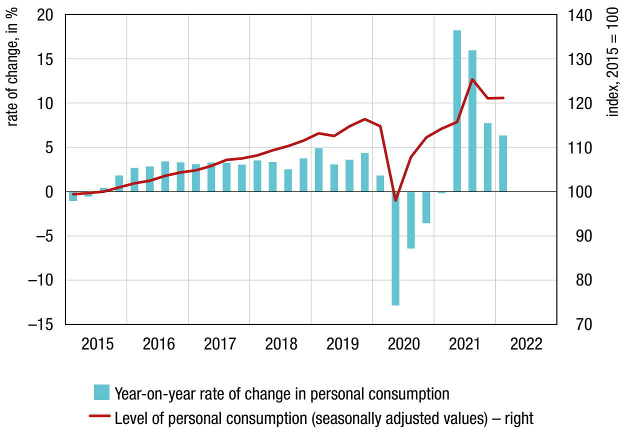
Government consumption fell sharply in the first quarter of 2022, following its leap at the end of last year (from 20.9% to

Figure 3.3 Exports of goods and services
real values



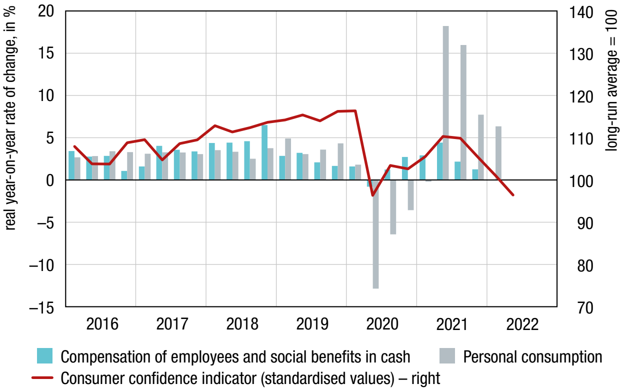
Source: CBS (seasonally adjusted by the CNB).

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 2022.
Sources: CBS, Ipsos and CNB.

15.2%). This component continued to record the high volatility started in early 2021, which complicates its analysis. On an annual level, the growth rate in government consumption stood at 5.9%.

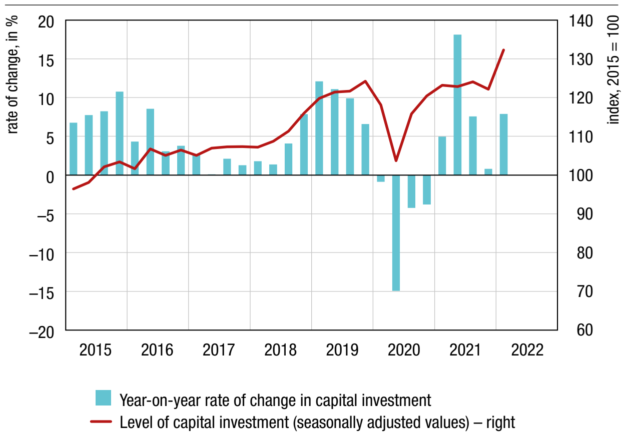
Real imports of goods and services continued their upward trend in the first quarter of 2022 (by 8.6% from the end of 2021), with a pick-up in goods imports, supported by a further rise in investment activity and by the growth in goods exports. Such developments resulted in a strong increase in the imports of goods and services on an annual level (25.0%), with nominal data on foreign trade pointing to the rise in imports in all main industrial groupings. The largest increase was recorded in the imports of energy, predominantly as a result of a considerable price hike over the past period.

Relative to the same period last year, the contribution of net foreign demand to economic growth in the period from January to March this year was negative (2.8 percentage points).

Aggregate supply

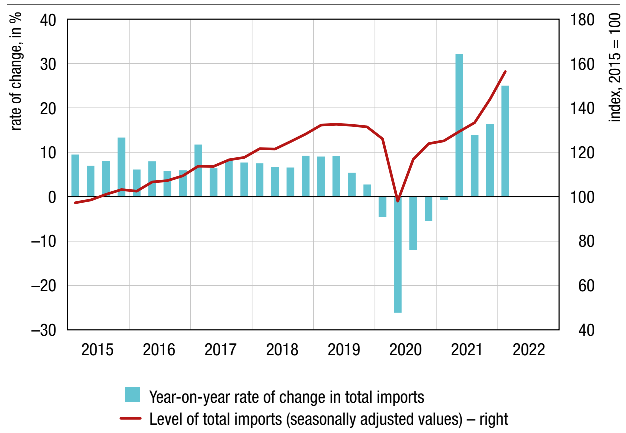
Real gross value added (GVA) rose by 2.8% in the period from January to March 2022, having decreased by 0.7% in the

Figure 3.7 Gross fixed capital formation
real values



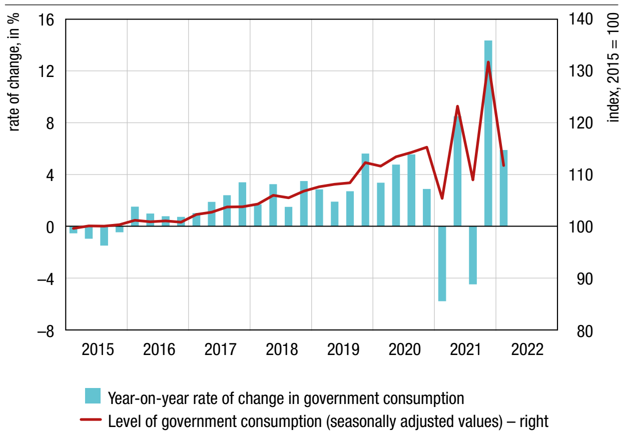
Source: CBS (seasonally adjusted by the CNB).

Figure 3.9 Imports of goods and services
real values



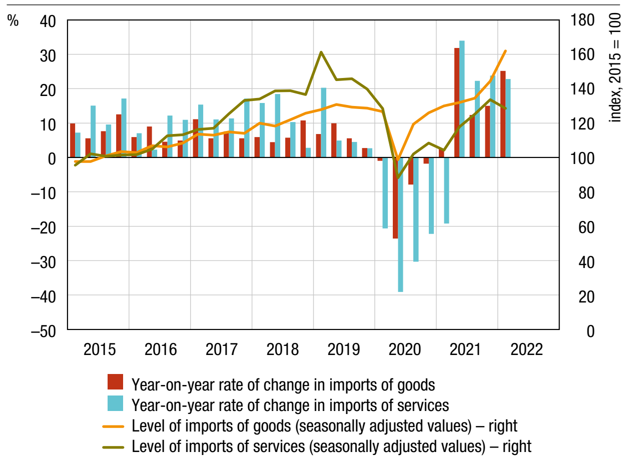
Source: CBS (seasonally adjusted by the CNB).

Figure 3.8 Government consumption
real values



Source: CBS (seasonally adjusted by the CNB).

Figure 3.10 Real imports of goods and services



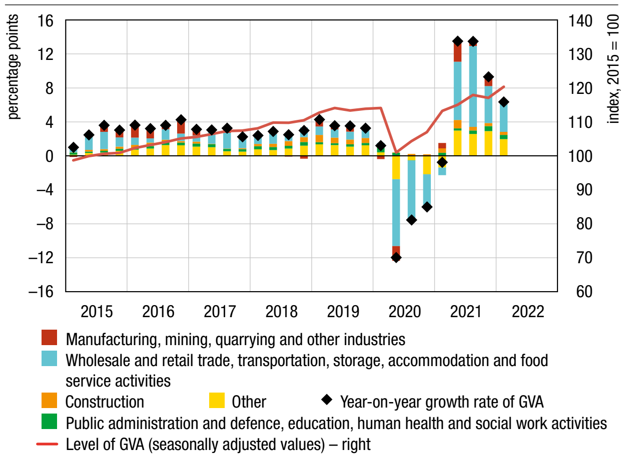
Source: CBS (seasonally adjusted by the CNB).

previous quarter. The quarterly growth in real GVA was primarily due to favourable developments in the services sector, which may be attributed to the improved epidemiological situation and recovered demand for services, especially those associated with tourism and hotels and restaurants. The strongest rise in gross value added was recorded in wholesale and retail trade, transportation and storage, accommodation and food service activities (16.2%), while growth was also recorded in construction, financial and insurance activities, professional, scientific, technical, administrative and ancillary services, as well as in public sector activities. In contrast, the quarterly GVA shrank in agriculture, forestry and fishing, manufacturing, mining and quarrying, information and communication and real estate activities. On an annual level, the real GVA was 6.3% higher than in the same period last year, with annual growth seen in all activities, except for other service activities.

The GDP nowcasting model, based on high-frequency data, mostly available for April, suggests that real economic activity continued to grow in the second quarter of 2022, at a similar pace as at the beginning of the year. Positive expectations regarding economic growth largely reflect the successful start of the tourist season. The growth of real retail trade turnover intensified in April and May 2022, increasing by 2.6% from the average recorded in the first three months of this year, when the recorded growth stood at 0.2%. In contrast, industrial production in April and May fell by 0.4% from the first quarter, as a consequence of a somewhat more pronounced decline in the production of intermediate goods, with an increase in the production of all the other product categories. The volume of construction works rose by 1.2% in April from the average performance in the previous three months. The volume of works on buildings increased, while the volume of civil engineering works declined.

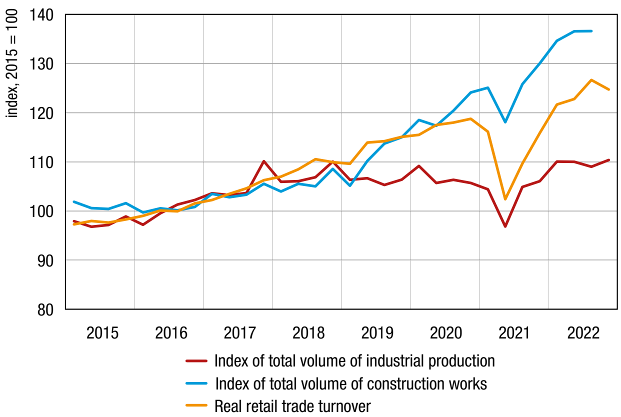
The consumer confidence index dropped in the second quarter of 2022 from the preceding quarter. In the period concerned, consumer optimism was at a level comparable to that recorded in the second quarter of 2020, i.e. at the beginning of the pandemic, when it dropped sharply. Unfavourable expectations in the period from April to June this year reflect a less favourable assessment of all the subcomponents of the index, with the most evident deterioration recorded in the assessment of the current financial situation of households compared to the state of affairs 12 months ago, which likely stems from the current inflationary pressures and leaps in consumer prices.

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



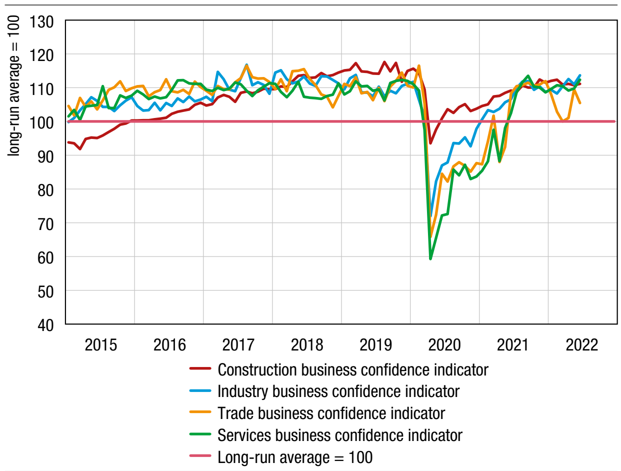
Source: CBS (seasonally adjusted by the CNB).

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 2022 refer to April and May, except for construction works, where data are available only for 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).

Business expectations have generally been more favourable than consumer optimism, standing around the pre-pandemic levels. Expectations in trade and industry improved in the second quarter from the previous three months, while optimism of business entities in construction and services held steady at the levels recorded last quarter.

Projected developments

Following the pick-up in domestic economic activity to 2.7% in the first quarter of 2022 relative to the previous quarter, the available high-frequency indicators show that economic activity continued to trend up at a similar pace in the second quarter, while the data on tourist bookings suggest that a very successful pre-season could be followed by a very favourable peak tourist season. Real GDP might increase by 5.5% in 2022, following its growth of 10.2% in 2021, when it exceeded its 2019 pre-crisis level.

Total exports in 2022 might increase sharply by 11.3% relative to 2021, when the growth rate was even higher due to the low base, standing at 33.3%. Services exports might grow more than goods exports in 2022, given that the last year's tourist activity was still on the path to full recovery and failed to match the record high of 2019. The preliminary results and booking data suggest that this year's tourist season could exceed the pre-pandemic financial results.

Personal consumption could increase by 5.3% in 2022, following a very strong recovery in the previous year (10.1%). The rise in personal consumption will be fuelled by relatively favourable labour market trends, a successful tourist season and the spending of a portion of savings accumulated during the pandemic. On the other hand, disposable income will drop as a result of elevated inflation. Of all domestic demand components, household consumption could make the largest positive contribution to total economic growth (3.1 percentage points).

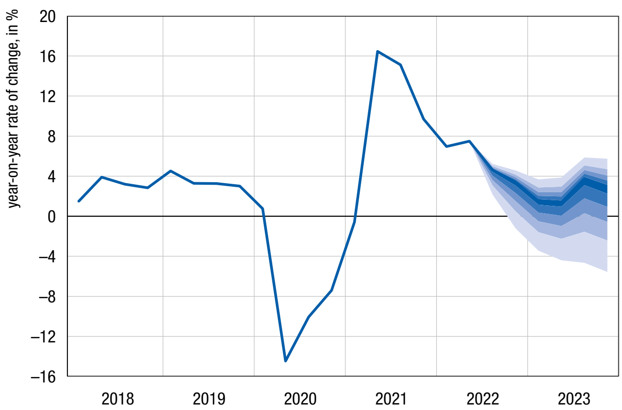
Gross fixed capital formation might come to 6.4% in 2022, having stood at 7.6% in 2021 when it exceeded its pre-crisis levels. Investments are especially expected to accelerate in the private sector. Increase in capital investments could make a strong positive contribution to overall economic growth (1.4 percentage points).

Government consumption might increase by 3.3.%, at a similar pace as in 2021, contributing positively to the growth of total real economic activity (0.7 percentage points). This is due to the expected rise in government expenditures for the use of goods and services.

Total imports might rise sharply by 9.9% in 2022 due to the increase in domestic and foreign demand. However, the expected increase in goods and services imports could be less pronounced than the growth in total exports, and thus net foreign demand might make a positive contribution to total economic growth (0.6 percentage points).

Economic activity is expected to slow down in 2023, and real GDP could increase by 2.5% on an annual basis. The expected growth deceleration is a reflection of global factors, i.e. the expected trends in the euro area, smaller increase in foreign demand, the tightening of international financing conditions and the deterioration in the terms of trade in the last two years, while on the domestic level this is due to the gradual approach being made to the potential output level, i.e. the closing of the positive output gap, also reflected in sectoral labour shortages. Such developments suggest that personal consumption, investments and total exports are losing momentum. The growth of total imports might also decelerate, but at a slower pace than the rise in exports so that the contribution of net foreign demand to total GDP growth might be negative. All domestic demand components are expected to make a positive contribution to the increase in total economic activity.

Figure 3.14 Projection of real GDP dynamics



Sources: CBS and CNB.

Mean estimated and projected values for 2022 and 2023 are expected to be more exposed to negative risks. Prolonged and further escalation of geopolitical tensions would have an even more adverse impact on global and especially European economic activity, which would be reflected negatively in the domestic economy. Further weakening of trade, a leap in the prices of energy and raw materials and prolonged uncertainty could be potential channels of impact. Increasing inflation, especially with respect to the prices of food and energy, could cause an additional decrease in real disposable income, affecting both foreign and domestic demand. There are also risks of a sharper tightening in financial conditions. The potential resurgence of the pandemic and new virus variants that could be more resistant to vaccines and cause the reintroduction of containment measures pose additional negative risk. These risks and the associated heightened uncertainty might have an unfavourable impact on investment decisions of business entities in the forthcoming period. In the projection period a significant withdrawal of resources available to Croatia from the EU funds is expected, posing both a positive risk (more intensive use than expected) and a negative risk (insufficient absorption capacities). A positive risk also arises from the potential de-escalation of the conflict in Ukraine, which could mitigate some supply chain disruptions.

4 Labour market

Employment and unemployment

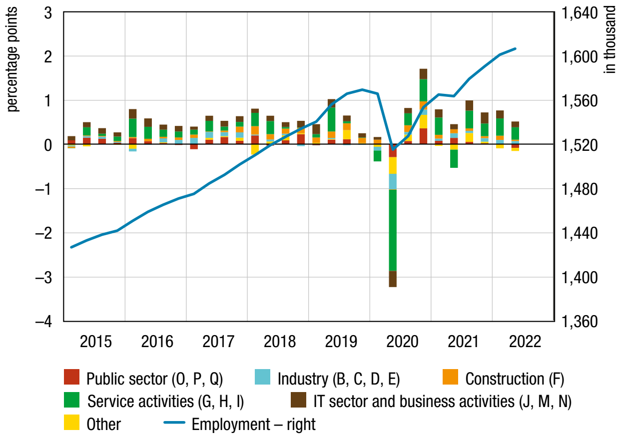
Employment continued to rise in early 2022 at the same pace as in late 2021. According to seasonally adjusted data, total employment grew by 0.7% in the first quarter of 2022 from the fourth quarter of 2021, increasing by a further 0.4% in April and May (Figure 4.1). This was due to the increase in the number of persons employed outside the public sector, with the largest contribution coming from trade, transportation and storage, accommodation and food service activities, as well as from the IT sector and business services.

The number of unemployed persons continued its downward trend in the beginning of 2022, albeit at a slower rate (by 3.5%, from 7.4% in the fourth quarter of 2021). The slowdown continued in April and May, when unemployment dropped on average by 1.2% relative to the first quarter (Figure 4.2).

The sharp rise in demand for labour is also evident from the record-high job vacancy rate (Figure 4.3). However, a sharper rise in employment relative to the decrease in unemployment suggests that the increased demand for workers is met by hiring workers from third countries.[2] Namely, the number of

2 The CPII data from May 2022 show that 43,000 workers from third countries were hired in the Republic of Croatia (2.7% of total employment), even though their actual number is probably even higher.

Figure 4.1 Employment by NCA
seasonally adjusted data, contributions to the quarterly rate of change



Note: Data for the second quarter of 2022 refer to April and May.
Source: CPII (seasonally adjusted by the CNB).

unemployed persons was around 3,000 lower than in December 2021, while the number of employed persons was four times as high.

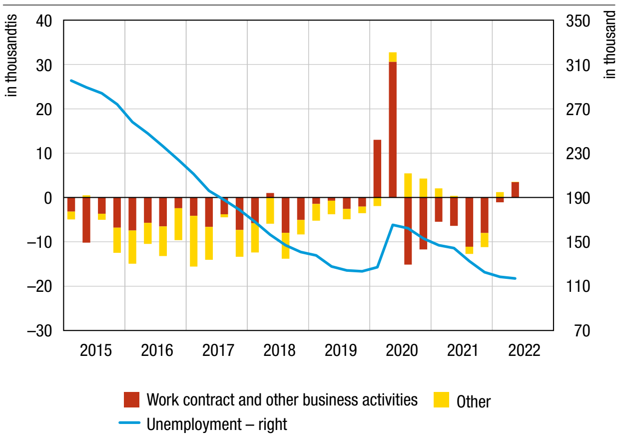
The registered unemployment rate edged down in 2022, in line with the movement in the number of unemployed persons. According to seasonally adjusted data, the share of unemployed persons in the labour force was 6.9% in the first quarter, standing at an average 6.8% in April and May (Figure 4.3).

According to the data from the Labour Force Survey, the ILO unemployment rate stood at 6.4% of the labour force in the first quarter of 2022 (5.9% in the fourth quarter of 2021) (Figure 4.3). In the same period, the employment rate was 49% and the participation rate was 52.4% (Figure 4.4).

Wages and unit labour costs

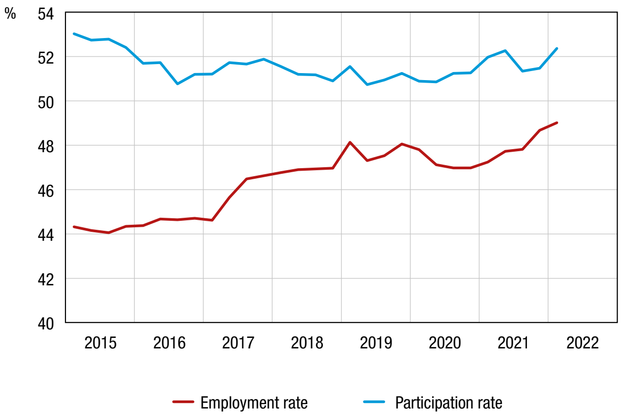
The quarterly growth of seasonally adjusted nominal gross wages continued its upward trend at the beginning of 2022 (2.2% from 1.7% in the fourth quarter of 2021), primarily due to a fairly sharp rise in wages of persons employed outside the public sector, widespread across different activities. Wages in the public sector remained unchanged. The increase in the average

Figure 4.2 Total unemployment and net unemployment inflows
seasonally adjusted data



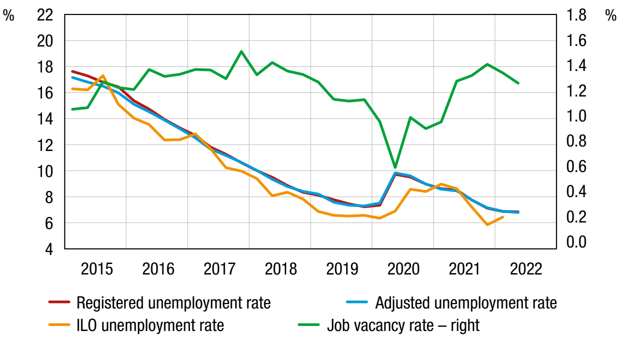
Note: Data for the second quarter of 2022 refer to April and May.
Source: CES (seasonally adjusted by the CNB).

Figure 4.4 Labour Force Survey
seasonally adjusted series



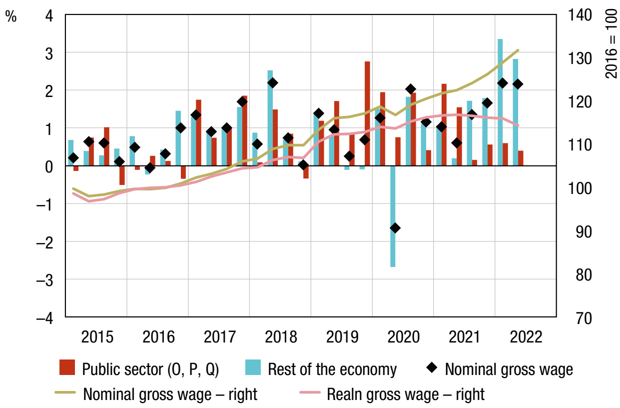
Source: CBS (seasonally adjusted by the CNB).

Figure 4.3 Unemployment and job vacancy 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. The job vacancy rate is calculated as the share of total posts that are vacant in the total demand for labour (the sum of the number of persons insured with the CPII and vacant posts). Data for the second quarter of 2022 refer to April and May.
Sources: CBS and CES (calculated and seasonally adjusted by the CNB).

Figure 4.5 Average nominal and real gross wage by NCA
seasonally adjusted data



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 2022 refer to April and May.
Source: CBS (calculated and seasonally adjusted by the CNB).

nominal gross wage continued in April and May, largely due to further growth of wages of persons employed outside the public sector, albeit at a somewhat slower pace (Figure 4.5).

Despite the continued rise in the average nominal gross wage in the first five months of 2022, due to the increase in consumer prices, the real gross wage fell on average by another 1.4% in April and May, having dropped by 0.2% in the first quarter of 2022 from the previous quarter (Figure 4.5).

Nominal unit labour costs fell in the first quarter of 2022, following their steady growth that began in the middle of 2021. The decrease in unit labour costs was due to the increase in labour productivity, coupled with moderate decline in compensation per employee (Figure 4.6).

Projected developments

Following the 2.2% increase in employment in 2021, the number of employed persons could grow by 2.6% in 2022 at the level of the whole year. The rise in total employment is expected to stem primarily from the fairly sharp growth of employment in the private sector, with a considerable portion accounted for by workers from third countries. Consequently, the number of unemployed persons is likely to decline in 2022 and the ILO unemployment rate could drop to 6.1% of the labour force.

The average nominal gross wage could increase by 7.5% in 2022, primarily on the back of higher wages in the private sector. Wage increases are influenced by the increased demand for workers, skilled labour shortages and inflationary pressures. With regard to the public sector, it has been agreed that the wage calculation base for public and civil servants will be raised by 4% starting from June. Despite a significant expected rise in the average nominal gross wage, its real value could fall by 1.8% due to the expected stronger increase in consumer prices.

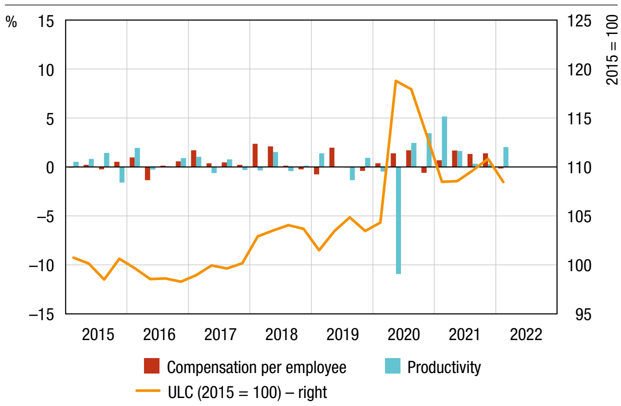
In 2023, in light of a slower growth in economic activity, employment is expected to decelerate to 1.1%, while the ILO unemployment rate might fall to 5.6% of the labour force. The growth in the average nominal gross wage is expected to decelerate, albeit with a pick-up in its real growth.

Table 4.1 Estimate and projection of labour market indicators for 2022 and 2023
year-on-year rate of change, in %

	2018	2019	2020	2021	2022	2023
Number of employed persons – CPII	2.3	2.3	–1.2	2.2	2.6	1.1
Number of employed persons – national accounts	2.6	3.1	–1.2	1.2	2.6	1.1
Participation rate (ILO)	51.2	51.2	51.0	51.8	52.5	53.1
Unemployment rate (ILO)	8.4	6.6	7.5	7.6	6.1	5.6
Average nominal gross wage	4.9	3.8	2.5	4.1	7.5	5.1
ULC	3.6	0.0	9.7	–3.1	3.8	3.7
Productivity	0.3	0.4	–7.0	8.9	2.9	1.3

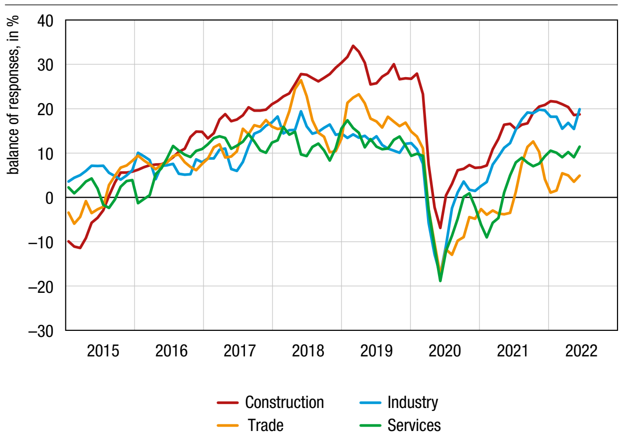
Notes: The year-on-year rates of change in employment refer to data on persons insured with the CPII, year-on-year rates of change in the average gross wage refer to data from the JOPPD form, whereas year-on-year rates of change in unit labour costs and productivity refer to national accounts data. The estimate of unit labour costs (and productivity) assumes 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.
Sources: CBS, Eurostat, CPII and the CNB projection.

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



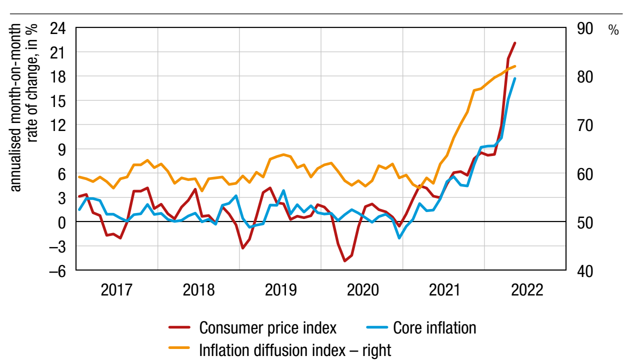
Source: Ipsos (seasonally adjusted by the CNB).

5 Inflation

Inflation has picked up recently due to a number of different factors. On the one hand, the relaxation and then the complete lifting of epidemiological measures amid the waning of the coronavirus pandemic gave an additional boost to demand, which had been recovering since the second half of 2020, among other things, for products and services partly or completely unavailable during the pandemic (particularly catering-related services). On the other hand, prolonged disruptions in supply chains affected a growing number of products. Containment measures in force in major global economic centres (such as Shanghai, one of the world's biggest ports) caused a reduction in transport capacities in that part of the world. In addition, the already high global prices of energy products (above all, crude oil and natural gas) surged further at the beginning of the Russian aggression against Ukraine. The increase in the prices of those inputs, which are important for both the production and provision of services, started to be gradually incorporated in the prices of a growing number of consumer products and services. Furthermore, the war in Ukraine prompted a rise in the prices of numerous food products as Russia and Ukraine are major global producers of food (particularly cereals and oilseeds), with Russia also being an important producer of mineral fertilisers used in agriculture. All this caused a substantial increase in the inflation diffusion index (Figure 5.1), whereas the annual rate of consumer price inflation (CPI) almost doubled in the first five months of 2022, up from 5.5% in December 2021 to 10.8% in May 2022. Core inflation (excluding agricultural product prices, energy prices and administered prices) also took a sharp upturn in the same period, from 4.6% in December to 9.8% in May (Table 5.1).

Considering consumer price inflation by individual components, the rapid increase in the first five months of 2022 was fuelled by all major components (Figure 5.2). The rise in the annual growth rate of energy prices largely reflects the increase in the prices of refined petroleum products that followed the trends in the price of a barrel of Brent crude oil, which shot up by 51% from December 2021 to May 2022. Also, administered prices of gas and electricity rose in April, which also contributed to the annual increase in energy prices. With regard to food products

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.

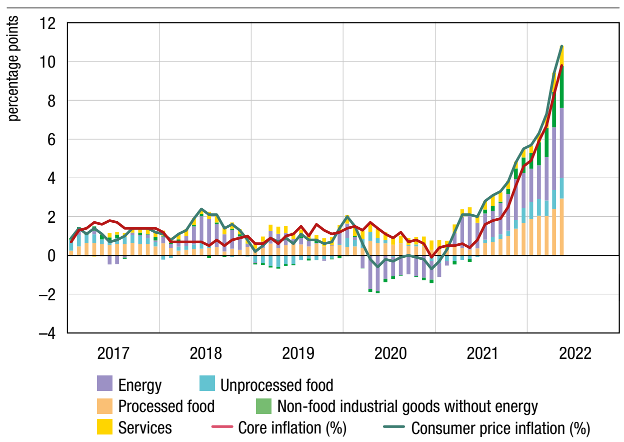
in the period under review, an increase was seen in annual growth rates of prices of all sub-components, except fruits and vegetables, in particular meat, bread and cereals, as well as milk, cheese and eggs[3], which was also due to imported inflationary pressures, that is, the spillover of the soaring global prices of raw materials to domestic consumer prices.

Imported inflationary pressures, which are primarily reflected in the high prices of energy products and other raw materials and supply chain disruptions, also added to the growth in the prices of industrial products and services. Furthermore, their increase was also propelled by the growing demand for some goods and services as the pandemic began to ease, as well as by the pressures stemming from the labour market, as evident in the growing unit labour costs. As regards industrial products, the largest increase was seen in the contribution of prices of durable and non-durable household goods (in particular, electronic products, which may be related to the lower global supply of semiconductors), while as regards services, the strongest growth was seen in the contribution of prices of catering and accommodation services, which were partly or completely unavailable during the pandemic due to travel restrictions.

The contribution of food products to overall inflation was 4.0 percentage points in May (with processed food products accounting for 2.9 percentage points and unprocessed food products accounting for 1.1 percentage point), while energy accounted for 3.6 percentage points and other goods and services accounted for 3.2 percentage points (industrial goods and services accounted for 2.2 percentage points and 1.0 percentage point, respectively).

The increase in the annual growth rate of prices of most inflation sub-components also reflects price increases in earlier phases of production. The annual growth rate of producer prices in the domestic market thus jumped from 19.6% in December

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.

3 Energy and consumer prices would have increased even more had there not been numerous measures taken by the Croatian government in February to curb price increases of many products. Gas and electricity prices grew on average by 16% and 9.6%, respectively (instead of 79% and 23%). The margins of oil traders were fixed and excise duties on diesel and gasoline were temporarily reduced as of 7 March, while VAT on many food and other products was cut from 1 April.

Table 5.1 Price indicators

year-on-year rate of change

	12/2020	5/2021	12/2021	3/2022	5/2022
Consumer price index and its components					
Total index	–0.7	2.1	5.5	7.3	10.8
Energy	–5.7	10.6	11.0	13.3	21.5
Unprocessed food	–3.5	–2.3	9.0	9.5	12.6
Processed food	1.3	1.3	7.0	9.0	13.0
Non-food industrial goods without energy	–0.7	–0.5	3.1	5.8	8.3
Services	1.8	1.7	1.7	2.6	4.0
Other price indicators					
Core inflation	–0.1	0.4	4.6	6.7	9.8
Index of industrial producer prices on the domestic market	–1.2	7.3	19.6	24.7	31.2
Index of industrial producer prices on the domestic market (excl. energy)	0.1	1.0	4.3	6.8	9.2
Harmonised index of consumer prices	–0.3	2.4	5.2	7.3	10.7
Harmonised index of consumer prices at constant tax rates	–0.1	2.2	5.0	7.3	12.1

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

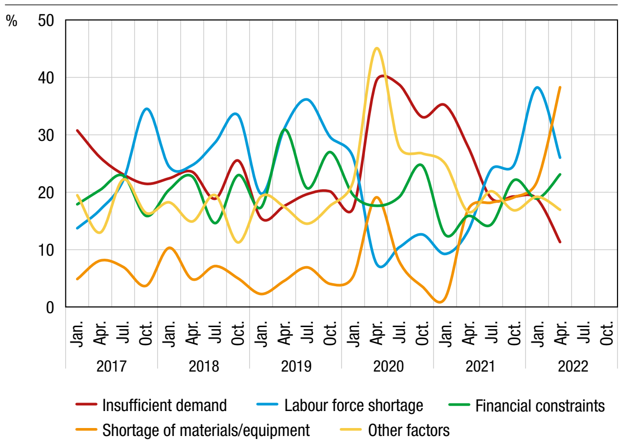
2021 to 31.2% in May 2022, largely due to more rapid growth in energy production prices. The annual growth rate of producer prices, excluding energy, went up from 4.3% to 9.2%, with the prices of non-durable consumer goods (food and alcoholic beverages) and durable consumer goods (furniture) accelerating at the fastest rate. The growth in the prices of intermediate and capital goods also picked up, albeit to a lesser extent.

The rise in producer prices reflects the increase in the global prices of energy and other raw materials as well as supply chain disruptions. In addition, due to these disruptions, a growing number of companies are facing difficulties in the procurement of materials and equipment (Figure 5.3). At the same time, the supply shortages (e.g. of semiconductors), which are directly reflected in the higher prices of production inputs, might point to further strengthening of inflationary pressures.

Consumer price inflation picked up speed in the euro area, reaching an all-time high since the monetary union began. The annual rate of growth in the harmonised index of consumer prices (HICP) in the euro area stood at 8.1% in May 2022, up from 5.0% in December 2021 (Figure 5.4). The rise in inflation was broad-based, with the sharpest increase seen in the contribution of energy prices (refined petroleum products, gas and, to a lesser extent, electricity). Furthermore, the rise in food prices also gained much momentum, reflecting, among other things, the growth in energy prices and transportation costs, as well as the increase in the prices of other raw materials and fertilisers. Though to a lesser extent, the acceleration in inflation was also due to the prices of services and industrial products, which pushed core inflation (excluding the prices of energy, food, alcoholic beverages and tobacco) upwards, from 2.6% in December to 3.8% in May.

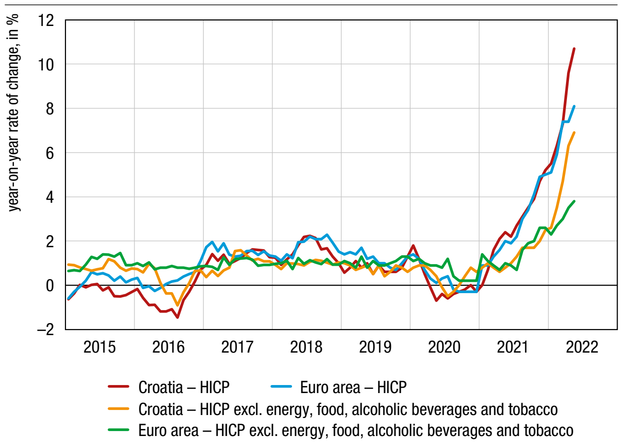
Inflation measured by the HICP, which was almost the same in Croatia and the euro area in late 2021, gained much more speed in Croatia than in the euro area in the last five months. This is true in particular of core inflation (measured by the HICP excluding energy, food, alcoholic beverages and tobacco) as the prices of industrial products and services (in particular catering and accommodation services) grew more in Croatia than in the euro area. At the same time, the increase in the contribution of food prices was slightly larger in Croatia than in the euro area, while the rise in the contribution of energy prices was marginally smaller as the growth in natural gas prices was noticeably slower

Figure 5.3 Factors limiting industrial production



Source: Ipsos.

Figure 5.4 Indicators of price developments in Croatia and the euro area



Source: Eurostat.

in Croatia than in the euro area. Croatia's overall inflation measured by the HICP increased from 5.2% in December to 10.7% in May, while core inflation went up from 2.5% to 6.9%. Thus, in May 2022, overall inflation and core inflation were, respectively, 2.6 and 3.1 percentage points higher in Croatia than in the euro area.

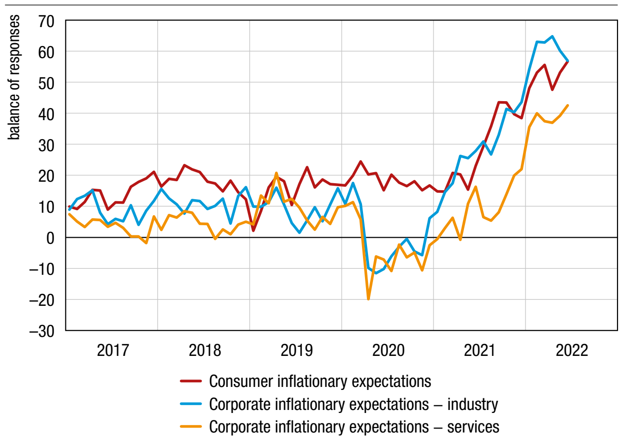
Inflationary expectations

Short-term inflationary expectations of consumers and corporate managers in Croatia continued to rise in the first six months of 2022 (Figure 5.5). Growing inflationary expectations of consumers may be attributed to the substantial increase in the prices of frequently used consumer products, which is why consumers are more apt to notice changes in their prices (in particular food and energy products), which are then integrated into consumer expectations regarding future inflation trends. Furthermore, the rise in inflationary expectations could also have been driven by the general increase in uncertainty following the Russian invasion of Ukraine, which triggered further growth in the prices of energy products and other raw materials and gave rise to concerns about energy supply. Inflationary expectations of consumers, which drifted lower from March to April, possibly also due to measures aimed at retarding the pace of inflation in Croatia, that is, the cut in the VAT rate on energy and numerous food products, as well as the fixing of margins and reducing excise duties on refined petroleum products, mounted again in May and June as inflation continued to accelerate.

The upward trend in the inflationary expectations of managers of industrial enterprises continued and was accompanied by a more substantial rise in corporate inflationary expectations in the services sector, which in 2021 grew slower than in industry. This was due to the shift in demand from goods to services, particularly just ahead of the summer tourist season.

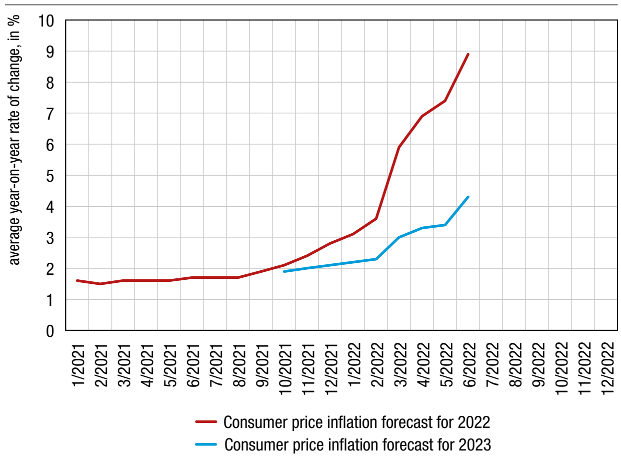
In the first half of 2022, economic analysts also revised their inflationary expectations for 2022 and 2023 sharply upwards (Figure 5.6). In December 2021, they expected that the average consumer price inflation in 2022 might be 2.8%, and in June they forecast a much higher rate of 8.9% for the entire year. This is attributable to more rapid inflation, which exceeded expectations in recent months, ongoing upward pressures on the prices of raw materials, partly associated with the impact of the Russian aggression against Ukraine, as well as persistent disturbances in global supply chains. Economic analysts expect that inflation might slow down noticeably in 2023, to 4.3%, which is still higher than projected in late 2021 (2.1%).

Figure 5.5 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 5.6 Short-term inflationary expectations by economic analysts



Source: Eastern Europe Consensus Forecasts.

Projected developments

The average annual HICP inflation[4] is expected to rise sharply in 2022, to 9.4% (from 2.7% in 2021), which should be a result of the rise in the annual growth rates of the prices of all subcomponents of inflation projection. The largest contribution to inflation might come from the HICP excluding food and energy (core inflation) and food (including alcohol and tobacco) and, to a slightly smaller extent, energy.

The average annual rate of growth in the HICP excluding food and energy might reach 6.2% in 2022 (up from 1.3% in 2021). This could primarily result from the longer than previously expected period of the high prices of energy and other raw materials on the global market, supply chain disruptions (further exacerbated by the war in Ukraine) and steep freight charges, which are, together with the higher prices of imported final goods, reflected in the rise in producer and consumer prices in the domestic market. To a lesser extent, the upswing in core inflation in 2022 may also be driven by inflationary pressures stemming from growing demand and from unit labour costs.

Furthermore, the annual rate of growth in food prices is expected to rise from 2.6% in 2021 to 11.5% in 2022. This is mostly a result of the spillover of the rise in the prices of energy, food raw materials and mineral fertilisers and supply chains disruptions to retail food prices.

Also expected is an increase in the average annual rate of growth in energy prices, from 8.8% in 2021 to 18.9% in 2022, which could be a result of the rise in the prices of refined petroleum products and prices which are administered for the most part (electricity and natural gas).

The annual inflation rate measured by the HICP might remain elevated through to the end of the third quarter of 2022, after which it might slow down slightly. This forecast is based on the expected fall in the prices of crude oil and other raw materials in the global market in the remainder of the year, which is in line with prices on the futures markets.

Current developments in the prices of crude oil and other raw materials on the global futures market suggest that inflation

4 From now on, the main inflation indicator forecast by the CNB is the harmonised index of consumer prices.

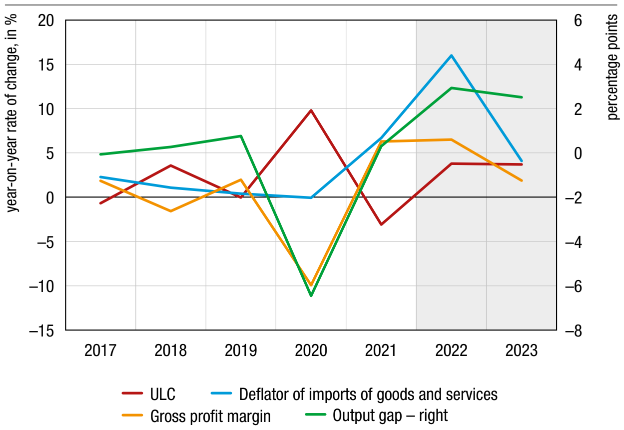
might slow down next year. The sharp deceleration in inflation expected in 2023, to 4.6% (from 9.4% in 2022), might be due even more to the negative base effect, that is, the waning effect of the sharp increase in the prices of numerous goods and services in early 2022 on the annual rate of inflation. The slowdown in inflation might thus be the outcome of the decrease in the annual growth rate of all inflation sub-components: energy from 18.9% to 4.5%, food from 11.5% to 6.00% and the HICP excluding food and energy (core inflation) from 6.2% in 2022 to 4.0% in 2023.

In view of relatively small differences between the national and harmonised index of consumer prices in Croatia (for more details, see Box 2 Comparison of the national and harmonised index of consumer prices in Croatia), overall inflation measured by the national index might in 2022 and 2023 correspond to the inflation measured by the harmonised index. In terms of the national index, inflation is expected to pick up to 9.4% in 2022 (from 2.6% in 2021) and slow down to 4.6% in 2023.

These projected developments are exposed to substantial uncertainty and risks, with prevailing risks that could drive inflation higher than anticipated. On the one hand, the prices of energy and other raw materials might exceed expectations, which will, among other things, depend on the evolution of the conflict in Ukraine, resulting in larger spillovers to the prices of a broad set of goods. Furthermore, there is substantial uncertainty regarding global market developments in the prices of food products, particularly those where Russia and Ukraine play an important global role, such as sunflower oil and seeds and cereals (see Box 1 The impact of the war in Ukraine on the Croatian economy). In addition, the strict epidemiological measures periodically enforced in large Chinese cities might exacerbate the mismatch between supply and demand on the global level and supply chain chokeholds, which might give an additional push to the prices of some semi-finished and finished products. External inflationary pressures might be more pronounced should inflation in Croatia's major trading partners be higher than expected. More substantial growth in the inflationary expectations of corporate managers might also lead to a sharper increase in prices. In addition, a wage increase more substantial than projected might reinforce domestic cost pressures on inflation.

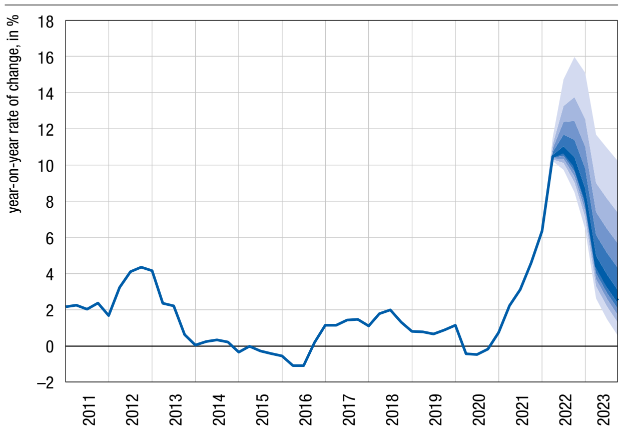
By contrast, risks that could drive inflation lower than anticipated are less pronounced. They arise from lower global prices of energy products and other raw materials as well as lower than anticipated food prices. Also, less severe and/or shorter supply chain chokeholds would alleviate upward pressures on the prices of intermediate and finished products. A more rapid monetary policy tightening and a worse-than-expected slump in economic growth might also lead to a more significant easing of inflationary pressures.

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



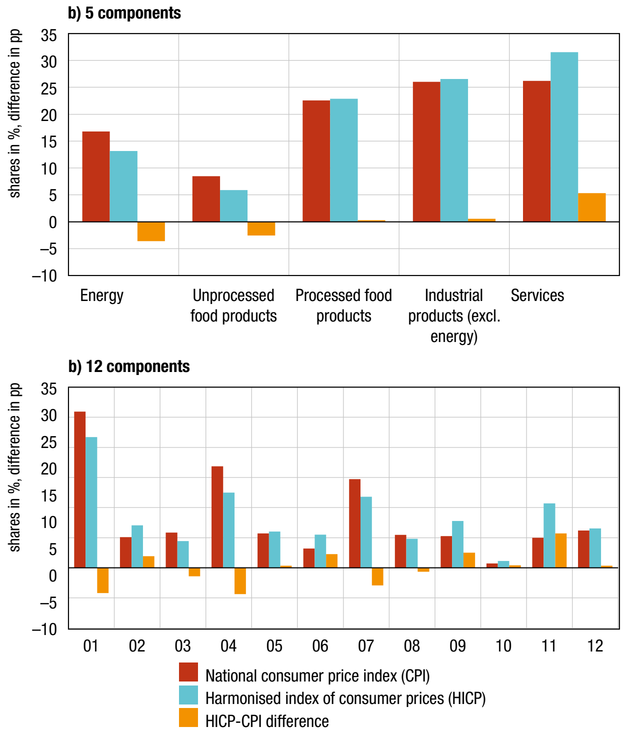
Sources: CBS and CNB calculations.

Box 2 Comparison of the national and harmonised index of consumer prices in Croatia

In view of Croatia's forthcoming entry to the euro area, in its inflation analysis and projections the Croatian National Bank has started to focus on developments in the harmonised index of consumer prices (HICP), while up to now it primarily analysed the national index of consumer prices (CPI). The methodologies for calculating the CPI and the HICP are compatible in most segments, with the main difference being the types of households covered. The CPI index covers consumption of domestic private households, while the HICP also covers consumption of non-residents and consumption of institutional households within the territory of Croatia. This results in different shares of individual components of the HICP and CPI baskets, which sometimes leads to differences in these two measures of inflation.

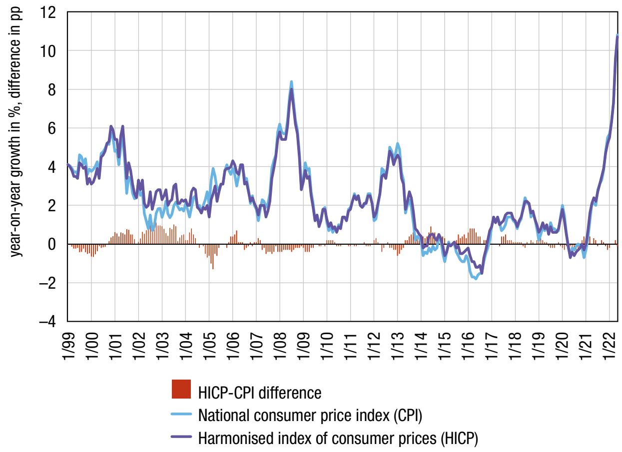
The main purpose of the national index of consumer prices (CPI) is to measure inflation, which reflects changes in the level of prices of goods and services in a country between two periods of time. In addition, the CPI is most often used for the indexation of wages and pensions, deflation of particular categories of the national accounts and other economic series (e.g. the nominal effective exchange rate) and for comparison of changes in the domestic rate of inflation with trends in the national consumer price indices in other countries. The harmonised index of consumer prices (HICP) is used to compare changes in inflation rates of EU countries and is a key inflation rate that is monitored by the European Central Bank and used to define price stability in the euro area over a medium term. The HICP has also been

Figure 1 Shares of individual components in the overall national and harmonised index of consumer prices in 2022



Notes: Processed food includes alcoholic beverages and tobacco.
Divisions of the ECOICOP (European Classification of Individual Consumption according to Purpose) classification: 01 Food and non-alcoholic beverages; 02 Alcoholic beverages and tobacco; 03 Clothing and footwear; 04 Housing, water, electricity, gas and other fuels; 05 Furnishings, household equipment and routine household maintenance; 06 Health; 07 Transport; 08 Communication; 09 Recreation and culture; 10 Education; 11 Restaurants and hotels; 12 Miscellaneous goods and services.
Sources: CBS and Eurostat.

Figure 2 Developments in the national and harmonised index of consumer prices
year-on-year rate of change



Sources: CBS and Eurostat.

developed for the purpose of assessing convergence in respect of the price stability criterion.

In producing the CPI, the Croatian Bureau of Statistics mostly followed the methodology employed by Eurostat for the production of the harmonised index of consumer prices. The HICP and the CPI are calculated on the basis of the same representative basket of goods and services, with the main difference between them being the types of households covered, resulting in a different structure of weights used in consumer price indices. The CPI covers consumption of domestic private households, while the HICP also covers consumption of non-residents (e.g. foreign tourists) and consumption of institutional households (e.g. retirement homes) within the territory of Croatia. Also different are the sources for the weight structure. Data obtained from the national accounts are the main data source for the calculation of the HICP weight structure at higher aggregation levels, while the Household Consumption Survey data are used at lower aggregation levels.[5]

Due to these methodological differences, energy and unprocessed food products have a lower weight in the HICP than in the CPI (Figure 1a). By contrast, the weight of services in the HICP is much higher than in the CPI, while the weights of processed food products (including alcoholic beverages and tobacco) and industrial products (excluding energy) are the same.

Considering the 12 CPI components under the ECOICOP classification (Figure 1b), it is evident that Food and non-alcoholic beverages (ECOICOP 01), Housing, water, electricity, gas and other fuels (04) and Transport (07) have a much lower weight in the HICP than in the CPI.[6] By contrast, Restaurants and hotels (11) and Recreation and culture (09) have a much heavier weight in the HICP as they cover the consumption of foreign tourists, which is significant in Croatia. Nevertheless, as the methodologies for the calculation of the HICP and the CPI are compatible in most segments and as differences in the contribution of individual inflation components are occasionally offset, CPI and HICP series mostly exhibit very similar dynamics on an annual level (Figure 2).

As regards differences between the average annual inflation rates measured by the HICP and the CPI, it is evident that neither of them is systemically higher or lower (Figure 3). Average inflation rates are similar in the long run: they were 2.2% (HICP) and 2.1% (CPI) from 1999 to 2021, falling to 1.3% (HICP) and 1.2% (CPI) in the period from 2009 to 2021.[7] Somewhat larger discrepancies were seen in the years when components with the largest differences in weights recorded above- or below-average annual growth in prices.

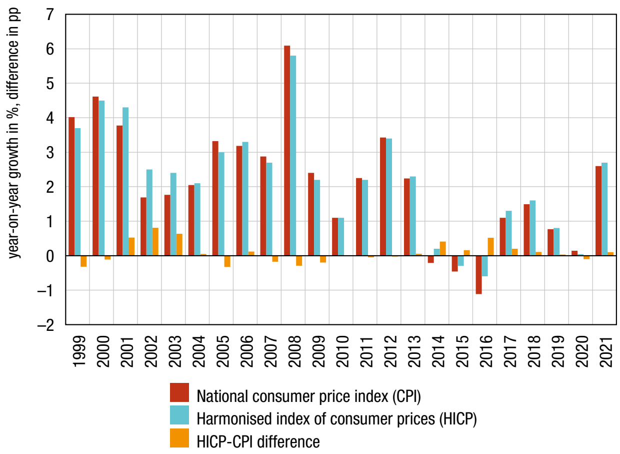
Inflation rates measured by the CPI and the HICP indicate that these indices exhibited largely similar dynamics in 2020 and 2021. Certain discrepancies were due to the differences in weights and annual growth rates of individual component prices, that is, their contributions to inflation trends (Figures 4a and 4b). The average annual rate of change in the HICP of 0.0% in 2020 was only 0.1 percentage point lower than the average annual rate of change in the CPI, which was mostly due to the lower contribution of service prices (0.27 percentage points in the HICP vs 0.43 percentage points in the CPI) to overall inflation. By contrast, the average annual growth rate of the HICP of 2.7% was marginally higher than the average annual growth rate of the CPI, which stood at 2.6%, as a result of the larger contribution of services (0.61 percentage point in the HICP vs 0.43 percentage

5 The coronavirus pandemic had a profound impact on household personal consumption. For this reason, when calculating the weights for 2022, the data from the 2019 Household Consumption Survey were further updated with estimated national accounts data on household final consumption expenditure for 2021.

6 Weights are also different on a higher level of disaggregation.

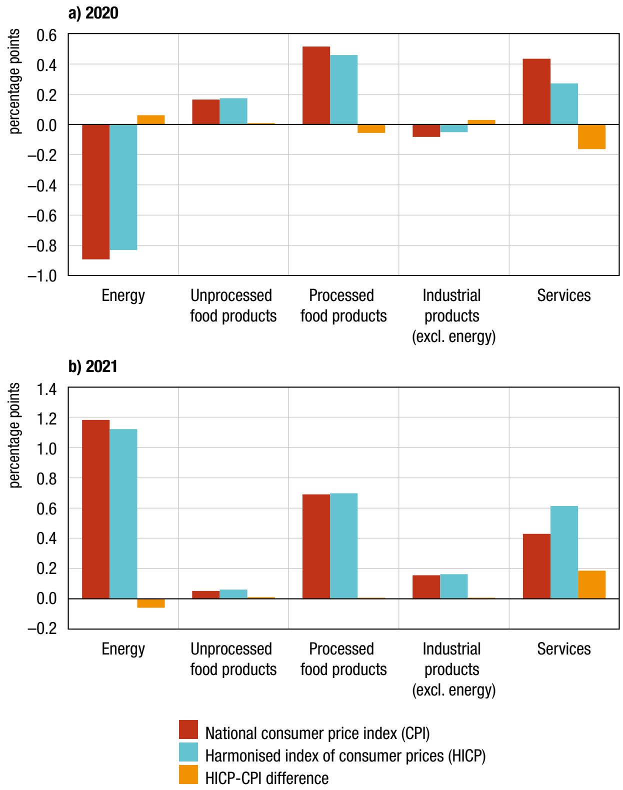
7 A comparison of the average annual inflation rates measured by the HICP in Croatia and the euro area shows that the average inflation in the period from 2002 to 2021 was slightly higher in Croatia than in the euro area (1.9% vs 1.6%). Particularly higher was the average inflation of processed food products. In the period from 2009 to 2021 the average inflation in Croatia and the euro area was the same and stood at 1.3%.

Figure 3 Average annual rates of change in the national and harmonised index of consumer prices



Sources: CBS and Eurostat.

Figure 4 Contributions of individual components to the average annual rate of change in the overall national and harmonised index of consumer prices in 2020 and 2021



Sources: CBS, Eurostat and CNB calculations.

points in the CPI). To a large extent, this was the outcome of the recovery in the prices of catering and accommodation services (which have a heavier weight in the HICP) due to the relaxation of epidemiological measures.

Recent data show that HICP inflation stood at 7.3% in March 2022 (the same as CPI inflation), while it grew to 9.6% in April and was 0.2 percentage points higher than CPI inflation. A somewhat larger contribution of service prices to the HICP (with the annual increase in accommodation prices of around 8%) than to the CPI was entirely offset by the lower contribution of energy and food prices (Table 1) By contrast, an even larger contribution of service prices to the HICP (with the annual increase in accommodation prices of around 17%) than to the CPI in April was only partially offset by lower contributions of other components. The situation changed in May, when CPI inflation (10.8%) exceeded HICP inflation (10.7%), mostly due to the slightly larger contribution of energy and processed food products to the CPI than to the HICP.

Table 1 Contributions of individual components to the annual rate of change in the overall national and harmonised index of consumer prices from March to April 2022

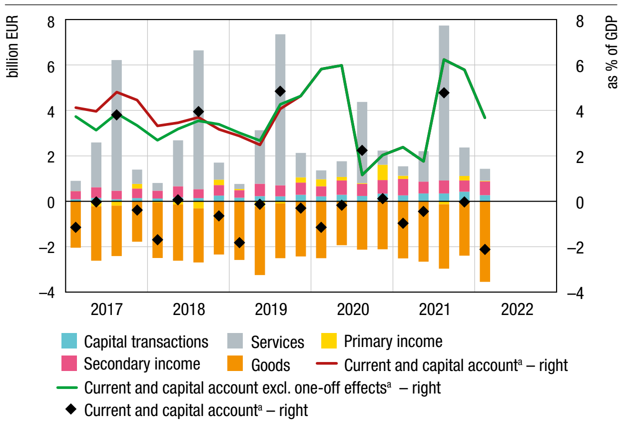
	Contributions, percentage points								
	March 2022			April 2022			May 2022		
	CPI	HICP	Difference	CPI	HICP	Difference	CPI	HICP	Difference
Energy	2.23	2.08	−0.15	3.24	3.04	−0.20	3.61	3.34	−0.26
Unprocessed food products	0.80	0.54	−0.26	0.98	0.65	−0.33	1.07	0.72	−0.35
Processed food products	2.03	1.94	−0.09	2.39	2.26	−0.13	2.93	2.68	−0.26
Industrial products (excl. energy)	1.51	1.51	0.01	1.82	1.78	−0.04	2.16	2.07	−0.09
Services	0.68	1.17	0.48	1.00	1.86	0.86	1.05	1.92	0.87
Total (%)	7.3	7.3	0.0	9.4	9.6	0.2	10.8	10.7	−0.1

Sources: CBS, Eurostat and CNB calculations.

6 Current and capital account

The current and capital account deficit more than doubled in the first quarter of 2022 from the same period of the previous year. The major contributor to this was the sharp increase in the foreign trade deficit triggered by the deterioration in trading conditions, with another leap in the prices of foreign energy products and food raw materials after the beginning of the war in Ukraine. To a much lesser extent, unfavourable developments were due to the increased profitability of foreign-owned banks and enterprises and smaller net income from transactions with the EU budget, which was only slightly mitigated by greater net exports of services. The cumulative values in the last four quarters show that the current and capital account surplus stood at 3.7% of GDP in the period up to the end of March 2022, which is a noticeable decrease from 5.8% of GDP in 2021 (Figure 6.1).

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.

Foreign trade and competitiveness

The ongoing recovery of domestic and foreign demand following the pandemic had a strong impact on foreign trade developments. Real trends were, however, intensified by massive price shocks, that is, substantial deterioration in the terms of trade due to persistent disruptions in global supply chains, which were further exacerbated by the war in Ukraine, leading to a hike in the prices of energy products and other raw materials in the world market (for more details on the energy dependence of the domestic economy, see Box 3). Thus, according to the balance of payments data[8], in the first quarter of 2022, total goods exports rose by 46.6% and imports grew by 44.2%, which, due to the much larger imports base resulted in a 41.1% increase in the deficit relative to the same period of the year before. If cumulative values in the past year are observed, the foreign trade deficit stood at 19.4% of GDP in the period up to the end of the first quarter of 2022, which is a deterioration of 1.2 percentage points from the entire 2021.

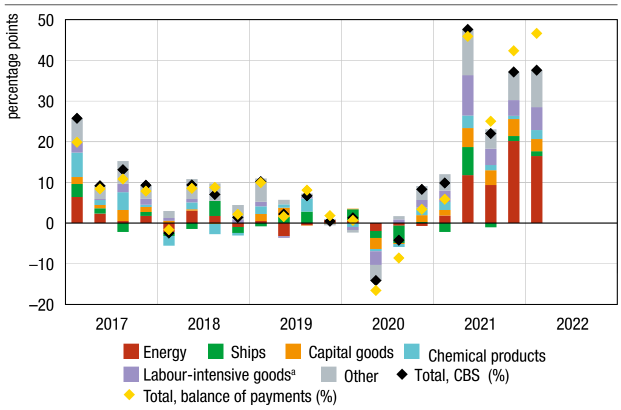
Detailed CBS data show that better export performance on an annual level was mostly due to energy products (Figure 6.2), particularly exports of electricity to Slovenia and gas to Hungary. To a much smaller extent, standing out is the growth in exports of food products, predominantly cereals and cereal preparations to Italy and metal industry products to Slovenia, Italy and Germany. An increase was also seen in the exports of other chemical products (including medical and pharmaceutical products) to Italy and capital goods, in particular electrical machinery, apparatus and appliances, to Germany.

Imports of goods (Figure 6.3) rose largely on the strength of the same production categories as exports, in particular energy products, that is, natural and manufactured gas from the USA, oil and refined petroleum products from Italy and electricity from Hungary. A sharp increase was also recorded in the imports of metal industry products from Italy and Germany, followed by particular categories of capital goods (notably electrical machinery, apparatus and appliances from China), other chemical products (excluding medical and pharmaceutical products) from Italy, Germany and Slovenia and food products from Hungary, Spain and Slovenia.

In contrast to foreign trade in goods, the foreign trade balance in services continued to improve vigorously thanks to the relaxation of epidemiological measures early in the year and the rebound in demand for services, which had been largely subdued during the pandemic. The improvement in the services sub-account balance was mostly the result of larger tourism revenues (Figure 6.4), which more than doubled in the first three months of 2022 from the same period of the previous year, slightly exceeding the results in the record-breaking 2019. Perceptible growth was also seen in the exports of other services not related to tourism, in particular transportation services.

The nominal effective exchange rate of the kuna remained stable in the first half of the year, but the different pace of growth in consumer and producer prices in Croatia and the countries included in the basket for the calculation of the effective exchange rate of the kuna was reflected in divergent movements of the Croatian export price competitiveness in that period. The

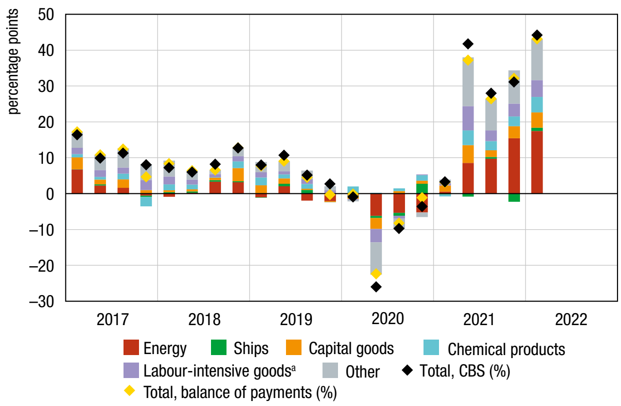
Figure 6.2 Exports of goods
year-on-year rate of change and contributions



[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.

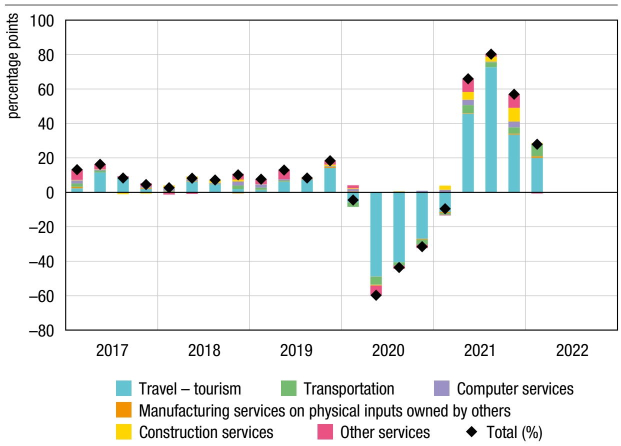
8 According to CBS data, in the first quarter of 2022 total goods exports rose by 37.6%, total goods imports by 43.1% and the deficit by 53.1% from the same period of the year before. For more information on the differences in the scope of the trade in goods according to the balance of payments and CBS 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



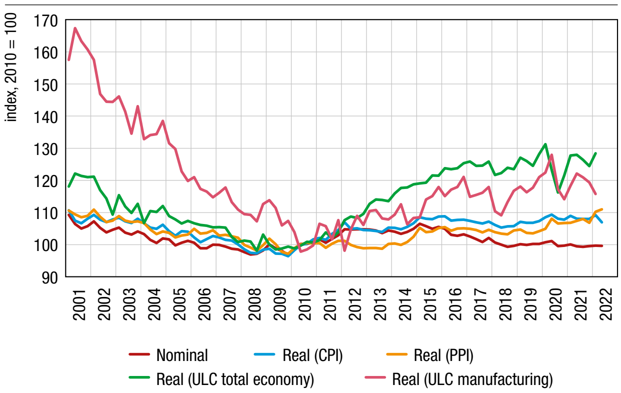
[a] Labour-intensive goods (according to the SITC) include: textile, wearing apparel, footwear, leather, paper, cork and wood, furniture, manufactures of metals and non-metallic mineral manufactures, prefabricated buildings and manufactured articles n.e.c.
Sources: CBS and CNB.

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



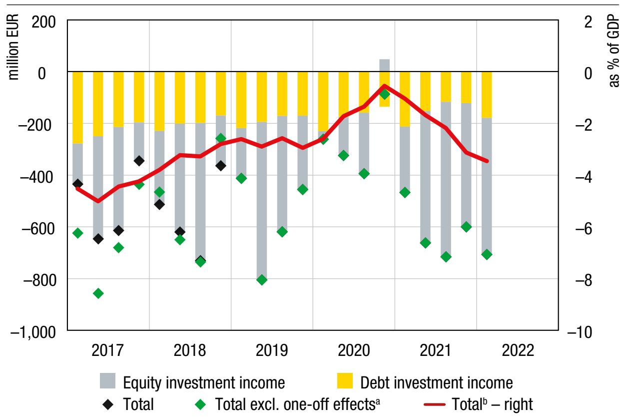
Notes: A fall in the index indicates an effective appreciation of the kuna. Data for the fourth quarter of 2021 relating to the nominal exchange rate refer to October and November and those relating to the real exchange rate deflated by consumer prices refer to October.
Source: CNB.

real effective exchange rate deflated by consumer prices appreciated from the end of 2021 to the first half of 2022 as prices grew faster in Croatia than in its major trading partners, while the real effective exchange rate deflated by producer prices depreciated. Diverse trends were also seen in terms of the cost competitiveness of Croatian exports, with the real effective kuna exchange rate deflated by unit labour costs for the economy as a whole depreciating in the first quarter of 2022, while the real effective exchange rate of the kuna deflated by unit labour costs in manufacturing appreciated (Figure 6.5).

Income and transactions with the EU

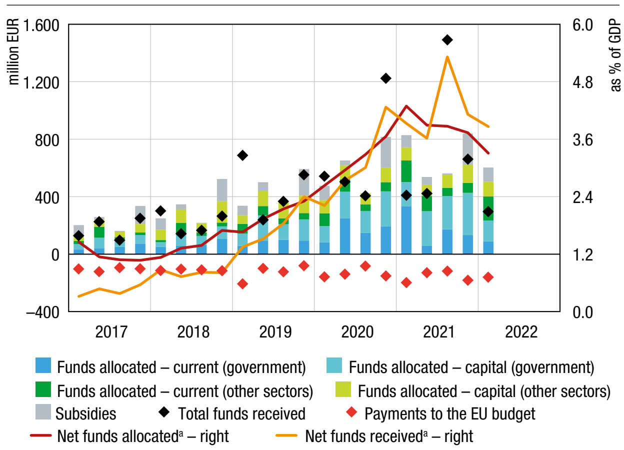
The surplus in the primary income account narrowed in the first three months of 2022 from the same period of the previous year, influenced by increased expenditures on direct equity investment (Figure 6.6). In particular, this was due to the improved business performance of domestic enterprises owned by non-residents, notably banks and oil industry, as well as real

Figure 6.6 Investment income



[a] One-off effects include 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



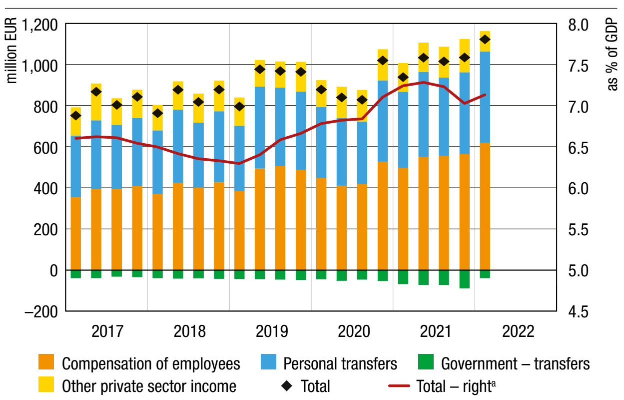
[a] Sum of the last four quarters.
Notes: As regards total funds received from EU funds, only funds allocated and paid out to end beneficiaries are recorded in the current and capital account of the balance of payments, while funds received but not allocated are recorded in the financial account. Payments 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.

estate activities. This supported a further trend of recovery in foreign-owned banks' and enterprises' profitability, recorded from the beginning of the previous year.

At the same time, net income from transactions with the EU budget diminished from the same period of 2021 due to the lower absorption of current funds allocated to the government sector. The use of capital funds also decreased slightly, but on the other hand, the same was true of the amount of payments to the EU budget. As a result, the surplus of EU funds paid to end users over the payments to the EU budget, reported as the sum of the last four quarters, decreased from 3.7% of GDP at end-2021 to 3.3% of GDP at the end of March 2022 (Figure 6.7).

By contrast, the net inflow of other income, which excludes income from equity and debt investment and transactions with the EU budget, increased sharply in the first quarter of 2022 from the same period of 2021, owing to a growth in net revenues from compensation of persons temporarily employed abroad and personal transfers (Figure 6.8).

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.

Projected developments

The surplus in the balance of payments, current and capital account, might deteriorate to 5.2% of GDP at the level of 2022 as a whole. A particularly strong negative impact is the strong increase in the foreign trade deficit. Also expected, though to a lesser extent, is the growth in the profitability of domestic banks and enterprises in foreign ownership, as is a notable increase in interest expenditure for foreign debt of domestic sectors. By contrast, unfavourable developments have been largely mitigated by the surge in net exports of services, in particular revenues from tourism. A greater use of EU funds, in particular capital funds, and bigger net inflows from personal remittances from abroad are also expected.

As for the assessment of foreign trade developments, the strong growth in exports and imports is expected to continue; due to the much larger imports base, this might result in a record-high increase in the total deficit, as evidenced by the performance in the year so far. The relatively high expected growth rates of total goods imports and exports in 2022 are largely the outcome of the growth in prices, particularly of energy products. According to CBS data, net imports of energy products might come to EUR 2.8bn or 4.3% of GDP in 2022, up from 1.6% of GDP in 2021. The prices of natural gas might hit all-time highs due to the Russian invasion of Ukraine.

Thanks to a recovery in tourism revenues, the growth in the net exports of services should largely mitigate the widening of the foreign trade deficit in 2022. Revenues from tourism consumption of foreign tourists in Croatia exceeded their pre-crisis level in the first three months of the current year, while the surge in bookings in the peak tourist season at significantly higher accommodation prices suggests that revenues for 2022 as a whole might surpass those in the record-setting 2019. The rise in the surplus in the services sub-account might also be spurred further by larger net exports of services not related to tourism.

In addition to net exports of services, the balance in the current and capital account might be favourably affected by stronger absorption of EU funds, particularly capital funds; the use of EU funds might reach record highs as Croatia is nearing the end of the current financial envelope and beginning with the new envelope and the use of the new EU recovery instrument (Next Generation EU, NGEU) and the EU Solidarity Fund. The positive balance of transactions with the EU budget could thus rise from 3.7% of GDP in 2021 to 4.0% of GDP in 2022.

The current and capital account surplus is expected to shrink noticeably in 2023, while the foreign trade deficit might become even wider. The parallel deterioration of the balance in the primary income account is a reflection of the increase in interest expenditures on foreign liabilities of domestic sectors. On the other hand, net exports of services are expected to continue to grow, albeit at a much slower pace than in the year before. As a result, the surplus in the current and capital account might narrow to 3.8% of GDP.

The projection of developments in the current and capital account of the balance of payments is exposed to significant risks, which are mostly tilted to the downside. The key risks arise from the assumed dynamics of developments in tourism revenues, which in the short-term mostly depends on the security situation in Europe and movements in geopolitical tensions, with pandemic-related risks far from being fully dissipated. Noticeable risks are also present in the international trade in goods and they are associated primarily with the movements in global energy prices. In addition, there is also a risk of unfavourable developments in foreign demand for Croatian goods and services. Finally, even though the use of EU funds could exceed present expectations, there is also a negative risk of a slower uptake.

Box 3 Croatia's energy dependence

With the beginning of the Russian invasion of Ukraine and the ensuing disruptions in global energy markets given Russia's key role in global energy supply, the topic of the energy dependence of the domestic economy once again came to the forefront. As Croatia is a net importer of all key energy products, including oil and refined petroleum products, coal, natural gas and electricity, the surge in the prices of energy products seen in recent months has already made a strong impact on macroeconomic developments in the country. This Box analyses the domestic energy position and attempts to answer the question of which energy product imports would be the most significant source of risk in the case of further price pressures or in a scenario that assumes that no substitutes can be found for these imports, at least not rapidly and efficiently.

Croatia recorded net imports of energy products (expressed as percentage of GDP) above the EU average in 2021 (Figure 1); the relative import dependence would be even more unfavourable had it not been for the sharp growth in the value of electricity exports towards the year-end, which was driven by price increases.

In terms of Eurostat's energy dependence indicator, which shows the ratio between a country's energy imports and its own production, Croatia's position is slightly more favourable than the EU average (Figure 2), but this does not change the fact that the domestic economy is highly exposed to price and other shocks in global energy markets.

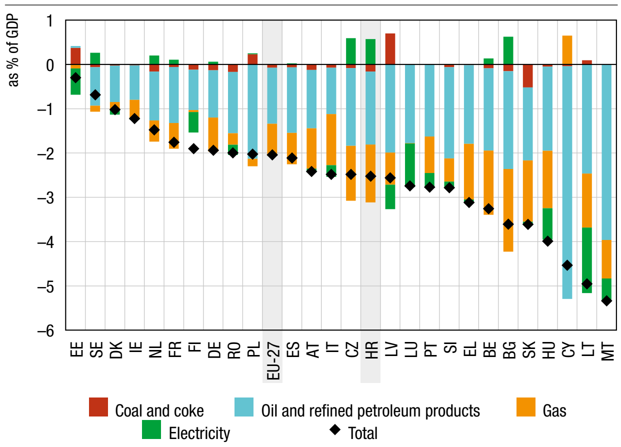
All domestic sectors are exposed to risks of significant price and distribution shocks and there is no major discrepancy between Croatia and the rest of the EU in terms of the usual structure of energy consumption (Figure 3). The largest consumption of oil and refined petroleum products is accounted for by the sector of transport, while the services sector and industry rely much more on gas and electricity, respectively. In this context, the only exception is the structure of energy consumption of Croatian households, which, compared with the rest of the EU, rely much more on solid biofuels used during the heating season. Though these types of heating are less desirable in ecological terms, such an unfavourable heating structure may prove to be an advantage amid energy supply disruptions.

It is worth noting the countries on which Croatia is mostly energy-dependent, in particular, how much the domestic economy depends on energy imports from Russia in the context of heightened geopolitical tensions and mutual sanctions imposed in recent months.

As regards coal, Croatia is not a significant importer as its annual coal imports amount to around EUR 100m. Nevertheless, this is also the segment where Croatia's direct dependence on imports from Russia is the biggest, accounting for over half of the total amount (Figure 4). It should be kept in mind that coal is an important fuel for a significant portion of the domestic electric power system. As for other energy categories, which account for a much larger absolute value of imports, the structure seems more favourable, i.e. diversified, with the share of imports from Russia being perceptibly lower now than in 2015 (Figure 4).

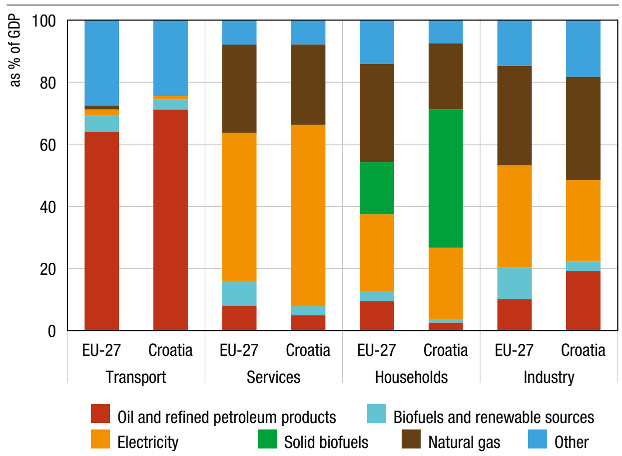
A deeper analysis shows that Croatia's actual exposure to energy imports from Russia is noticeably greater, particularly as

Figure 1 Net EU imports of energy products by member states (2021)



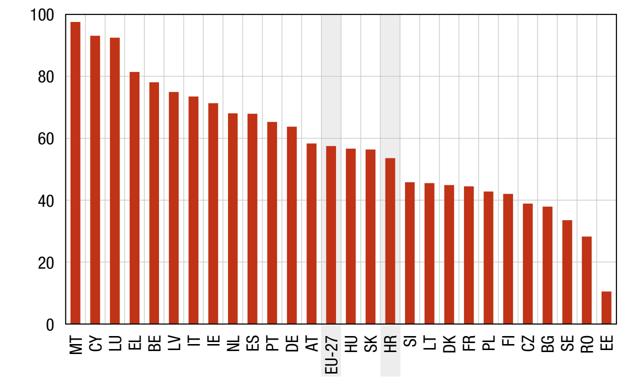
Source: Eurostat (Comext).

Figure 3 Structure of energy consumption by sector (2020)



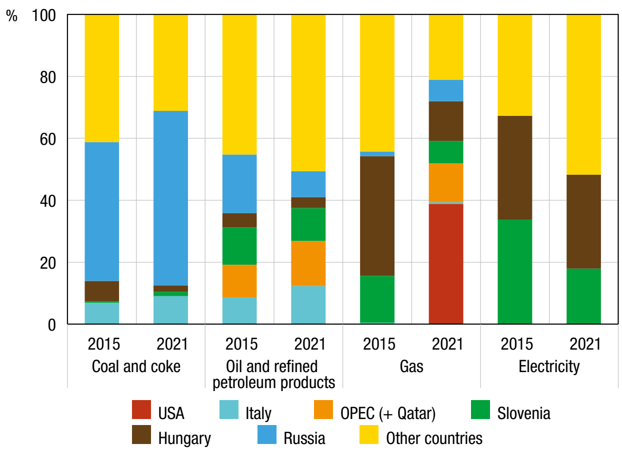
Source: Eurostat.

Figure 2 Energy dependence indicator (2020)



Notes: The indicator shows the extent to which an economy relies upon imports in order to meet its energy needs. Energy dependence is defined as the ratio of net imports to gross available energy, where gross available energy is defined as: Total production + Net imports + Stock changes.
Source: Eurostat.

Figure 4 Imports of selected energy products to Croatia by country

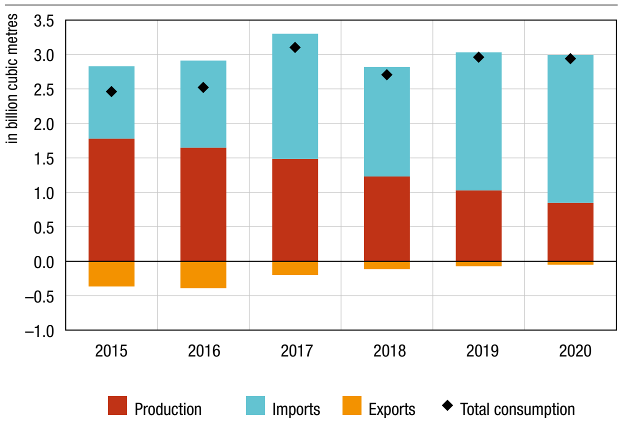


Source: Eurostat (Comext).

regards imports of gas. More precisely, data from the Ministry of Economy suggest that the country's needs for natural gas have been relatively stable from year to year, amounting to around 3.0 billion cubic metres (Figure 5). Nevertheless, domestic production, which covered over 70% of Croatia's needs for natural gas in 2015, has been decreasing for some time, falling to 30% by the end of 2020. As a result, imports of natural gas from other countries have become increasingly important, which presents an important source of economic risks for the domestic economy as most of the natural gas supplies coming to Croatia up to 2020 originated directly from Russia, although imports were made via third countries and were statistically recorded as imports from Hungary or Slovenia, as evident in Figure 3.

However, the floating liquefied natural gas (LNG) terminal on the island of Krk, which started operational activity in early 2021, is a significant alternative domestic supply chain for natural gas. As evidenced by CBS data, the launching of the terminal sharply increased imported gas quantities in 2021, as the terminal also provided a channel for gas imports to the neighbouring countries, with liquefied gas becoming a dominant type of supply in the structure of gas imports to Croatia (Figure 6).

Figure 5 Balance of natural gas consumption and supply in Croatia



Source: Ministry of Economy and Sustainable Development, Energy in Croatia, 2020.

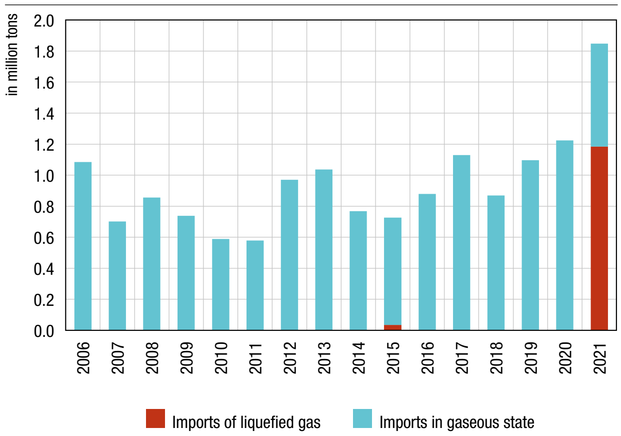
The opening of the LNG terminal has led to a perceptible decrease in the share of Russian gas imports (via Hungary and Slovenia) to Croatia and a rise in the share of imports from the USA, OPEC countries and Qatar (Figure 2). Though the terminal improved Croatia's energy position and supply security, it remains to be seen to what extent it eliminated the risks associated with exposure to imported gas originating from Russia. In theory, the new terminal has the capacity to deliver 2.6bn of cubic metres of gas annually to the gas network and can thus satisfy the bulk of domestic needs, which seemingly diminishes potential damage in the event of a materialisation of negative risks associated with a suspension of gas supply from Russia. However, as domestic suppliers are not the only bookers of the terminal capacity, it is uncertain to what extent the terminal might actually compensate for domestic gas supply in the event of a suspension of Russian gas deliveries via the neighbouring countries. As this suspension would boost demand for liquefied gas, it is questionable to what extent this gas would be available to Croatia. In addition to supply security risks, Croatia is even more exposed to the adverse risk of price changes as gas import prices depend on the current prices in the market for liquefied gas, that is, prices at Austrian Baumgarten gas hub for gas in gaseous state.

Though less pronounced than the risks related to natural gas, the risks associated with the security and price of electricity supply are significant and partly depend on energy imports from Russia. According to Ministry of Economy data, own production capacity installed in Croatia totalled 4,661 MW at the end of 2020, half of which was accounted for by hydroelectric plants, approximately one third was accounted for by thermal power plants and one fifth of total capacity consisted of renewable energy sources. Also, Croatia has at its disposal half of the capacity of Krško Nuclear Power Plant (348 MW) and some capacities in Bosnia and Herzegovina and Serbia. However, own production is insufficient even in ideal hydroelectric conditions, particularly during the summer months, so that Croatia imports around 40% to 50% of the electricity needed for domestic consumption (Figure 7).

Electricity supply security is further complicated by the fact that over 1,000 MW of thermoelectric power plant capacity installed in Croatia (around 20% of total power) is operated on natural gas and coal, a significant portion of which originates from Russia.

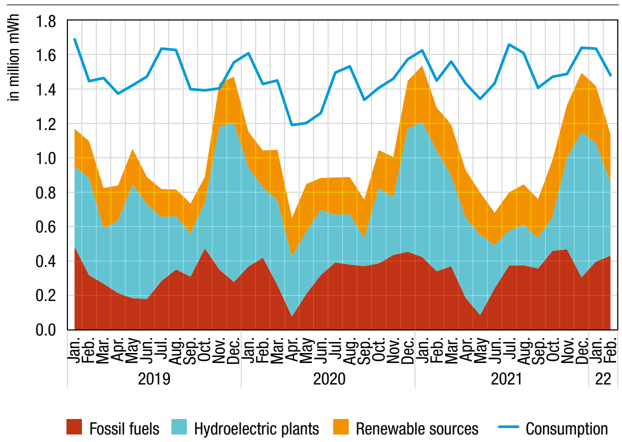
As regards the supply of refined petroleum products, Croatia

Figure 6 Gas imports to Croatia by types of supply



Source: CBS.

Figure 7 Balance of electricity consumption and production in Croatia

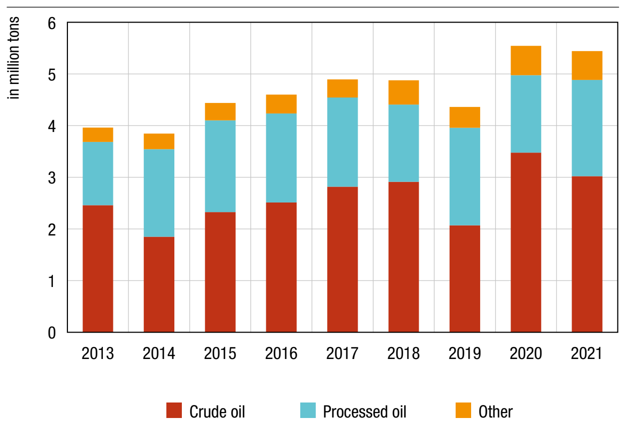


Sources: ENTSOE and Eurostat.

mostly depends on imports of crude oil as its domestic production is relatively small. Total imports of oil and refined petroleum products to Croatia are geographically diversified, with direct imports from Russia accounting for slightly more than 4% of the total. Croatia's position in this segment is also enhanced by the fact that Croatia itself refines significant amounts of crude oil in Rijeka Refinery, so that most of the country's needs for refined petroleum products are satisfied from its own refinery (Figure 8). This diminishes the damage that disruptions in oil supply from Russia would create for the domestic economy (although there is still an issue of supplying vacuum gas oil needed for refinery purposes), as Croatia does not entirely depend on imports of final petroleum products.

In conclusion, Croatia's energy dependence, particularly as regards Russia, is particularly prominent in the segment of gas imports, although the new LNG terminal has significantly enhanced Croatia's position in this regard. The next in line is electricity supply, which significantly depends on imports, whereas a noticeable share of domestic production facilities uses coal and gas as motor fuels, which indirectly raises exposure to Russia. At the same time, although oil and refined petroleum products account for the biggest relative share of imports, the existence of a domestic refinery with substantial manufacturing capacity provides a larger manoeuvring space regarding supply of refined petroleum products should there be further disruptions (bans) on the oil market, resulting in somewhat smaller risks in that segment.

Figure 8 Imports of oil and refined petroleum products to Croatia



Source: Eurostat (Comext).

7 Private sector financing

Mounting concerns over geopolitical uncertainties and substantial inflationary pressures were reflected in the growth in market yields on government debt securities in the first half of the year. However, the tightening of financing conditions in financial markets has had no spillover effect on financing costs for the private sector so far. Interest rates on corporate loans remained close to their record lows, while the costs of household financing dipped to the lowest ever in April. Credit standards for households continued to ease in the first quarter, while credit standards for corporate loans tightened slightly. Credit demand of both households and corporates gained momentum in the same period. The sharp pick-up in corporate borrowing is likely tied to the higher costs of procurement owing to the rapid increase in the prices of imported energy products and raw materials, as well as attempts by enterprises to pre-empt the expected rise in borrowing costs by borrowing under the existing favourable conditions. All types of financing intensified, in particular borrowing from domestic credit institutions. The rise in household placements continued to accelerate slightly, with housing loans seeing the sharpest growth, which was also driven by the government subsidy programme.

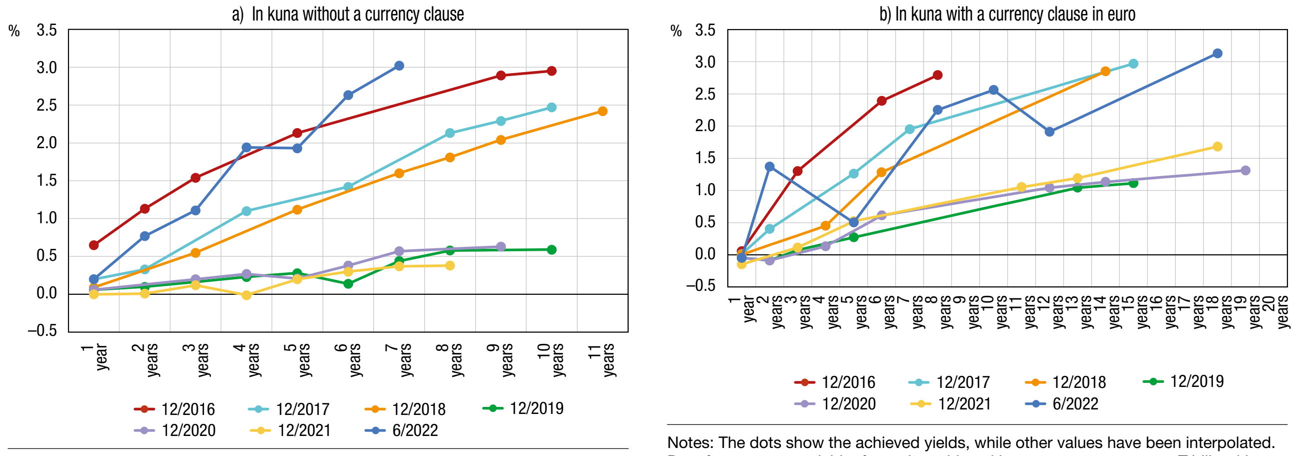
Government borrowing costs, one of the determinants of borrowing costs for other domestic sectors, were on the rise in the first half of the year, with short-term borrowing costs edging up. The interest rate on one-year kuna T-bills in the domestic market went up from 0.00% in late 2021 to 0.2% in June (Figure 7.1a), while the interest rate on euro T-bills of the same maturity issued in the domestic market went up to –0.05% in May (Figure 7.1b), after standing at –0.15% in last October. In May, the government refinanced a large issue of one-year euro T-bills, reducing the amount to EUR 1.0bn from EUR 1.2bn a year ago, while the interest rate rose from –0.05% to 0.1%. Long-term borrowing costs grew faster, e.g. the yield on seven-year kuna bonds without a currency clause increased by 2.7 percentage points in the first six months of the year, reaching 3.0% in June (Figure 7.1a). The yield on eighteen-year bonds in kuna with a currency clause in euro grew by 1.5 percentage points in the same period, standing at 3.1% in June (Figure 7.1b). In early February, the government issued an eight-year bond on the domestic capital market worth EUR 1bn, with a currency clause and a yield of 1.39%. In addition, in mid-April the government issued 10-year eurobonds worth EUR 1.25bn on the international capital market with a yield of 2.98%. Notwithstanding the higher yields, the impact of their growth on government financing costs should be limited due to the relatively long average maturity of public debt.

The country's credit rating remained unchanged in the first half of 2022. The credit rating agency Fitch maintained Croatia's BBB investment rating with a positive outlook (two notches above speculative rating), while Moody's maintained its BBB– rating with a stable outlook (one notch above speculative rating). In late June, Moody's announced that it might upgrade Croatia's credit rating by two notches, to Baa2 (two notches above speculative rating), once Croatia's euro-area membership becomes formally confirmed and codified in EU law.

The interest rate on pure new corporate loans fluctuated around 1.9% in the first four months of 2022 (Figure 7.2), which was equal to the 2021 average and close to all-time lows. It dipped to 1.59% in May, so that the cost of corporate financing was 30 basis points lower than in the same month of 2021 (Figure 7.3), mostly owing to a negative contribution from interest rates on investment and syndicated loans (21 basis points). Broken down by the size of enterprises, this annual drop was equally due to the decline in the interest rate on loans to large enterprises (by 18 basis points) and the decrease of the share of micro, small and medium-sized enterprises in total financing (17 basis points), which mostly borrow at higher interest rates than large enterprises.

For most categories of enterprises in terms of size, the quarterly average of financing costs was higher in May than in the last

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 T-bills with a currency clause in euro. Data for the end of 2016 refer to November, for the end of 2017, 2019, 2020 and 2021 refer to October, and for 2022 refer to May.
Source: CNB.

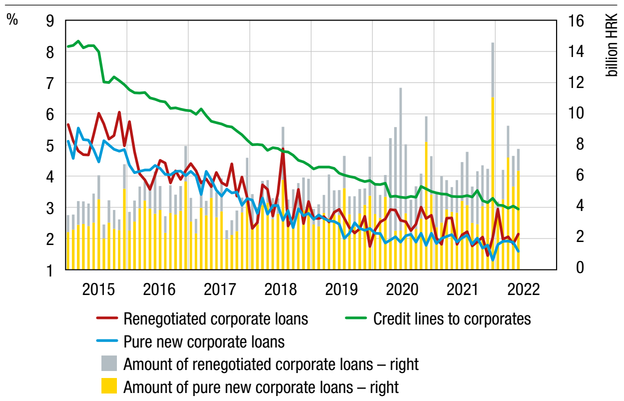
quarter of the previous year (Figure 7.4), when financing costs hit record lows. Interest rates were lower for larger enterprises, since they are generally perceived as less risky. The quarterly weighted interest rate on pure new loans to micro enterprises was 2 percentage points higher in May than on such loans to large enterprises, similar to the average difference over the past year.

As regards households, the interest rate on pure new loans to that sector fell noticeably in April, to a new lowest-ever of 3.45% (Figure 7.5), but edged up to 3.55% in May. The most favourable borrowing conditions for households thus far mostly reflect a considerable increase in the share of housing loans in total financing as a result of the subsidy programme, given that these housing loans are granted at relatively lower interest rates. The volatility of total costs of household financing in recent years has been due to fluctuations in the lending structure, which in the months when favourable housing loans under the government subsidy programme are granted considerably changes in their favour to the detriment of more expensive general-purpose cash loans. The costs of household financing on an annual level decreased by 28 basis points (Figure 7.6), due largely to the fall in interest rates on general-purpose cash loans.

The interest rate on general-purpose cash loans was close to historic lows in the first five months of 2022, averaging 5.4% in that period (Figure 7.7). Nevertheless, it still remained noticeably higher than the costs of housing financing which, influenced by the housing loans subsidy programme, dropped to their all-time low of 2.2% in April and edged up in May. The bulk of household lending activity was accounted for by these two instruments, since in the first ten months of 2022 they accounted for 90% of the total amount of pure new household loans.

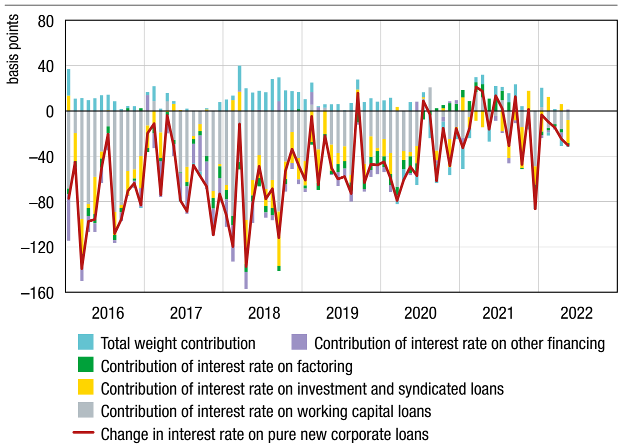
The decrease in the funding costs of the Croatian banking system in conditions of the exceptionally expansionary monetary policy and historically high surplus liquidity contributed to the maintenance of the favourable financing conditions of the private sector. The national reference rate[9] (Figure 7.8), which is most often used in loan contracts as a parameter for determining

Figure 7.2 Interest rates and amounts of loans to corporates



Note: Data on pure new loans are not available for credit card loans, overdrafts, revolving loans and receivables on charge cards since their new business volume (for other instruments, this includes both pure new loans and renegotiated loans) is equal to balances and thus included in the credit line category.
Source: CNB.

Figure 7.3 Contributions to the annual change in interest rate on pure new corporate loans



Note: Calculated by applying the Bennet index, according to which total contribution is divided into interest rate effect and weight effect.
Source: CNB.

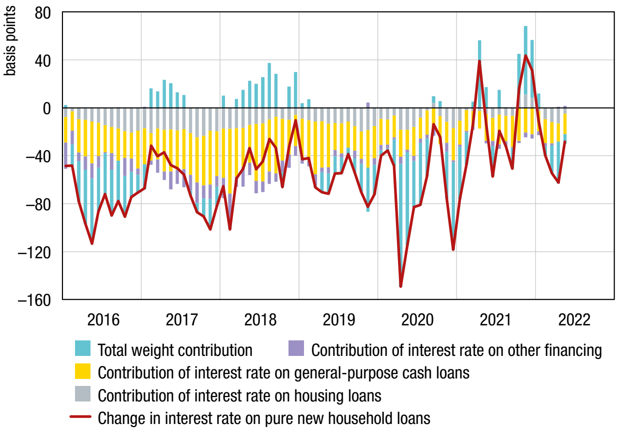
9 The national reference rate (NRR) is the average interest rate paid on deposits by the banking sector. It is used as one of the benchmark interest rates for determining the level of the variable component of variable interest rate on loans, in accordance with Article 11a of the Consumer Credit Act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

the level of the variable component of variable interest rate on loans, continued to decrease slightly in the first quarter. On the other hand, the six-month EURIBOR rose by 0.8 percentage points in the first half of the year, reaching 0.3%, the highest level since 2014.

According to the bank lending survey, the loosening of the credit standards for corporate loans, seen throughout most of 2021, came to an end in the first quarter of 2022, while the rise in demand steadily gained momentum (Figure 7.9). The tightening of credit standards in the first quarter was mainly affected by the negative expectations related to overall economic trends as well as the worsened outlook of industry or the individual corporation. The easing of credit standards continued only for small and medium-sized enterprises, albeit at a pace much slower than in the second half of 2022. Demand picked up for almost all groups of loans, in particular short-term loans. The most important drivers of rising demand for loans in the first quarter were corporate needs for financing inventories and working capital as well as gross fixed capital formation.

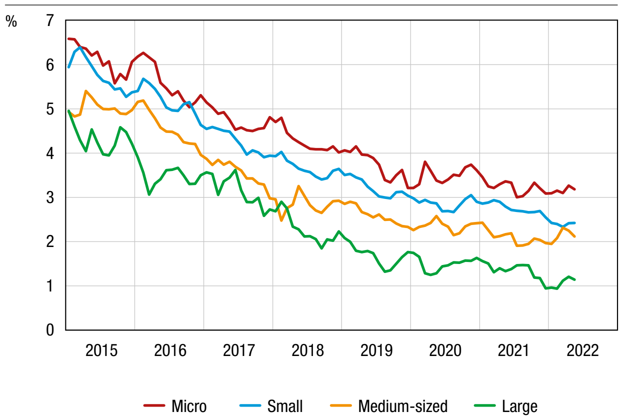
As for households, the easing of credit standards and rising demand for household loans gained traction in the first quarter

Figure 7.6 Contributions to the annual change in interest rate on pure new household loans



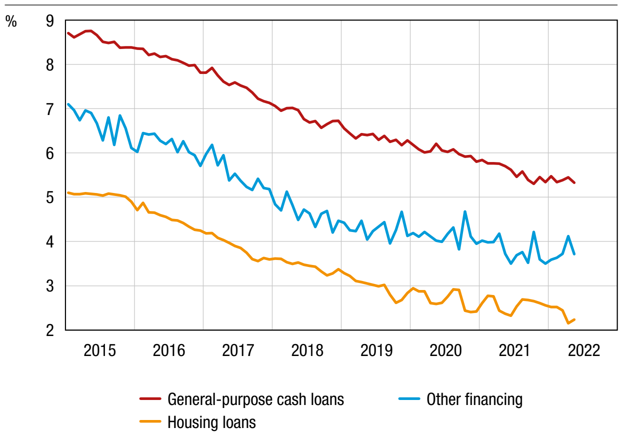
Note: Calculated by applying the Bennet index, according to which total contribution is divided into interest rate effect and weight effect.
Source: CNB.

Figure 7.4 Interest rates on pure new loans by the size of enterprises



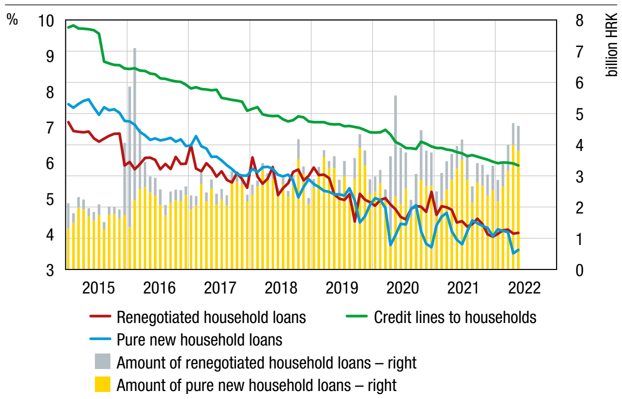
Note: Quarterly weighted moving averages.
Source: CNB.

Figure 7.7 Interest rates on pure new household loans by purpose



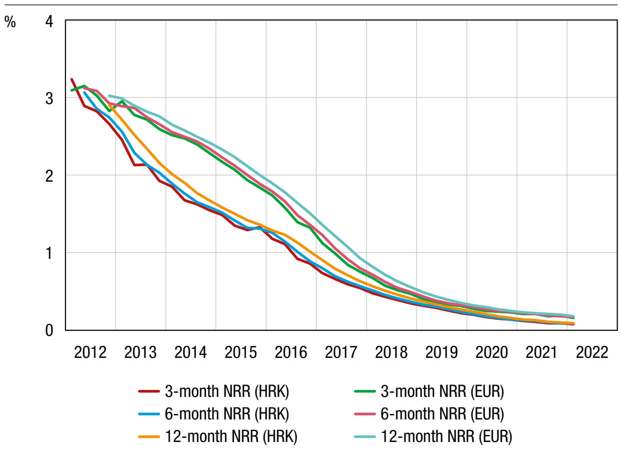
Source: CNB.

Figure 7.5 Interest rates and amounts of household loans



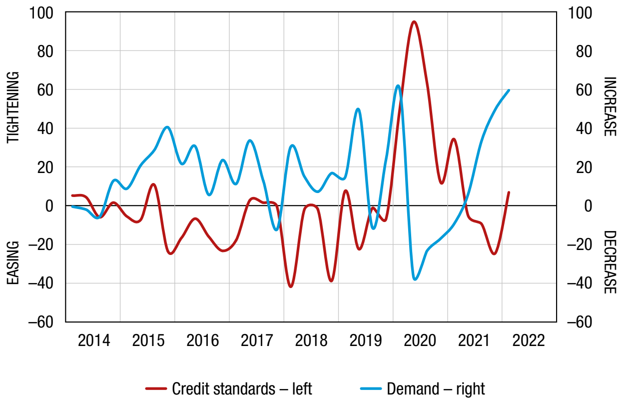
Note: Data on pure new loans are not available for credit card loans, overdrafts, revolving loans and receivables on charge cards since their new business volume (for other instruments, this includes both pure new loans and renegotiated loans) is equal to balances and thus included in the credit line category.
Source: CNB.

Figure 7.8 National reference rate (NRR)



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

Figure 7.9 Credit standards and corporate demand for loans



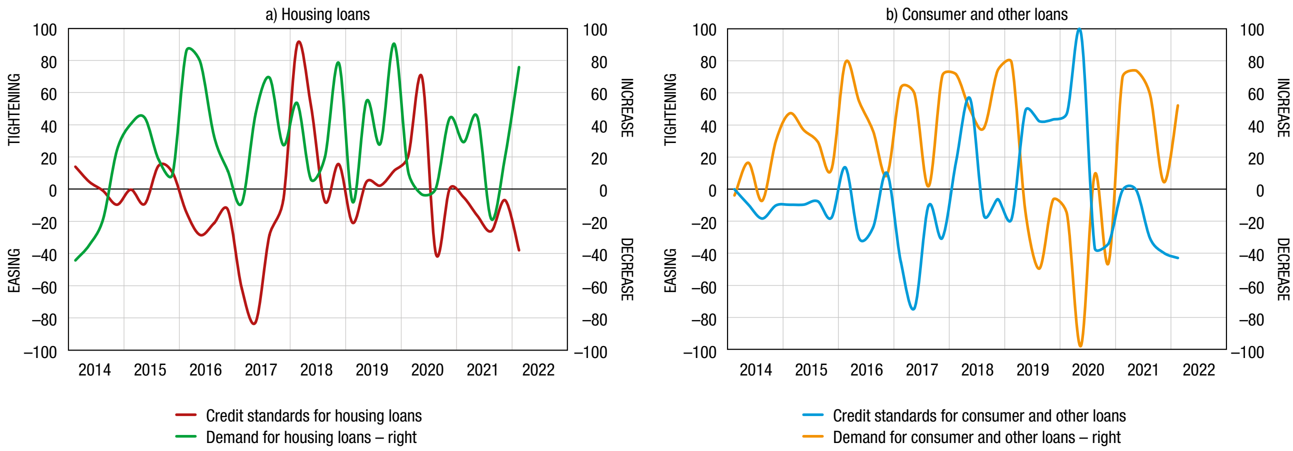
Note: Data show the net percentage of banks weighted by the share in total corporate loans.
Source: CNB.

(Figure 7.10). According to bank responses, interest margins and collateral requirements were reduced, with the increase in the loan to value ratio also reflecting the relaxation of credit conditions. As regards consumer and other loans, banks stated that competition was the main reason behind this relaxation. Household demand for loans grew sharply in the first quarter, particularly for housing loans, driven by a favourable real estate market outlook and the subsidy programme.

Total corporate financing trended up strongly in the first quarter, by almost EUR 1bn (Figure 7.11), with the largest increase seen in borrowing from domestic credit institutions. As a result, the growth in total corporate financing picked up to 4.7% (transaction-based) on an annual basis, a rate last recorded in early 2011. All types of financing gathered momentum on an annual level, in particular borrowing from domestic credit institutions, whereas external debt grew slightly less.

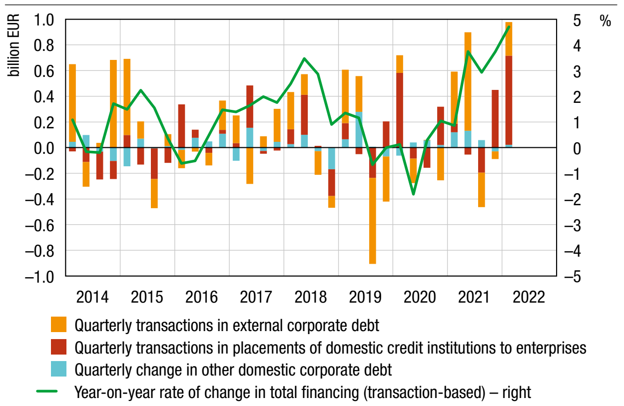
The surge in corporate financing from domestic credit institutions continued into the second quarter, with debt growing by a total of HRK 9.2bn or 10.3% in the first five months. The annual growth in domestic placements picked up to 12.3% (transaction-based, Figure 7.12) in May. Corporate needs for

Figure 7.10 Credit standards and household demand for loans



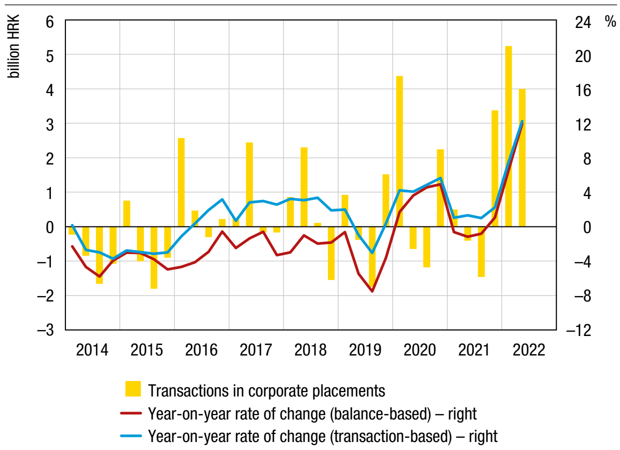
Note: Data show the net percentage of banks weighted by the share in total household loans.
Source: CNB.

Figure 7.11 Corporate financing



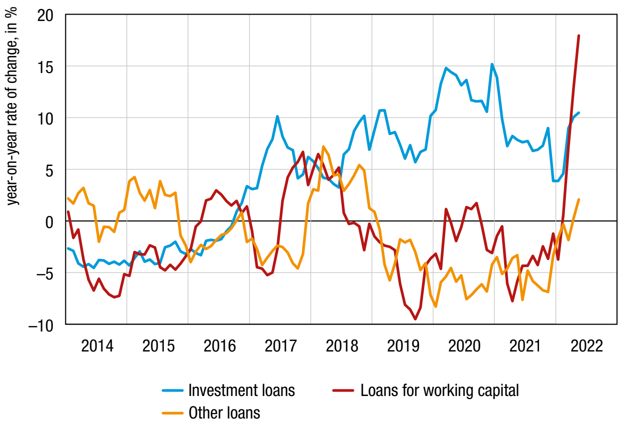
Notes: Other domestic financing includes borrowing from domestic leasing companies, the CBRD and HAMAG-BICRO. External debt excludes the effect of debt-equity swaps. All changes were calculated on the basis of transactions (except for leasing companies).
Sources: HAMAG-BICRO, HANFA, CNB and CNB calculations.

Figure 7.12 Corporate domestic placements of credit institutions



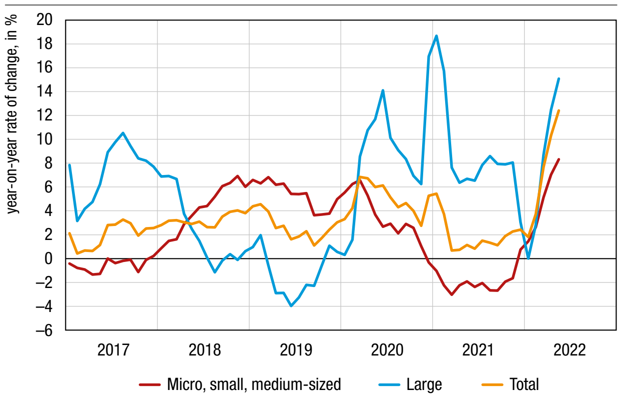
Note: Data for the second quarter of 2022 refer to April and May.
Source: CNB.

Figure 7.13 Growth in corporate loans by purpose
transaction-based



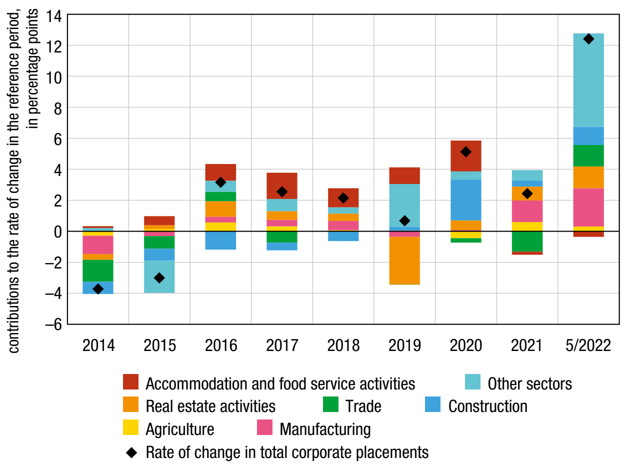
Source: CNB.

Figure 7.14 Growth in corporate placements by size
transaction-based



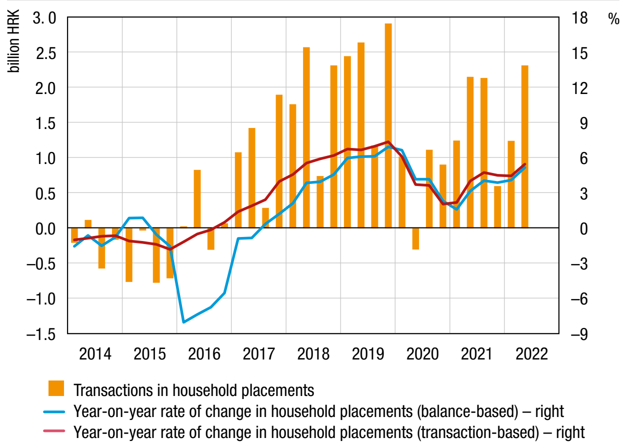
Note: The data were adjusted for the assessment of the effect of activated government guarantees for loans to particular shipyards and the decrease in the claims on the Agrokor Group linked to the operational implementation of the settlement.
Source: CNB.

Figure 7.15 Growth in corporate placements by activity
transaction-based



Notes: 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 in 2019 a sharp decrease in placements was recorded in Real estate activities, and a substantial rise was seen in Other sectors, which include Water supply activity.
Source: CNB.

Figure 7.16 Household placements



Note: Data for the second quarter of 2022 refer to April and May.
Source: CNB.

financing of current operations shot up amid rising costs, so that the annual increase in working capital loans went up from −1.2% in late 2021 to almost 18% in May (Figure 7.13). The annual growth in investment loans also accelerated from the previous year, reaching 10.5% in May. With regard to the structure of financing in terms of enterprise size, the annual increase in borrowing by large enterprises reached 15.1% in May (Figure 7.14), while lending to micro, small and medium-sized enterprises grew at about half of that rate.

Broken down by activities, almost all activities recorded annual growth in placements in May (Figure 7.15). The sharpest increase was seen in manufacturing and other activities, especially in electricity, gas and steam supply, as well as professional, scientific and technical activities.

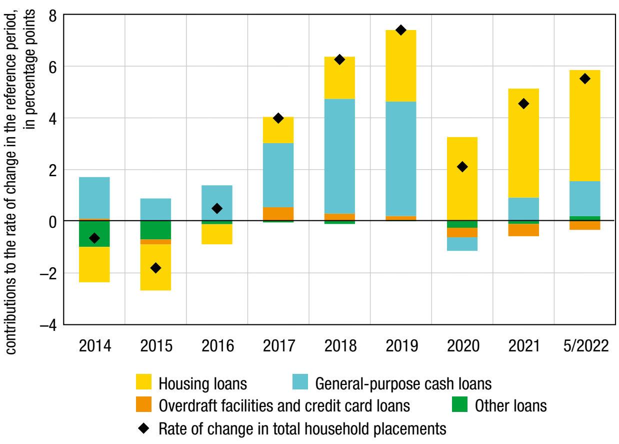
The growth rate of household placements continued to accelerate slightly, but has not yet reached that seen in the pre-pandemic year 2019. The annual growth rate went up from 4.5% in 2021 to 5.5% in May (transaction-based, Figure 7.16). More than three-quarters of the annual increase in household placements in May related to housing loans (Figure 7.17), the annual growth rate of which picked up to 9.3%, spurred also by the government subsidy programme. The annual growth in general-purpose cash loans continued to recover mildly and reached 3.6% in May, yet remaining much lower than the 11.5% seen in 2019.

The total amount of bank placements covered by payment deferral or restructuring measures decreased in late May 2022 to a historical low, which is largely attributable to the expiry of granted moratoria. At end-May, 3.6% of bank placements to corporates and only 0.3% of placements to households were covered by the measures (Figure 7.18).

Projected developments

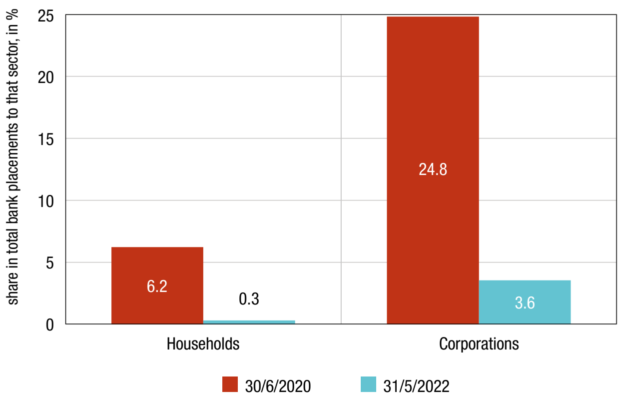
Total placements (government excluded) might record an annual growth rate of 7.4% (transaction-based) in 2022, which is almost twice the rate of 3.9% recorded in 2021. The faster growth in 2022 is mostly driven by the increase in corporate loans, which might grow by as much as 13.6% by the end of the year relative to the year before. A stronger growth in placements

Figure 7.17 Growth in household placements by loan type
transaction-based



Source: CNB.

Figure 7.18 Placements under payment deferral or restructuring measures



Note: Since June 2021, data on approved loan payment deferral or restructuring applications have been collected according to a new methodology, but this has not led to significant deviations from the data collected by the old methodology.
Source: CNB.

to the corporate sector might be due to the sharp increase in the prices of imported energy products and raw materials, which raised the cost of their procurement, as well as corporate attempts to borrow at favourable conditions and thus forestall the expected increase in borrowing costs. A positive contribution to growth is also expected to come from household loans, which might accelerate to 5.0%, strongly driven by housing loans, which are boosted by the largest ever number of applications for the new round of housing loan subsidies, with a smaller positive contribution coming from general-purpose cash loans.

8 Foreign capital flows

The financial account of the balance of payments saw a large net inflow of capital in the first quarter of 2022 (Figure 8.1). Net liabilities of domestic sectors, excluding the change in gross international reserves and CNB liabilities, increased by EUR 2.7bn, mostly as a result of the increase in net foreign debt liabilities of domestic sectors, especially banks. Net equity investments in Croatia also grew, due to the larger amount of reinvested earnings of banks and enterprises in foreign ownership and new foreign direct equity investments in Croatia. At the same time, international reserves decreased.

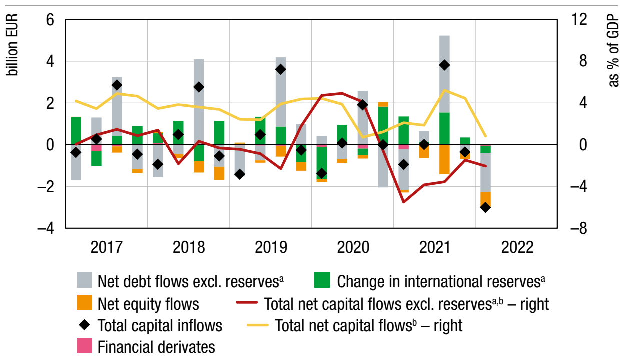
Net inflow from equity investment of EUR 0.7bn generated in the first quarter of 2022 was for the most part the result of the increase in liabilities, arising mostly from reinvested earnings of banks and enterprises in foreign ownership. New direct equity investments in Croatia, debt-to-equity transactions excluded, also grew significantly, reflecting mostly the steady sharp increase in the value of the real estate purchased by non-residents (Figure 8.2). Assets based on equity investments decreased mildly at the same time, largely due to the sale of foreign shares and equity holdings owned by residents.

The surge in net foreign debt liabilities (of EUR 1.9bn, excluding the change in gross international reserves and CNB liabilities) seen in the first three months of 2022 was primarily a result of a deterioration in the external position of credit institutions, common at the beginning of the year, which was notably worse than in the same period of the previous year. Other domestic sectors also increased their net debt liabilities, including net liabilities to affiliated creditors abroad. By contrast, the net debt position of the government improved, given that the disbursements to beneficiaries from the European funds exceeded the inflows from the EU funds.

The international reserves of the central bank dropped in the same period as a result of foreign exchange interventions, that is, the March sale of foreign exchange to banks. The smaller volume of repo transactions also added to the decrease in gross international reserves; however, given that the external liabilities of the central bank decreased by the same amount, these transactions did not influence its net external position.

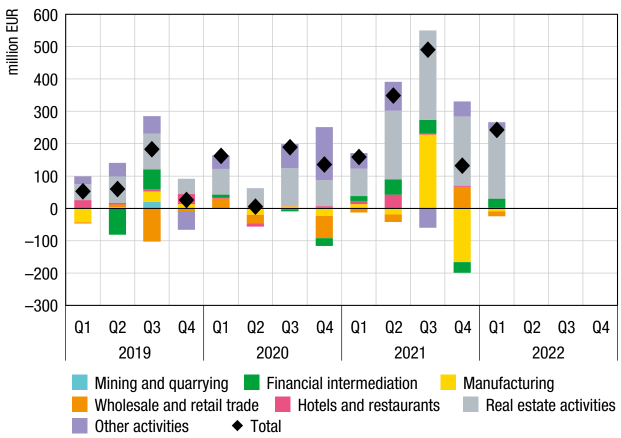
Despite the growth in domestic sectors' foreign debt liabilities in an absolute amount, owing to a nominal GDP growth,

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



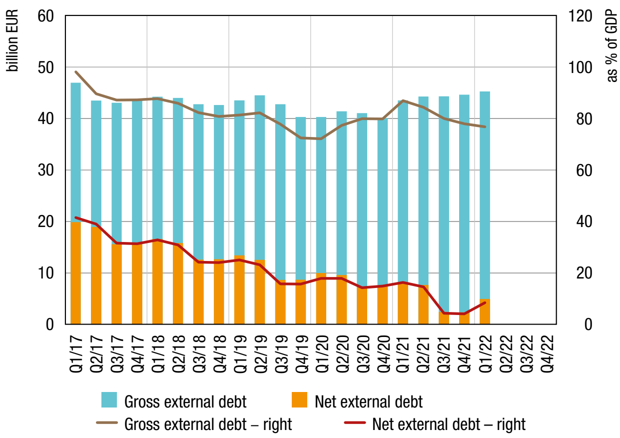
[a] Changes in gross international reserves net of CNB liabilities.
[b] Sum of the previous four quarters.
Notes: Net flows are the difference between changes in assets and liabilities. Equity flows comprise changes in foreign direct equity investments, reinvested earnings and portfolio equity investment, 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



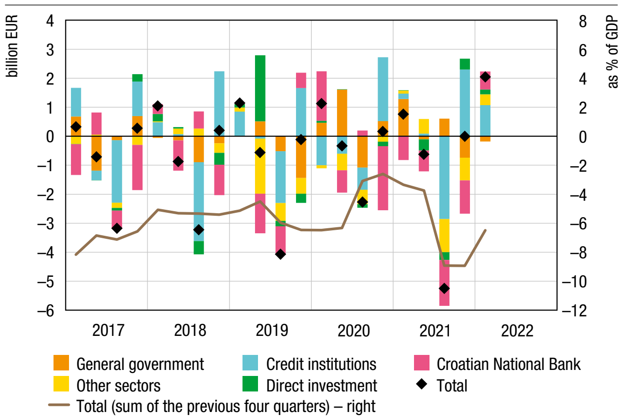
Note: Equity investment net of debt-to-equity transactions and round-tripping investments.
Source: CNB.

Figure 8.4 Stock of gross and net external debt



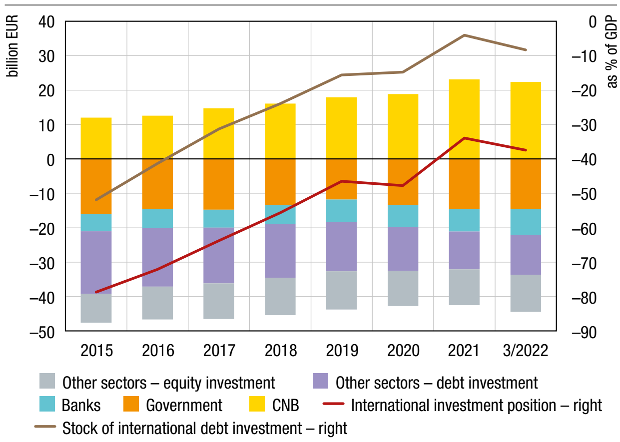
Note: Net external debt is calculated as the gross external debt stock net of external debt claims.
Source: CNB.

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 external 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.

the relative indicator of gross external debt improved at the beginning of 2022. Thus, at the end of March 2022, gross external debt stood at EUR 45.2bn, or 76.7% of GDP, down by 1.2 percentage points from the end of 2021 (Figure 8.4). Since foreign assets of domestic sectors plummeted at the same time, net external debt grew noticeably, reaching EUR 4.9bn or 8.3% of GDP in late March 2022, up by 4.3 percentage points from the end of 2021.

The increase in net debt and net equity liabilities also led to a deterioration in the relative indicator of the international investment position, which was partly offset by a favourable impact of price, exchange rate and other adjustments, as well as the rise in nominal GDP. As a result, the net international investment position at the end of March 2022 stood at –37.5% of GDP, whereas at the end of 2021 it came to –34.0% of GDP (Figure 8.5).

Projected developments

In line with the projected slight growth in the current and capital account surplus (in absolute terms), the financial account of the balance of payments is expected to see a somewhat greater net capital outflow in 2022 than in the year before. The estimated net capital outflow is due to a further decline in net foreign debt liabilities of domestic sectors, which might be accompanied by a net capital inflow from equity investments.

As for equity investments, net inflows are expected to be significantly smaller in 2022 than in the previous year. More specifically, despite the steady increase in the total profitability of banks and foreign-owned non-financial corporations, reinvested earnings might be much lower than last year due to larger dividend payments, particularly on the part of banks in foreign ownership, following a ban of almost two years. Also, direct equity investments might be considerably smaller than in 2021, as the relatively favourable performance last year was due to one-off effects of several large acquisitions in the domestic corporate sector by foreign investors.

At the same time, the projected fall in net debt liabilities, which might be much smaller in 2022 than in 2021, primarily reflects a noticeable improvement in the net debt position of banks and other domestic sectors. Also expected, though to a much lesser extent, is an improvement in the net external position of the central bank, that is, an increase in international reserves. Finally, the country's net external position, which worsened sharply last year amid higher pandemic-driven budget expenditures, might improve mildly in 2022.

Despite the expected growth in the gross external debt in an absolute amount, owing to a steep nominal GDP growth, the relative indicator might improve noticeably by the end of 2022 and reach 69.8% of GDP. The relative indicator of gross external debt would thus fall below its pre-crisis level at end-2019, when it stood at 72.4% of GDP. By contrast, net external debt might improve in both relative and absolute terms by the end of the year, where the value of foreign debt assets might for the first time exceed that of foreign liabilities, bringing the relative indicator of net external debt to the negative territory (–0.3% of GDP).

Net outflows of capital are expected to be much smaller in 2023 than in 2022. The net inflow of equity investments might grow due to larger reinvested earnings of banks and enterprises in foreign ownership, and the rise in the value of direct equity investments in Croatia. The improvement in the net debt position of domestic sectors is expected to lose much of its momentum. The relative indicators of gross and net external debt are expected to improve further thanks to their decrease in absolute terms and the rise in nominal GDP.

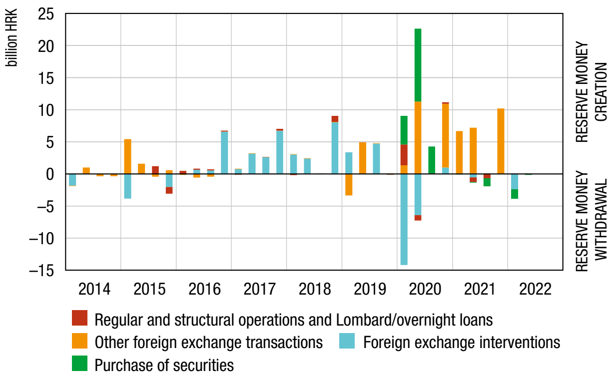
The large foreign liabilities accumulated earlier continue to expose Croatia's external position to risks, mostly those associated with the possible deterioration in financing conditions and a more pronounced worsening of the global investment climate. However, Croatia has significantly reduced its external imbalances in recent years, which, together with the entry to the euro area, largely mitigates these risks, particularly bearing in mind that a substantial surplus in the current and capital account is expected throughout the projection horizon.

9 Monetary policy

The first half of 2022 was marked by mounting inflationary pressures and expectations of a faster and sharper tightening of the monetary policies of many central banks, including those of the most developed economic areas. The expected reversal of monetary policies, backed by the first steps taken in that direction and announcements regarding future actions, spurred a substantial tightening of global financial conditions. In this context, the exchange rate of the kuna against the euro remained stable, while monetary system liquidity held steady at a very high level. Though the rise in geopolitical tensions spurred by the Russian aggression against Ukraine created some pressures in the foreign exchange market in March, their intensity was relatively limited as market expectations were further anchored by Croatia's participation in the exchange rate mechanism ERM II and the expected introduction of the euro. The CNB intervened in the foreign exchange market on three occasions in March, selling a total of EUR 385m worth of foreign exchange to the banks, with one intervention taking place outside of auction. As regards other foreign exchange transactions, the CNB continued to purchase foreign exchange from the Ministry of Finance, albeit at a much slower pace than in the first half of 2021. More specifically, from the beginning of the year to end-June, the CNB purchased only EUR 13.4m net from the MoF. If total foreign exchange transactions are observed, the CNB sold net EUR 371.6m in that period, withdrawing a total of HRK 2.8bn in reserve money (Figure 9.1).

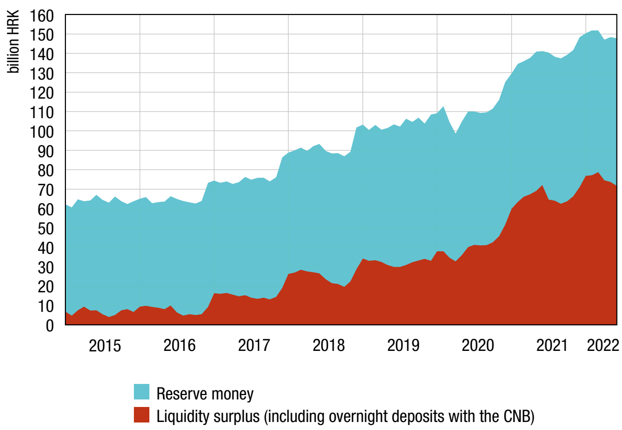
As regards kuna operations, the CNB continued to conduct regular weekly operations at a fixed rate of 0.05%, with banks showing interest in short-term kuna funds through this instrument in March, when the CNB placed a total of HRK 770m to them on three occasions. On the other hand, no structural operations were used to create additional kuna liquidity, and their stock dropped to HRK 3.0bn, down by HRK 60m from the end of the previous year due to early repayments. No purchases of government bonds took place in the first six months of 2022. However, certain bonds having fallen due, the stock of total subscribed bonds of the Republic of Croatia decreased by HRK 1.6bn from the end of 2021.

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 European Commission and foreign currency swaps with banks. The positive values refer to the purchase of foreign exchange.
Source: CNB.

Figure 9.2 Bank liquidity and reserve money



Source: CNB.

The average daily surplus kuna liquidity remained very high in the first half of 2022. Having reached a record high in March (HRK 78.7bn), it started to fall, coming to HRK 71.6bn in June (Figure 9.2). Banks' free reserves diminished, mostly as a result of the sale of foreign exchange to banks and the increase in government kuna deposits with the CNB. The average daily liquidity surplus drifted up from last December to this June, by HRK 0.5bn.

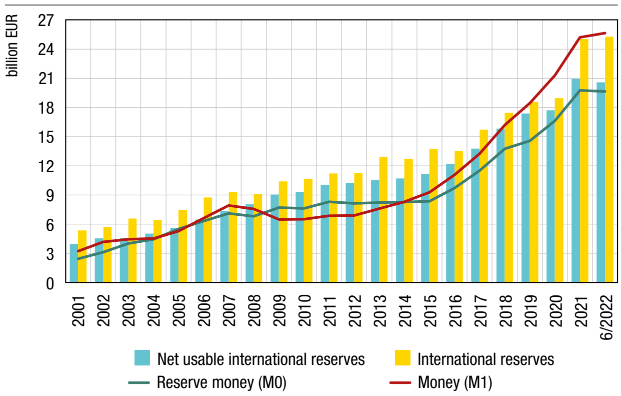
A higher level of repo agreements and rising government foreign exchange deposits with the CNB led to an increase in international reserves in the first six months of 2022. Gross international reserves were EUR 25.2bn at the end of June (Figure 9.3), up by EUR 0.2bn (0.9%) from the end of 2021. Net usable reserves decreased by EUR 0.4bn (1.7%) in the same period. Both gross and net reserves continued to be higher than reserve money (M0).

The kuna/euro exchange rate was stable in the first half of 2022 owing to foreign exchange interventions of the CNB. In the first quarter, the exchange rate came under strong depreciation pressures, stemming from unfavourable geopolitical events, but it started to appreciate in April, ahead of the summer tourist season, and continued to do so to the end of June, when it stood at EUR/HRK 7.53, up by 0.1% from the end of 2021. The exchange rate of the kuna against the euro rose by 0.5% from the end of June 2021 to the end of June 2022, while the average exchange rate from the beginning of January to end-June 2022 stood at EUR/HRK 7.54, down 0.1% from the average exchange rate in the same period of the previous year (Figure 9.3). Compared to the central rate[10], in the period from Croatia's entry to the European Exchange Rate Mechanism to the end of June 2022, the average exchange rate moved within a very narrow range of –1.0% to +0.7%. The exchange rate of the kuna against the US dollar and the Swiss franc was higher in mid-June than at the end of June 2021, reflecting the weakening of the euro against these two currencies on global financial markets.

Following a surge in 2021, monetary aggregates grew at somewhat lower, but still relatively high, rates in the first half of 2022. The annual growth rate in total liquid assets (M4) decelerated from 10.4% at the end of 2021 to 8.0% (transaction-based) at the end of May 2022 (Figure 9.5). The annual increase in net domestic assets (NDA) accelerated, while the rise in net foreign assets (NFA) decelerated in that period. The growth in NDA was mostly fuelled by the growth in placements to domestic sectors, followed by the rise in net claims on the central government, with foreign exchange deposits growing and kuna deposits falling.

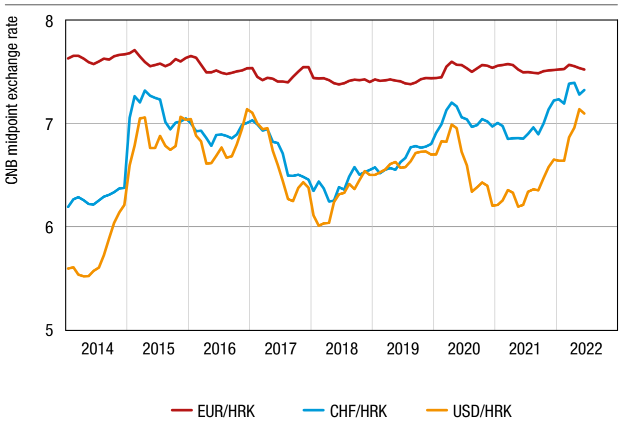
In the forthcoming period, monetary policy will be gradually adjusted to the instruments and orientation of the common monetary policy in the euro area, which will lead to a significant easing of monetary conditions. This will somewhat alleviate the expected impact of tighter global and European financing conditions on the domestic economy.

Figure 9.3 International reserves of the CNB and monetary aggregates



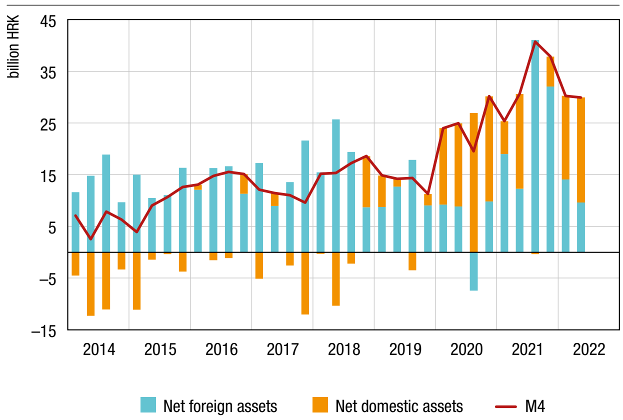
Notes: Net usable international reserves are defined as international reserves net of CNB foreign liabilities, reserve requirements in f/c, government foreign currency deposits and off-balance sheet liabilities (swaps). The most recent data available for M1 in 2022 refer to May.
Source: CNB.

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 2022 are up to May.
Source: CNB.

10 Croatia entered the Exchange Rate Mechanism in July 2020, 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

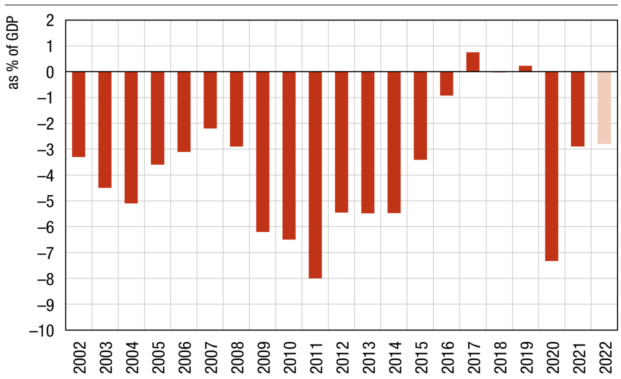
Public finance indicators improved sharply in 2021 on the back of the strong economic recovery. The rise in revenues and the drop in COVID-19 related support to the economy pushed the consolidated general budget deficit (ESA 2010) down to 2.9% of GDP, from 7.3% in 2020. Despite the ongoing very favourable trends in revenues, the Ministry of Finance expects only a minor decrease in the general government deficit this year, bearing in mind the fiscal support measures implemented to mitigate the negative effects of energy price growth and health care expenditures exceeding the previous estimate. The revised budget passed in May foresees a general budget deficit of 2.8% of GDP in 2022.

The decomposition of the change in the nominal general government balance into a structural and a cyclical component shows that, as mentioned earlier, the change in the nominal balance in 2021 was mostly positively affected by the cyclical component because of the strong economic rebound. The primary structural deficit was also reduced, partly due to lower expenditures for COVID-19-related support and lower investment activity, whereas expenditures on interest also decreased owing to improved conditions of refinancing of the capital market liabilities that had fallen due previously.

As regards the revenue side of the budget, total revenues (ESA 2010) grew by a high 11.8% in 2021, after shrinking by 6.4% in 2020. The revenue growth was boosted the most by revenues from indirect taxes, mirroring the rebound in personal and tourist consumption. Social contributions also gave an upward momentum to total revenues, which was attributable to the favourable labour market situation, as did other non-tax revenues, reflecting in part an increase in the use of EU funds.

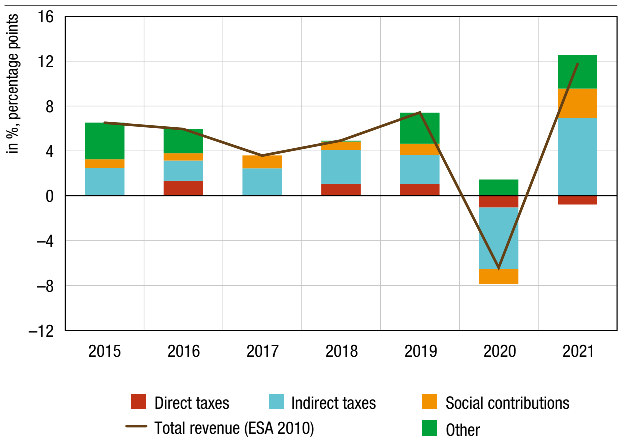
By contrast, revenues from direct taxes made a negative contribution to the movement of total revenues, reflecting the effect of tax changes in the profit and income tax system, which

Figure 10.1 General government deficit (ESA 2020)



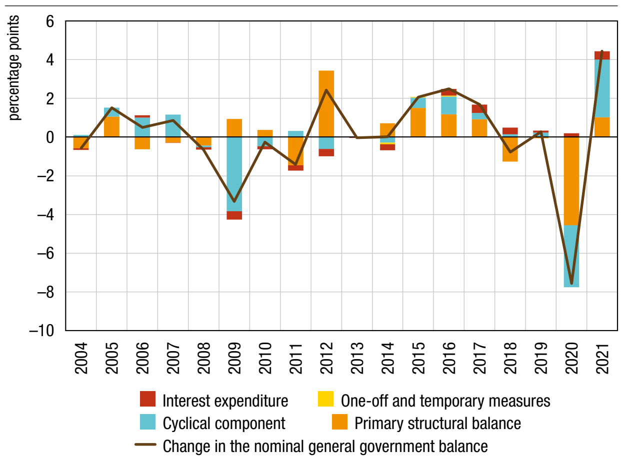
Sources: Eurostat and MoF.

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



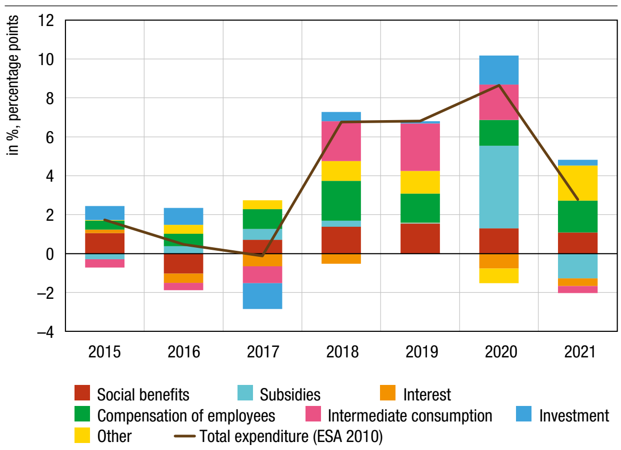
Source: Eurostat (CNB calculations).

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



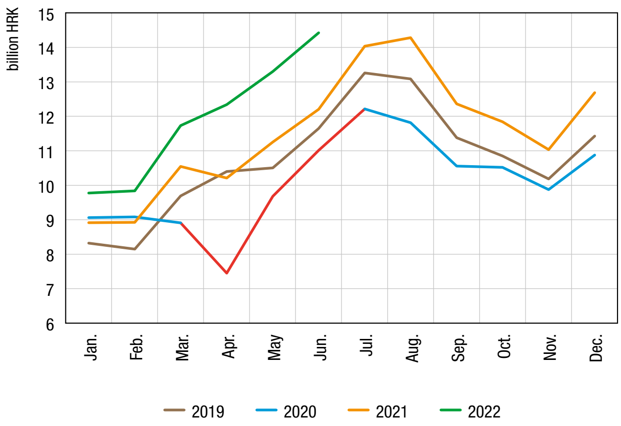
Source: CNB.

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



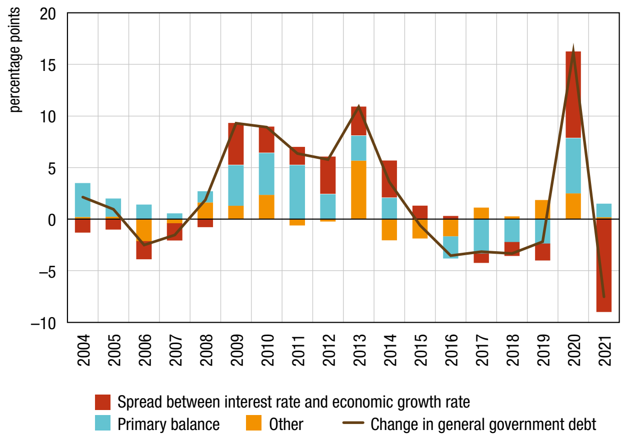
Source: Eurostat (CNB calculations).

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



Note: The red line denotes a period of restrictive epidemiological measures.
Sources: MoF and Tax Administration (CNB calculations).

Figure 10.6 Decomposition of the change in general government debt



Sources: Eurostat and MoF (CNB calculations).

had been applied since 1 January 2021, and the drop in profit tax revenues under annual statements for 2020 caused by the pandemic-induced crisis.

As regards the expenditure side of the budget (ESA 2020), total expenditures grew relatively mildly in 2021, by 2.8%, decelerating significantly from 8.7% in 2020. Expenditures on subsidies quite clearly declined on an annual level, due to the discontinuation of job preservation grants, with expenditures for investments following suit despite the notable increase in capital transfers from EU funds. By contrast, total expenditures were driven up mostly by expenditures for intermediate consumption, which is partly attributable to larger expenditures in the health sector. The rise in total expenditures was also fuelled by social benefits, as well as compensation of employees, with the latter reflecting the increase in the base for the calculation of wages of civil servants and government employees of 4%, effective as of 1 January 2021.

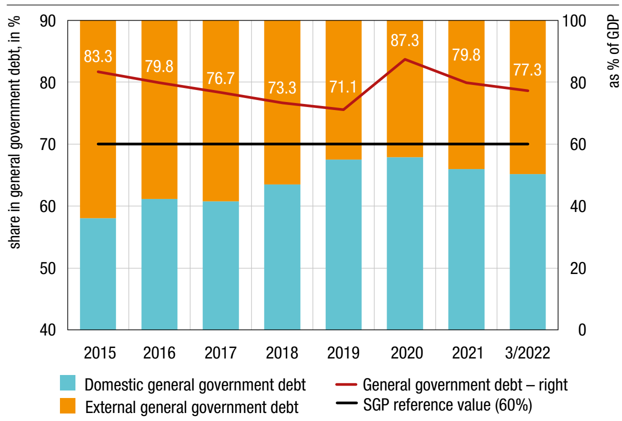
As regards available fiscal results in the current year, according to Ministry of Finance data[11], the central government budget deficit was HRK 2.4bn in the January to May 2022 period, down by HRK 4.1bn from the same period of the previous year. Favourable fiscal developments reflect the annual rise in revenues and a smaller contraction in expenditures. Data on the amount of fiscalised receipts (up to June) suggest that tax revenues continued to trend up on an annual basis. The amount of fiscalised receipts in trade (which generates approximately 70% of the total amount of such receipts) rose annually by 18.2% in May and June 2022, which may probably be attributed to the growth in consumption of residents and non-residents and the impact of price changes.

Public debt

On the back of the favourable trends in nominal GDP, the public debt-to-GDP ratio decreased from 87.3% at the end of 2020 to 79.8% at the end of 2021. Consolidated general government debt stood at HRK 342.5bn, or 77.3% of GDP at the end of March, some HRK 1bn less than at the end of 2021. Under the revised budget, the public debt-to-GDP ratio should continue to

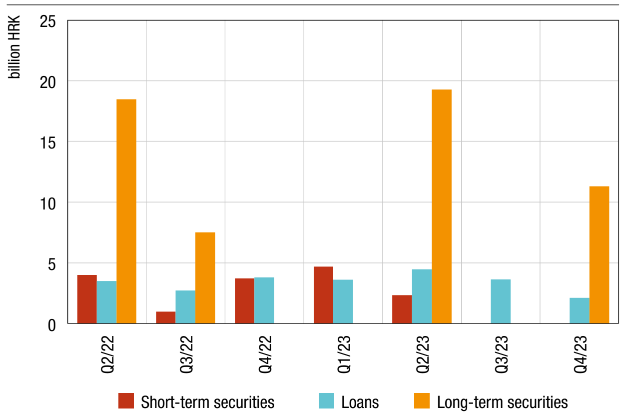
11 Monthly data for the central government, state government and social security sub-sectors, which are required, under Council Directive 2011/85/EU, to be published before the end of the following calendar month. The published data refer to general government units according to the scope of ESA 2010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

Figure 10.7 General government debt
end-period stock



Note: Nominal GDP calculated as the sum of GDP for the first quarter of 2022 and the last three quarters was used for the calculation of the relative indicator at the end of March 2022.
Source: CNB.

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 15 June 2022 and projection of the repayment of loans on the balance as at 31 March 2022.
Sources: MoF and CNB.

trend down in 2022, to 76.2% of GDP at the year-end.

As regards the issues of public debt instruments thus far in 2022, in early February the government issued a bond in the nominal amount of EUR 1bn in the domestic capital market, while in mid-April it issued a eurobond worth nominally EUR 1.25bn on the international capital market. The domestic bond falling due in 2030 has a yield to maturity of 1.39% and an annual interest rate of 1.25%. The funds raised were used to refinance maturing bonds (EUR 500m worth of bonds with a currency clause fell due on 5 February 2022 and HRK 3bn worth of bonds fell due on 7 February 2022). Furthermore, the eurobond issue falling due in 2032 has a yield to maturity of 2.98% and an annual coupon interest rate of 2.88%. The funds thus raised were used to refinance the matured eurobond worth nominally EUR 1.25bn.

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

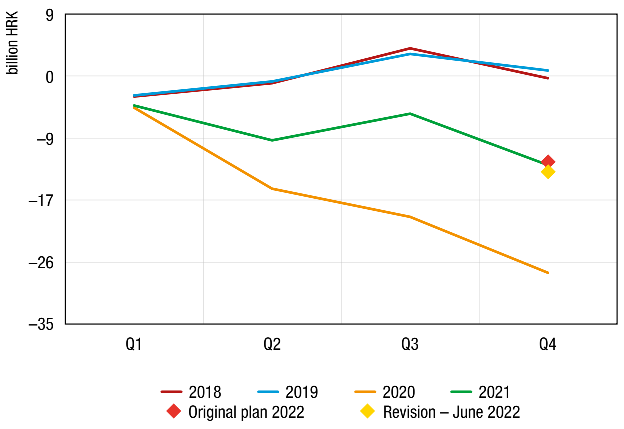
According to this year's Convergence Programme for Croatia, after the budget ran a deficit in 2021 (2.9% of GDP), the Government of the Republic of Croatia expects a budget deficit of 2.8% of GDP in 2022, after which the deficit could shrink further in 2023, to 1.6% of GDP.

As regards the year 2022, budget revenues are expected to grow on the back of the further increase in real economic activity and the effect of inflation on the increase in the nominal macroeconomic bases. Personal and tourist consumption should contribute usefully to the growth of revenues from indirect taxes, while measures to alleviate adverse inflationary effects, in force as of 1 April 2022, could produce the opposite effect.[12] Revenues from indirect taxes and social contributions should also increase, due to the recovery in the profit of enterprises and expected growth in employment and wages. A positive contribution is also expected from other revenues, which largely mirror the use of transfers from EU funds.

The rise in budget expenditures might accelerate markedly in relation to the previous year, largely due to the rise in prices and measures to alleviate the negative economic and social consequences of inflation. More specifically, social benefits are expected to rise sharply, largely as a result of the foreseen indexation of pensions and a one-off supplement to pensions aimed at mitigating the inflationary impact of energy price increases. Also expected is substantial growth in intermediate consumption and compensation of employees, reflecting the 4% increase in the wage base of civil servants and government employees as of 1 May 2022. Other current and capital transfers and investment expenditures might also go up as a result of an increased use of EU funds. By contrast, expenditures on subsidies might continue to trend down due to the drop in pandemic-related support to the economy.

In its spring forecasts, the European Commission estimated that the general government balance in Croatia might be more favourable (–2.3% of GDP) in 2022 and slightly more unfavourable (–1.8% of GDP) in 2023 than envisaged under the Convergence Programme of the Republic of Croatia.

Figure 10.9 General government cumulative balance (ESA 2010)



Note: The plan of the general government balance for 2022 is based on the revised 2022 State Budget.
Sources: Eurostat and MoF (CNB calculations).

12 The VAT rate on specific goods and services (some food products, and concerts, cultural and sport events) was cut to 5%. Also, a VAT rate of 13% applies to the delivery of natural gas and heating from heat stations, wood logs, pellets, briquettes and chipped wood and some cosmetic supplies. In addition, the VAT rate of 5% on gas supplies will be applied in the period from 1 April 2022 to 31 March 2023.

11 Deviations from the previous projection

The current estimates of global economic growth for 2022 are considerably less favourable than foreseen in the December 2021 projection. Thus, according to the most recent IMF projection, global economic growth in 2022 might be as much as 1.3 percentage points lower than in the previous projection cycle. The negative correction of the expected growth in the euro area is even more pronounced given the higher exposure to the unfavourable events concerning Ukraine and Russia. The prices of crude oil and other raw materials, as well as the estimated inflation in the euro area have significantly exceeded earlier projections. Against such a backdrop, the normalisation of monetary policies of major central banks sped up considerably more than expected under the previous projection.

Croatian real gross domestic product might grow by 5.5% in 2022, faster than expected in December 2021 when the annual growth rate was projected at 4.1%. The revision of the expected growth rate primarily reflects better expectations with regard to the contribution of net foreign demand to total economic growth. Total exports might thus increase by 11.3% as against the 8.1% previously projected. The upward revision reflects better expectations with regard to the exports of both goods and services. According to the available data, results of the tourist season in the first half of 2022 were notably better than the earlier projections, which was reflected positively in the exports of services. At the same time, performance in the exports of goods also exceeded the earlier expectations. As regards domestic demand, the expected personal consumption growth rate in 2022 was also corrected upwards to 5.3% (from 3.7%). The correction reflects better results generated in the first quarter this year than the previously projected values, with the expected increase in spending of savings accumulated during the pandemic. In addition, the growth in gross wages in the first quarter of 2022 was more pronounced than earlier expected, especially in the private sector, partly attributable to the rise in wages due to increasing inflationary pressures and labour shortages in certain segments of the economy. Government consumption might also increase at a somewhat faster pace than previously expected (3.3% from the previous 2.8%), with the correction reflecting considerably better performance in the first quarter of 2022. In contrast, gross fixed capital formation might grow slower than previously expected (6.4% rather than 7.8%). The downward correction stems from poorer results in the first quarter and the expected postponement of investments due to the rise in costs in the past year, as well as the anticipated continued increase in operating expenses due to the rise in the prices of energy and other key raw materials. Total imports might increase by 9.9% in 2022, more than projected in December, when growth was expected to be 7.8%. The sharper rise in goods and services reflects much better results in the first quarter of 2022, as well as more favourable expectations regarding total exports and personal consumption. To a certain extent, the correction was offset by somewhat less favourable expectations concerning the growth in investment activity. Since the upward correction of goods and services exports is more pronounced than the revision of total imports, net foreign demand could make a positive contribution to total economic growth in 2022 (0.6 percentage points), even though it was expected to be neutral under the December 2021 projection.

The consumer price inflation currently projected is not fully comparable to the December projection due to the changeover to the harmonised index of consumer prices as the main inflation indicator projected by the CNB. In view of relatively small differences between the national and the harmonised index of consumer prices in Croatia (for more details, see Box 2 Comparison of the national and harmonised index of consumer prices in Croatia), the annual rate of growth of both indices for the whole of 2022 is estimated to stand at 9.4%, up by 7.0 percentage points from the December inflation projection.

Table 11.1 Basic assumptions, deviations from the previous projection

	2022		
	Previous projection (12/2021)	Current projection	Deviation
GDP (real rate of change, in %)			
Rest of the world	4.9	3.6	–1.3
Euro area	4.3	2.8	–1.5
USA	5.2	3.7	–1.5
Developing countries and emerging market countries	5.1	3.8	–1.3
Central and Eastern European countries	3.6	–2.9	–6.4
Main trading partners of the Republic of Croatia	3.6	2.6	–1.0
Prices			
Euro area HICP[a]	3.2	6.8	3.6
Oil prices (USD/barrel)[b]	68.9	107.5	38.6
Key interest rates			
EURIBOR 3M (end of year)[c]	–0.47	0.17	0.6
ECB main refinancing rate[c]	0.00	0.45	0.5
US federal funds target rate[c]	0.40	2.70	2.3

[a] ECB, June 2022. [b] Bloomberg, Brent crude oil futures. [c] Bloomberg, rates at the end of the year.
Note: Weighted average economic growth of the major trading partners includes six countries accounting for 60% of Croatian exports of goods.
Source: IMF (WEO), April 2022.

Table 11.2 Domestic indicators, deviations from the previous projection

	2021			2022		
	Previous projection (12/2021)	Outturn	Deviation	Previous projection (12/2021)	Current projection	Deviation
National accounts (real rate of change, in %)						
GDP	10.8	10.2	–0.5	4.1	5.5	1.5
Personal consumption	9.4	10.1	0.7	3.7	5.3	1.7
Government consumption	1.0	3.1	2.1	2.8	3.3	0.5
Gross fixed capital formation	7.9	7.6	–0.3	7.8	6.4	–1.3
Exports of goods and services	31.1	33.3	2.2	8.1	11.3	3.2
Imports of goods and services	19.0	14.7	–4.3	7.8	9.9	2.2
Labour market						
Number of employed persons (average rate of change, in %)	2.2	2.2	0.0	1.5	2.6	1.1
Registered unemployment rate	8.2	8.0	–0.2	7.5	6.4	–1.1
ILO unemployment rate	6.8	7.6	0.8	6.2	6.1	–0.1
Prices						
Consumer price index (rate of change, in %)	2.4	2.7	0.3	2.4	9.4	7.0
External sector						
Current account balance (as % of GDP)	2.0	3.4	1.4	1.4	2.1	0.7
Current and capital account balance (as % of GDP)	4.6	5.8	1.2	5.0	5.2	0.1
Gross external debt (as % of GDP)	74.6	77.9	3.4	68.1	69.8	1.8
Monetary developments (rate of change, in %)						
Total liquid assets – M4	10.1	10.7	0.5	8.0	9.9	1.9
Total liquid assets – M4[a]	10.0	10.4	0.4	8.0	9.6	1.5
Placements (excl. central government)	2.8	3.0	0.2	3.3	7.4	4.1
Placements (excl. central government)[a]	3.4	3.9	0.5	3.4	7.4	4.1

[a] The national consumer price index, which is also taken into account in the outturn for the entire 2021, was forecast in the December 2021 projection. By contrast, the current projection for 2022 forecasts the harmonised index of consumer prices.
[b] 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.

Substantial upward revision of the projected consumer price inflation reflects noticeably better results at the end of last year and in the first five months of the current year than previously expected, as well as considerably higher assumptions regarding the expected movements in the prices of energy and other raw materials in the global market, amid elevated global inflationary pressures, which have been gradually spilling over to domestic developments. The revision of total inflation stems from higher estimated contribution from all the main components, especially energy. The estimated contribution of consumer prices excluding food and energy was also revised up to a somewhat lesser extent, due to improved expectations concerning the tourist season and a more intense rise in the prices of tourism-related services, among other things. Finally, the estimated growth of food prices has also been revised upwards, taking into account the impact of the Russian invasion of Ukraine and the fact that both countries are important global suppliers in the segment concerned.

The estimate of the current and capital account surplus in 2022 as a percentage of GDP was raised only slightly from the previous projection (by 0.1 percentage point), given that the marked increase in the projected balance in absolute terms was followed by considerably more favourable estimated nominal GDP movements. This correction is mostly the result of a significantly bigger estimate of the movements in tourism revenues, judging from the results generated so far in 2022 and the booking trends in the peak tourist season. On the other hand, due to heightened inflationary pressures and more prominent price shocks (especially of energy), goods exports and imports are expected to increase considerably. However, as a result of the perceptibly higher import base, the movements in the total deficit could be more unfavourable than previously anticipated. Moreover, the surplus in the primary income account might be considerably lower than foreseen in the previous projection, due to higher profitability of foreign-owned banks and enterprises, as well as higher interest expenditure for the foreign debt of domestic sectors. At the same time, the sum of the secondary income account balance and capital transactions edged down. As regards external debt, gross external debt is expected to exceed the December projection by the end of 2022, mainly due to less favourable projected movements in banks' foreign liabilities. Despite the higher gross debt level, the relative indicator of gross external debt was not significantly revised, thanks to a more favourable estimate of nominal GDP.

Having risen by 3.9% in 2021, total placements (government excluded) might accelerate to 7.4% (transaction-based) in 2022, more than twice as high as in the previous projection (3.4%). Such trends reflect the stronger lending to both corporates and households in the preceding part of the year. Corporate demand for loans is estimated to have increased owing to the sharper increase in the price of imported energy and raw materials, which increased the cost of their procurement, as well as corporate attempts to borrow on favourable terms and thus forestall the expected increase in borrowing costs. The growth in corporate lending could reach 13.6% by the end of the current year, up from 2.3% in 2021 (transaction-based), with expectations having been revised considerably upwards from the previously projected growth of 2.9% in 2022. Furthermore, the growth in household placements could accelerate to 5.0% (transaction-based), higher than the previous projection when a slowdown in lending to this sector (3.8%) was forecast. This correction of the estimated growth has been largely the result of increased placements to households over the past months and the record number of applications within the scope of the new round of housing loan subsidies that ended in April. As in the previous few years, growth might be largely achieved through housing lending, and to a lesser extent through demand for general-purpose cash loans.

The projected growth in total liquid assets (M4) in 2022 is somewhat higher than earlier expected (9.6% as opposed to the previously projected 8.0%, transaction-based), mostly due to the expected continuation of the sharp rise in foreign currency deposits.

12 Annex A: Macroeconomic projections of other institutions

Table 12.1 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	
	2022	2023	2022	2023	2022	2023	2022	2023	2022	2023	2022	2023	2022	2023
Croatian National Bank (July 2022)	**5.5**	**2.5**	**5.3**	**2.5**	**6.4**	**4.1**	**11.3**	**6.2**	**9.9**	**7.5**	**–**	**–**	**9.5**	**4.4**
Eastern Europe Consensus Forecasts (July 2022)	3.1	3.5	3.2	3.2	5.3	6.6	–	–	–	–	2.8	3.0	7.4	3.4
European Commission (May 2022)	3.4	3.0	2.4	3.6	6.5	8.2	8.4	5.5	8.1	8	–	–	6.1	2.8
European Bank for Reconstruction and Development (May 2022)	3.0	3.5	–	–	–	–	–	–	–	–	–	–	–	–
Raiffeisen bank[a] (April 2022)	3.5	3.7	3.1	3.8	6.1	7.5	15.7	12.6	22.4	9.6	1.9	3.0	6.3	2.4
International Monetary Fund (April 2022)	2.7	4.0	–	–	–	–	–	–	–	–	–	–	5.9	2.7
Ministry of Finance (April 2022)	3.0	4.4	1.4	3.2	5.8	6.1	6.9	6.0	6.1	6.9	–	–	7.8	3.7
World Bank (April 2022)	3.8	3.4	–	–	–	–	–	–	–	–	–	–	–	–

[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 the period from 2023 to 2025.

Sources: Publications of the respective institutions.

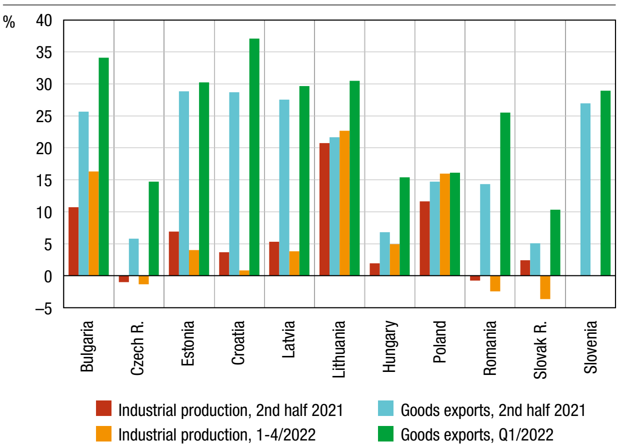
13 Annex B: Comparison of Croatia and selected countries

Table 13.1 Gross domestic product

	Year-on-year rate of change, original data			Quarter-on-quarter rate of change, seasonally adjusted data			
	2019	2020	2021	Q2/2021	Q3/2021	Q4/2021	Q1/2022
Bulgaria	4.0	–4.4	4.2	0.9	0.9	1.3	0.8
Czech R.	3.0	–5.8	3.3	1.4	1.7	0.8	0.9
Estonia	4.1	–3.0	8.3	2.3	0.9	1.3	0.1
Croatia	3.5	–8.1	10.2	1.5	1.3	1.0	2.7
Latvia	2.5	–3.8	4.5	2.4	0.5	–0.2	3.6
Lithuania	4.6	–0.1	5.0	1.2	0.7	1.3	1.0
Hungary	4.6	–4.5	7.1	2.4	1.1	2.2	2.1
Poland	4.7	–2.2	5.9	2.0	2.6	1.8	2.5
Romania	4.2	–3.7	5.9	3.3	–2.9	1.0	5.2
Slovak R.	2.6	–4.4	3.0	1.9	0.4	0.4	0.4
Slovenia	3.3	–4.2	8.1	1.9	1.3	5.3	0.8
Average[a]	**3.7**	**–4.0**	**6.0**	**1.9**	**0.8**	**1.5**	**1.8**

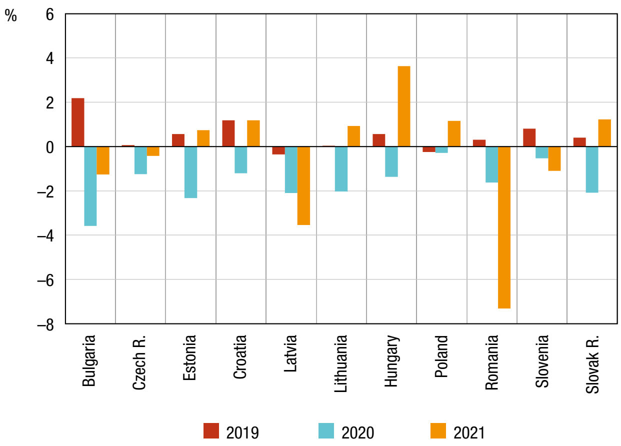
[a] Simple average.
Sources: Eurostat, EC, CBS and CNB.

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



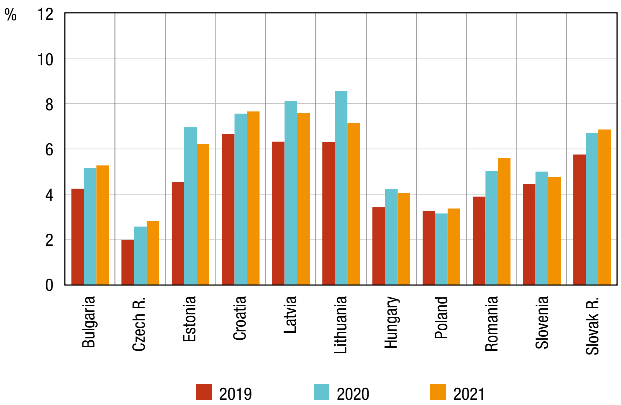
Sources: Eurostat and CBS.

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



Source: Eurostat.

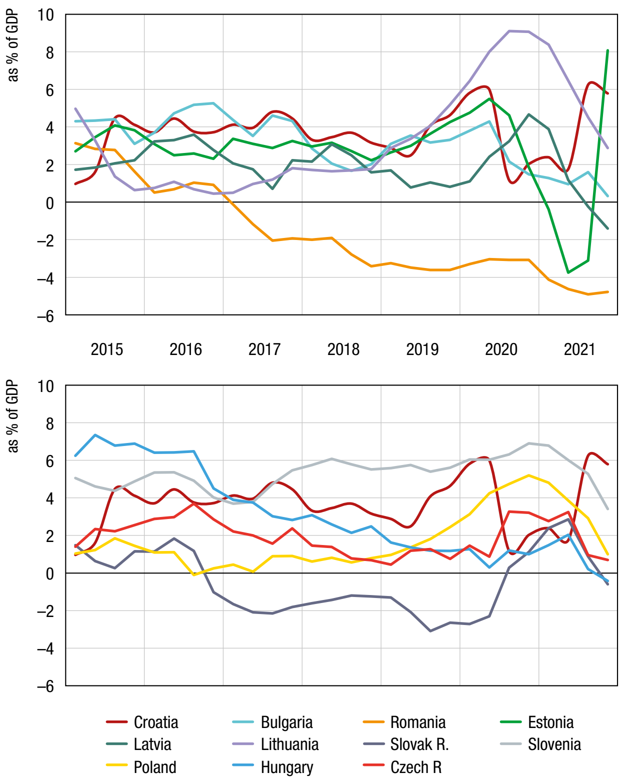
Figure 13.3 Labour Force Survey unemployment rate



Note: Data from the Labour Force Survey are given up to 2020 as data from the first quarter 2021 onwards are not comparable to previously published data due to changes in the methodology.
Source: Eurostat.

Figure 13.4 Current and capital account balance

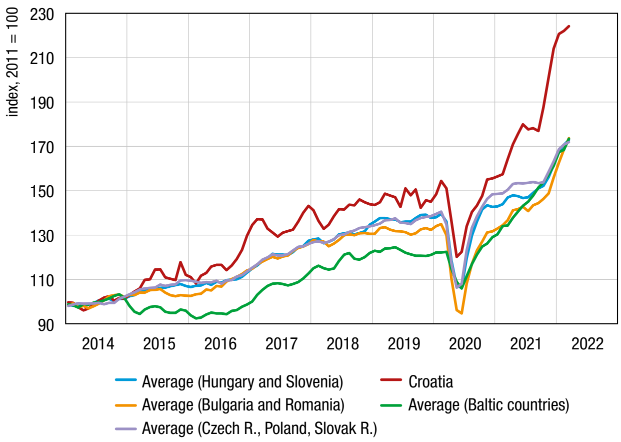
sum of the last four quarters



Sources: Eurostat and CNB.

Figure 13.5 Goods exports

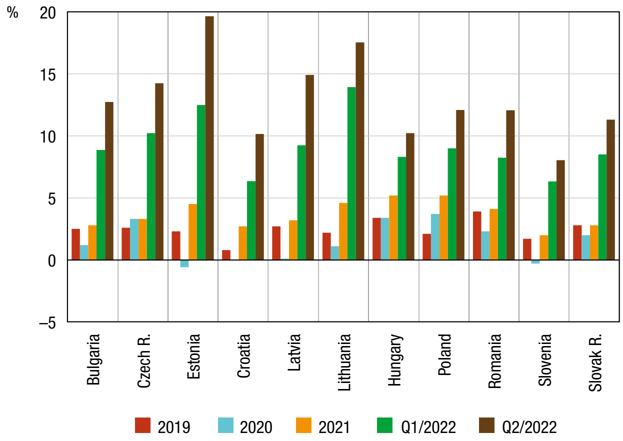
quarterly moving average, seasonally adjusted data



Sources: Eurostat and CNB.

Figure 13.6 Consumer price inflation

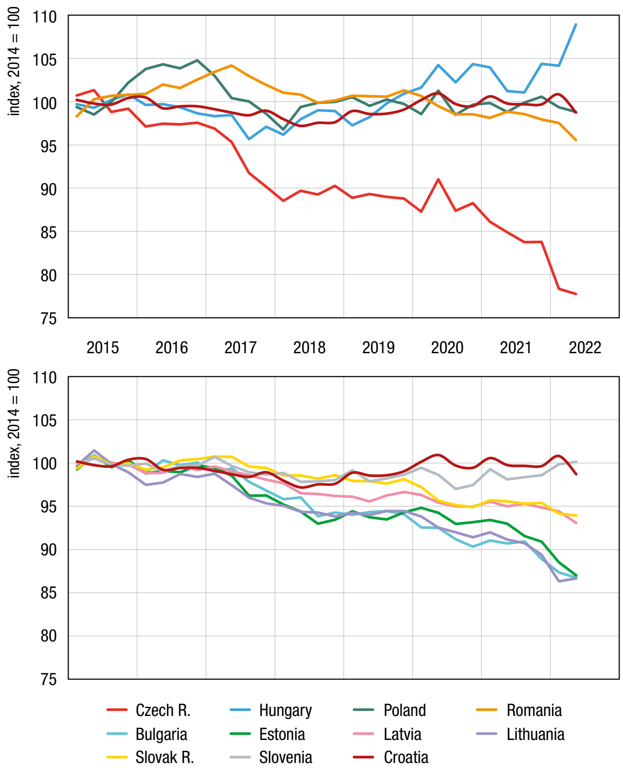
average year-on-year rate of change



Note: Data for the second quarter of 2022 refer to April and May.

Source: Eurostat.

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

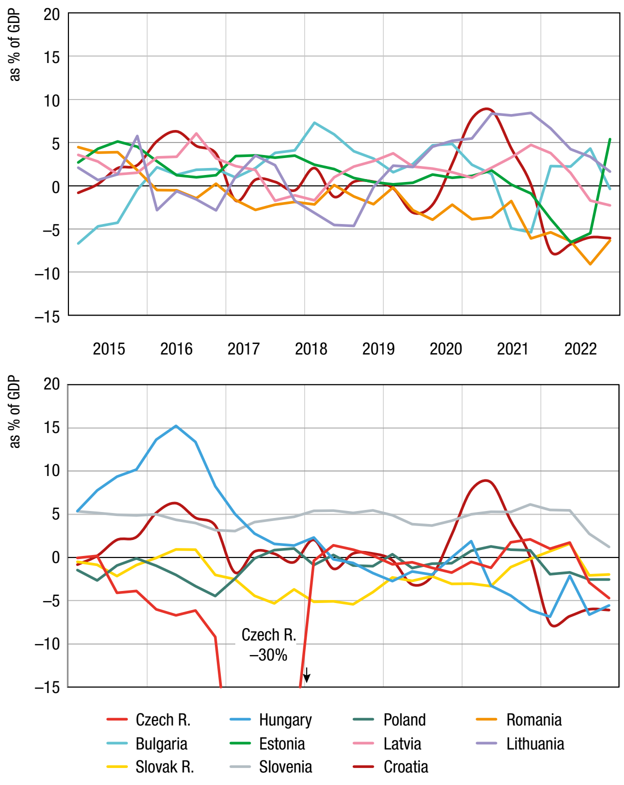


Notes: Data for 2022 refer to the January-May period. A fall in the index indicates a real effective appreciation.

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.

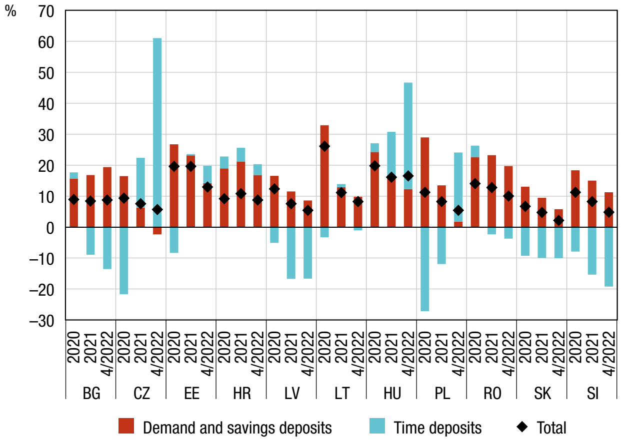
Figure 13.9 Bank loans to the private sector

contributions to the year-on-year rate of change, transaction-based

Sources: ECB and CNB.

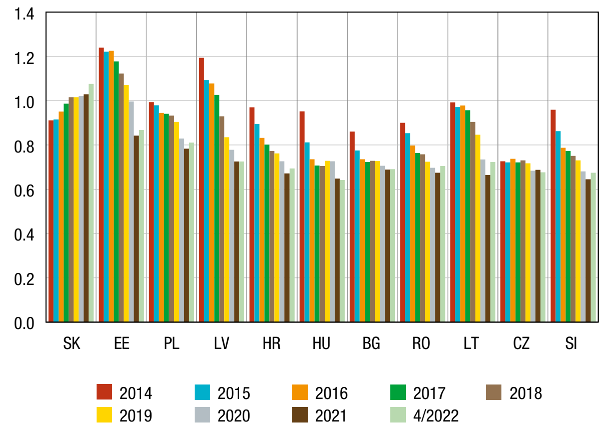
Figure 13.10 Private sector deposits

year-on-year rate of change, transaction-based



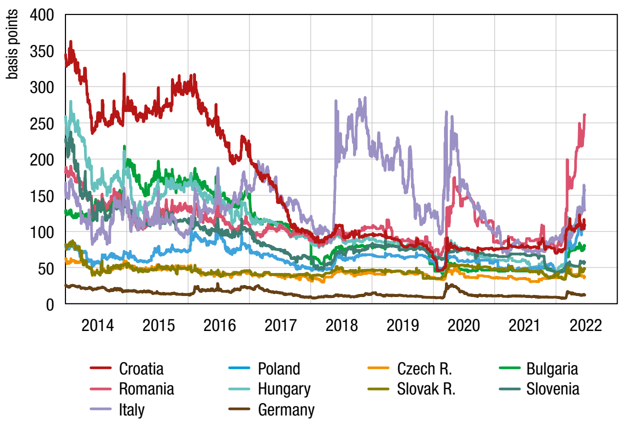
Sources: ECB and CNB.

Figure 13.11 Placement to deposit ratio of the private sector



Sources: ECB and CNB.

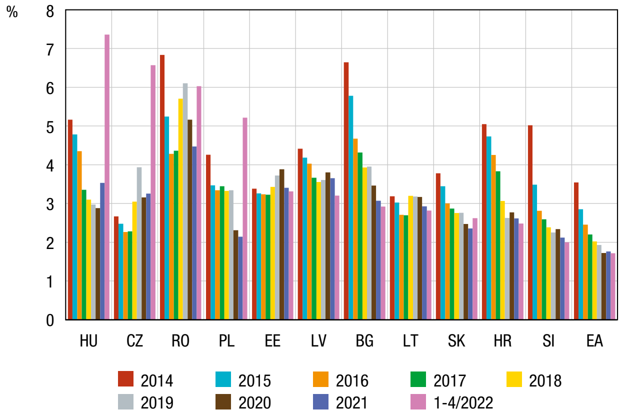
Figure 13.12 CDS spreads for 5-year government bonds of selected countries



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.

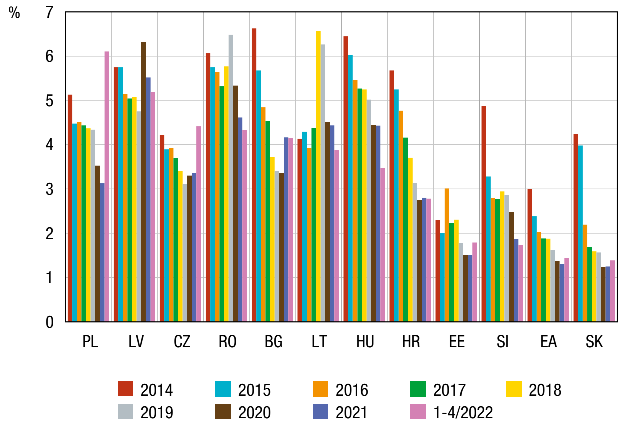
Source: S&P Capital IQ.

Figure 13.13 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.

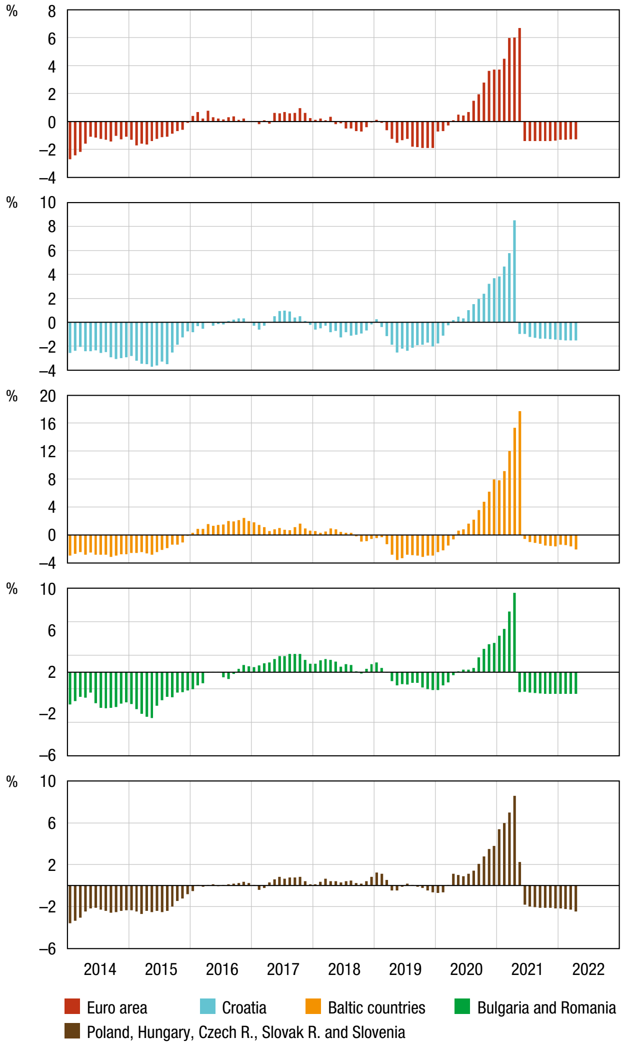
Figure 13.14 Interest rates on housing loans



Sources: ECB and NCBs.

Figure 13.16 Spread between expected and achieved real interest rate on corporate loans

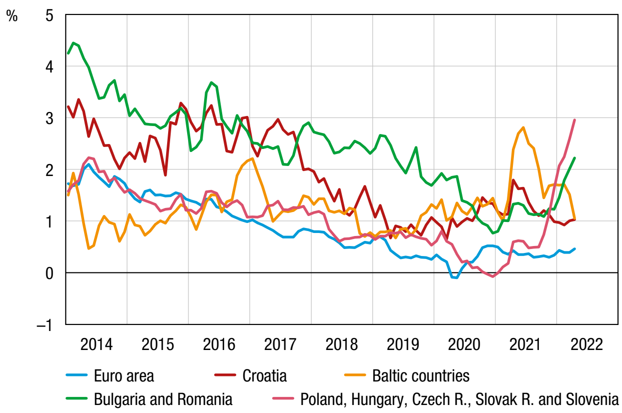
up to EUR 1m and with maturity up to 1 year



Notes: The expected real interest rate equals the nominal interest rate deflated by inflation projected for the next year from the Consensus Forecasts 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 13.15 Expected real interest rate on corporate loans

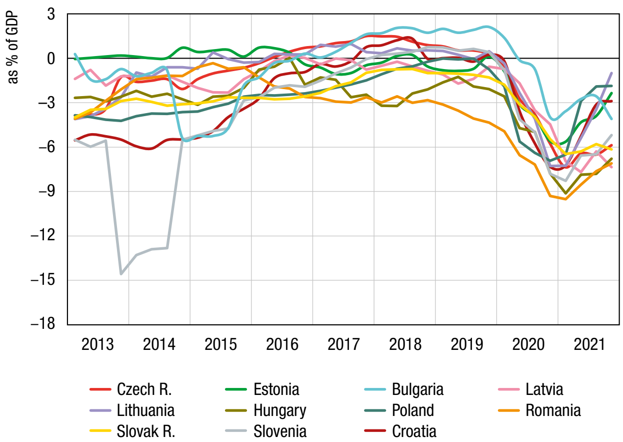
up to EUR 1m and with maturity up to 1 year



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.

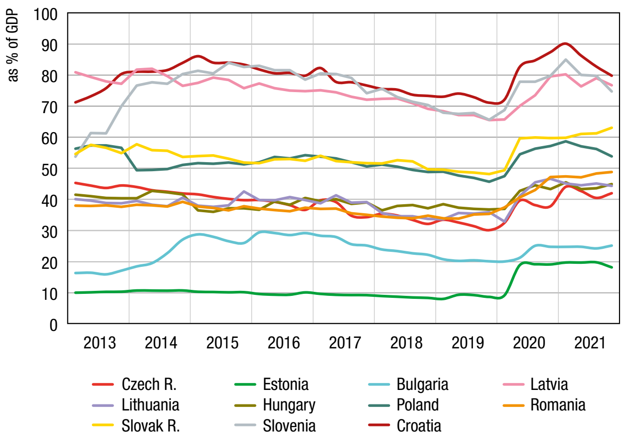
Figure 13.17 Consolidated general government balance

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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