HNB

Macroeconomic Developments and Outlook

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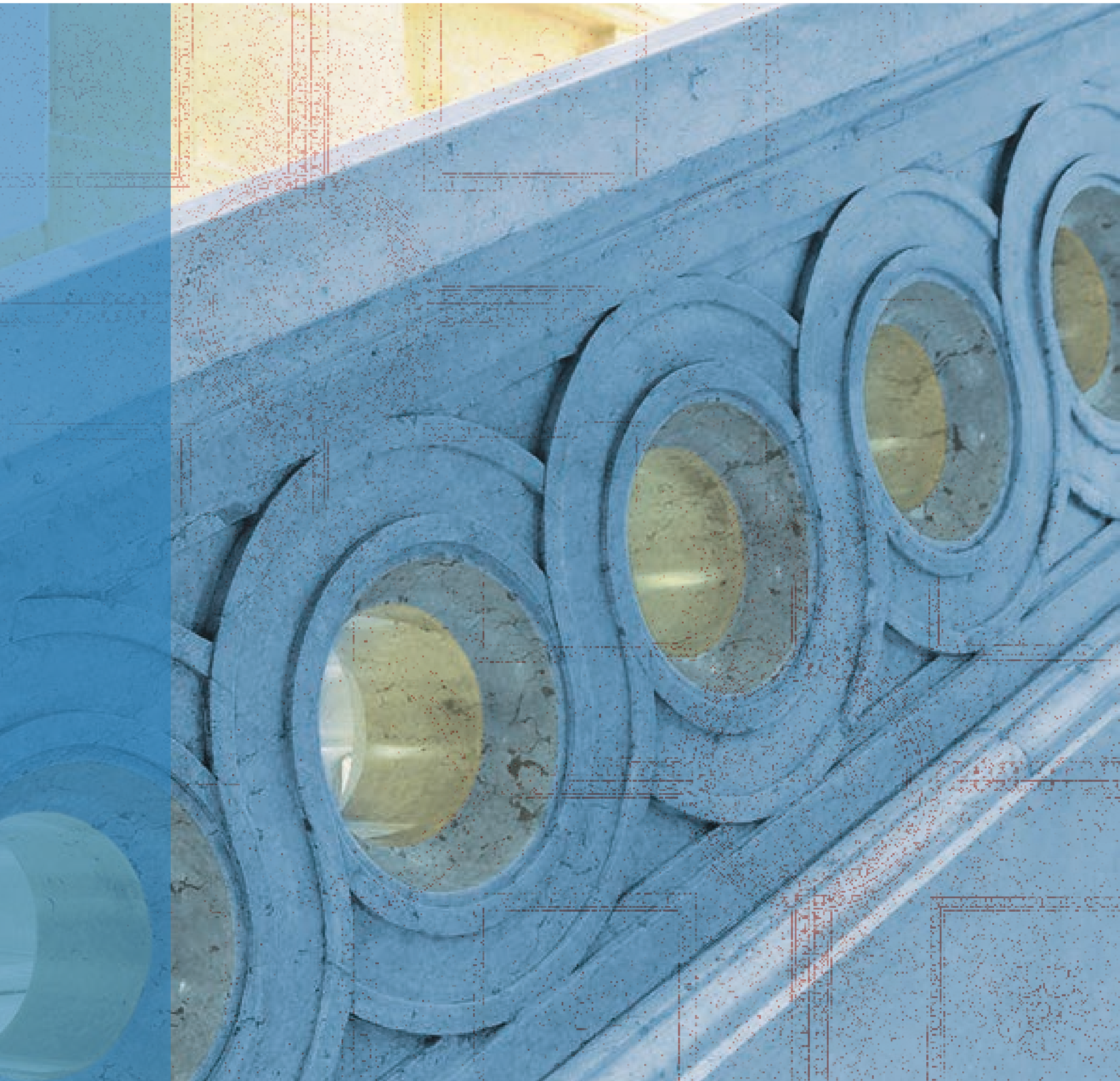

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Sadržaj

General information on Croatia

Economic indicators

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
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]	4.312	4.310	4.303	4.290	4.280	4.268	4.256	4.238	4.204	4.174	4.125
GDP (million HRK, current prices)[b]	322,464	347,750	331,367	329,143	333,457	330,825	331,785	331,570	339,616	351,349	365,643
GDP (million EUR, current prices)	43,956	48,144	45,148	45,173	44,854	44,008	43,808	43,456	44,630	46,664	49,013
GDP per capita (in EUR)	10,194	11,171	10,493	10,530	10,480	10,311	10,293	10,254	10,616	11,180	11,882
GDP – real year-on-year rate of growth (in %)	5.3	2.0	–7.3	–1.5	–0.3	–2.3	–0.5	–0.1	2.4	3.5	2.9
Average year-on-year CPI inflation rate	2.9	6.1	2.4	1.1	2.3	3.4	2.2	–0.2	–0.5	–1.1	1.1
Current account balance (million EUR)[c]	–3,138	–4,227	–2,299	–482	–313	–50	414	858	2,018	1,204	1,902
Current account balance (as % of GDP)	–7.1	–8.8	–5.1	–1.1	–0.7	–0.1	0.9	2.0	4.5	2.6	3.9
Exports of goods and services (as % of GDP)	39.0	38.5	34.5	37.6	40.4	41.6	42.8	45.3	48.1	48.8	51.2
Imports of goods and services (as % of GDP)	46.3	46.5	38.2	38.0	40.8	41.2	42.5	43.4	45.8	46.0	49.1
External debt (million EUR, end of year)[c]	33,721	40,590	45,600	46,908	46,397	45,297	45,803	46,416	45,384	41,668	40,069
External debt (as % of GDP)	76.7	84.3	101.0	103.8	103.4	102.9	104.6	106.8	101.7	89.3	81.8
External debt (as % of exports of goods and services)	196.6	219.1	292.7	275.8	256.0	247.3	244.1	235.9	211.4	182.9	159.8
External debt service (as % of exports of goods and services)[d]	40.1	33.8	52.9	49.5	40.9	43.3	41.0	44.1	42.5	34.4	32.0
Gross international reserves (million EUR, end of year)	9,307	9,121	10,376	10,660	11,195	11,236	12,908	12,688	13,707	13,514	15,706
Gross international reserves (in terms of months of imports of goods and services, end of year)	5.5	4.9	7.2	7.5	7.3	7.4	8.3	8.1	8.0	7.6	7.8
National currency: kuna (HRK)											
Exchange rate on 31 December (HRK : 1 EUR)	7.3251	7.3244	7.3062	7.3852	7.5304	7.5456	7.6376	7.6615	7.6350	7.5578	7.5136
Exchange rate on 31 December (HRK : 1 USD)	4.9855	5.1555	5.0893	5.5683	5.8199	5.7268	5.5490	6.3021	6.9918	7.1685	6.2697
Average exchange rate (HRK : 1 EUR)	7.3360	7.2232	7.3396	7.2862	7.4342	7.5173	7.5735	7.6300	7.6096	7.5294	7.4601
Average exchange rate (HRK : 1 USD)	5.3660	4.9344	5.2804	5.5000	5.3435	5.8509	5.7059	5.7493	6.8623	6.8037	6.6224
Consolidated general government net lending (+)/borrowing (–) (million HRK)[e]	–7,880.6	–9,604.6	–19,844	–21,257	–25,930	–17,267	–17,517	–17,033	–11,687	–3,275	2,754
Consolidated general government net lending (+)/borrowing (–) (as % of GDP)[e]	–2.4	–2.8	–6.0	–6.5	–7.8	–5.2	–5.3	–5.1	–3.4	–0.9	0.8
General government debt (as % of GDP)[e]	37.2	39.0	48.3	57.3	63.8	69.4	80.4	84.0	83.7	80.2	77.5
Unemployment rate (ILO, persons above 15 years of age)	9.9	8.5	9.2	11.6	13.7	15.9	17.3	17.3	16.2	13.1	11.2
Employment rate (ILO, persons above 15 years of age)	47.6	48.6	48.2	46.5	44.8	43.2	42.1	43.3	44.2	44.6	45.8

[a] The population estimate of the Republic of Croatia for 2000 is based on the 2001 Census and that for the 2001 – 2016 period on the 2011 Census. Data for 2017 are preliminary.
[b] The GDP data are presented according to the ESA 2010 methodology. Data for 2017 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 2018 and data on the gross external debt position as at the end of March 2018.
[d] Includes principal payments on bonds, long-term trade credits and long-term loans (excluding liabilities to affiliated enterprises), as well as total interest payments (including FISIM), without interest payments on direct investment.
[e] Fiscal data is shown according to the ESA 2010 methodology.
Sources: CBS, MoF and CNB.

Macroeconomic Developments and Outlook

1 Introduction

After the stagnation of real GDP in late 2017, economic activity grew slightly in the first three months of 2018 driven by domestic demand, in particular personal consumption. In line with favourable expectations regarding export demand in the rest of the year, and capital investment and personal consumption, the GDP growth rate might be 2.8% in 2018 and remain at the same level in 2019. Employment growth and unemployment decline are also expected to continue. Inflation is expected to accelerate to 1.7% in 2018, predominantly as a result of the bigger contribution of energy prices owing to the strengthening of imported inflationary pressures. Notwithstanding the resurgence of domestic inflationary pressures, inflation might slow down slightly in 2019 because of the expected smaller contribution of energy prices. The surplus in the current and capital account might decrease gradually in 2018 and 2019, due notably to the widening of the goods trade deficit, while the improvement in the relative indicators of external debt might continue. The monetary policy of the CNB remained expansionary and continued to support the economic recovery while working towards the maintenance of the stable kuna/euro exchange rate, which is a prerequisite for the preservation of financial stability. As regards fiscal developments, the general government budget deficit might be around –0.5% of GDP in 2018 and 2019 according to the Convergence Programme, while it might be much more favourable according to the projections of the European Commission.

Real GDP grew by 0.2% from the end of 2017 to the end of the first quarter 2018. Annual growth reached 2.5%, largely due to the rise in personal consumption, while other components of domestic demand also made a positive contribution. On the other hand, total exports were smaller than in the same period of the previous year owing to unfavourable current developments in goods trade and the strong base effect. Monthly data for April suggest that economic activity picked up in the second quarter of 2018, so that economic growth might come to 2.8% in 2018, or slightly less than in the year before. Foreign demand is expected to be the main driver of overall economic activity in 2018 as well, notwithstanding the projected deceleration in exports of goods and services. The rise in investment activity might intensify in the same period, due to the steady growth in capital investments of the private sector and the gradual increase in public sector investments. In addition, the upward trend in household

Table 1.1 Summary table of projected macroeconomic measures

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
National accounts (real rate of change, in %)										
GDP	–1.5	–0.3	–2.3	–0.5	–0.1	2.4	3.5	2.9	2.8	2.8
Personal consumption	–1.5	0.3	–3.0	–1.9	–1.6	1.0	3.4	3.6	3.6	3.1
Government consumption	–0.6	–0.4	–0.8	0.6	1.8	–1.0	0.7	2.7	2.5	1.7
Gross fixed capital formation	–15.2	–2.7	–3.3	1.4	–2.8	3.8	6.5	3.8	6.4	6.7
Exports of goods and services	6.2	2.2	–0.1	3.1	6.0	9.4	5.6	6.4	4.9	4.7
Imports of goods and services	–2.5	2.5	–3.0	3.1	3.1	9.2	6.2	8.1	7.1	6.0
Labour market										
Number of employed persons (average rate of change, in %)	–4.2	–1.1	–1.2	–1.5	–2.0	0.7	1.9	1.9	2.2	1.9
Registered unemployment rate	17.4	17.8	18.9	20.2	19.6	17.0	14.8	12.1	10.0	9.0
ILO unemployment rate	11.6	13.7	15.9	17.3	17.3	16.2	13.1	11.2	9.7	8.8
Prices										
Consumer price index (average rate of change, in %)	1.1	2.3	3.4	2.2	–0.2	–0.5	–1.1	1.1	1.7	1.6
Consumer price index (rate of change, end of period, in %)	1.8	2.1	4.7	0.3	–0.5	–0.6	0.2	1.2	1.8	1.4
External sector										
Current account balance (as % of GDP)	–1.1	–0.7	–0.1	0.9	2.0	4.5	2.6	3.9	2.3	1.8
Current and capital account balance (as % of GDP)	–0.9	–0.6	0.0	1.1	2.4	5.2	4.0	4.5	3.2	2.8
Gross external debt (as % of GDP)	103.8	103.4	102.9	104.6	106.8	101.7	89.3	81.8	75.8	69.4
Monetary developments (rate of change, in %)										
Total liquid assets – M4	1.9	5.6	3.6	4.0	3.2	5.2	4.7	2.1	5.3	5.2
Total liquid assets – M4[a]	0.7	4.6	3.9	3.6	2.4	5.0	5.3	3.1	5.3	5.4
Credit institution placements to the private sector	4.7	4.8	–5.9	–0.5	–1.6	–3.0	–3.7	–1.2	2.7	5.0
Credit institution placements to the private sector[b]	2.3	3.5	–1.2	1.0	–1.5	–2.2	1.1	2.9	4.6	5.0
Credit institution placements to corporates[b]	5.9	7.6	–1.5	2.2	–3.7	–2.9	3.2	2.5	4.3	4.3
Credit institution placements to households[b]	–1.4	–0.7	–1.1	–1.2	–0.7	–1.7	0.5	4.0	5.6	5.7

[a] Exchange rate effects excluded.
[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).
Note: The projections for 2018 and 2019 are derived from data available until 14 June 2018.
Sources: CBS, MoF and CNB.

consumption is projected to continue, largely driven by the increase in household disposable income supported by favourable developments in the labour market. The GDP growth rate might be the same in 2019 as in 2018, assuming a continued increase in capital investments and a slower growth in other components of GDP. As regards the labour market, employment and wages should grow steadily, while the unemployment rate might fall below 9% in 2019.

The annual consumer price inflation rate picked up in the first half of 2018, largely due to stronger imported inflationary pressures, i.e. higher prices of crude oil in the global market. The average annual inflation is projected to go up to 1.7% in 2018, mostly owing to the notable increase in the annual growth of energy prices. The average annual inflation might drop to 1.6% in 2019 owing to the expected slower annual increase in energy prices, in particular refined petroleum products. By contrast, the annual increase in food prices might accelerate in 2019, spurred by the expected mild growth in food product prices in the global market. The average annual growth in the consumer price index excluding food and energy might continue to pick up slightly amid the rising positive domestic output gap and the pass-through of previous increases in the prices of refined petroleum products, accompanied by the ongoing relatively strong growth in unit labour costs.

A further increase in personal consumption and larger capital investments coupled with slower foreign demand might gradually reduce the surplus in the current and capital account in 2018 and 2019. The main factor in the diminishing surplus is the widening of the foreign trade deficit, which is mitigated by positive trends in the international trade in services, spurred mostly by the steady increase in tourism revenues. As regards foreign capital flows, net outflows stemming from deleveraging by domestic sectors might weaken gradually, prompting a further improvement in the relative indicators of external debt, which, however, remain relatively high.

By pursuing an expansionary monetary policy, the CNB has continued to support the very high levels of liquidity in the monetary system and maintain the stable exchange rate of the kuna against the euro. The upsurge in kuna liquidity was spurred predominantly by reserve money creation through the purchase of foreign exchange from banks, which alleviated appreciation pressures on the domestic currency. In the conditions of high liquidity, there was no interest on the part of banks for short-term kuna funds offered at regular weekly reverse repo auctions. Against this background, interest rates on loans of domestic credit institutions mostly continued to fall. Favourable financing conditions, positive developments in business and consumer confidence and the ongoing economic recovery stimulated an increase in lending to domestic sectors, particularly households, which have recorded an increasingly faster annual growth in loans since October 2016.

As regards fiscal policy, the Convergence Programme of the Republic of Croatia suggests that the general government might run a deficit of about –0.5% of GDP in 2018 and 2019, following a surplus recorded in 2017. In May this year, the European Commission issued an assessment of the mid-term fiscal projections of the Republic of Croatia, establishing that the general government balance might be more favourable than projected by the government and that the structural balance would not exceed the mid-term budget objective in the projection period, while general government debt might continue to fall in line with the prescribed fiscal rules.

It is estimated that the risks to GDP projections in the projection period are balanced. On the one hand, exports of tourist services might grow more than currently expected. Also, the Croatian government announced further tax cuts as of the beginning of 2019, which might provide a boost to economic activity. On the other hand, the adverse impact of financial problems in the Agrokor Group on investment activity and personal consumption might be stronger than currently projected, although this risk is not as pronounced as in late 2017. The lingering weaknesses in the operation of other domestic companies that have not been restructured might have an unfavourable effect on aggregate export performance, which was poor in early 2018. Downside risks arise also from the external environment, mainly from the strengthening of American trade protectionism and political instabilities in Italy, which might result in a lower than expected growth of the Italian economy. Furthermore, the relatively poor use of capital transfers from EU funds in 2017 and early 2018 points to risks that project financing from EU funds might fall short of current projections, also implying a lower than expected increase in investment. Finally, potential further growth in the prices of refined petroleum products might have a negative effect on overall economic activity in Croatia.

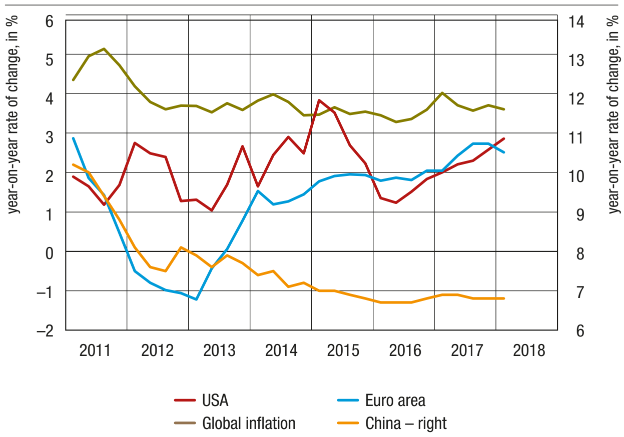
2 Global developments

Late 2017 and early 2018 saw relatively favourable global economic developments. The acceleration of growth was widespread, in particular among developed countries, accompanied by an additional pick-up in global trade. Despite growing energy prices and intensified economic activity, global inflation remained subdued. Accommodative monetary policies, still prevailing in the majority of large economies, continued to provide for favourable financing conditions.

Among developed countries, the USA recently recorded particularly good economic results, with the annual rate of growth reaching 2.9% in the first quarter of 2018, the fastest rate of growth in the last two years. The growth was primarily driven by personal consumption supported by historically low unemployment and a very positive consumer sentiment. Growth acceleration is also reflected in the developments seen in the investment activity of the private sector and in the exports of goods and services that continued to trend up in spite of uncertainties associated with the domestic economic and foreign trade policy. Against such backdrop, the inflation in the USA is moving up steadily; in May 2018, it reached 2.8%, supporting further monetary policy tightening.

Solid growth in the first quarter of 2018 continued in the euro area (2.5%) as well, although a slight slowdown is noticeable from the dynamic second half of 2017, seemingly continuing into the beginning of the second quarter as well. Slower growth in the euro area was widespread among member states, including Germany, France and the Netherlands. However, observed from a several-year perspective, economic activity is still relatively strong. In addition to private sector investments, economic growth was spurred by personal consumption driven by favourable developments in the labour market and the exports of goods and services due to strong global demand.

Figure 2.1 Economic growth in selected markets and global inflation



Sources: Eurostat, BEA, NBS and IMF.

In developing and emerging market economies, the beginning of 2018 saw the continuation of favourable developments, particularly in large Asian markets (notably China and India) and European markets (Turkey). Russia also continued to recover, benefiting, like other oil-exporting countries, from the steady rise in crude oil prices that started in mid-2017. On the other hand, the long-lasting crisis in some regions, notably in Latin America and the Middle East, was further exacerbated.

Croatia's main trading partners

Most of Croatia's major trading partners saw continued strong economic activity in early 2018. This particularly held true for trading partners from the euro area, primarily Slovenia, Austria and Italy, which continued to record high growth rates, although somewhat lower than at the end of 2017. Growth continued to be supported by personal consumption owing to increased disposable income. Growth in investments and exports was also noticeable. Although growth began to slow down in Germany after peaking at end-2017, economic activity remained strong there as well thanks to increased personal consumption and exports. Trading partners in the SE region, particularly Serbia and Bosnia and Herzegovina, are witnessing accelerated growth again following weaker performance in 2017 caused by adverse weather conditions.

Prices, exchange rates and financing conditions

The increase in world oil prices seen in the second half of 2017 continued into the first half of 2018. The average price of a barrel of Brent crude oil stood at USD 77 in May, up by 19% from December and 51% from May 2017. This was mainly due to the adjustment of the supply from the OPEC and other producers to the agreed production curb, exacerbated geopolitical tensions in the Middle East, reduced stockpiles in the USA and the drop in oil production in Venezuela caused by the political and economic crisis in the country. The decision of the USA to reimpose economic sanctions on Iran also contributed to the oil price hike.

Prices of raw materials excluding energy also grew in the first half of 2018. Prices of food products (cereals, oil and oil seeds) increased the most, which may primarily be attributed to strong demand and somewhat reduced production. Prices of industrial raw materials climbed as well, particularly those of agricultural raw materials such as cotton, on account of expectations of reduced supply from India. Metal prices increased too, partly due to the fact that the USA decided to impose sanctions on Russia's largest aluminium producer in April.

The divergent trends in the monetary policies of the US and the euro area continued. The Fed raised its benchmark interest rate by a total of 50 basis points in March and June, while the ECB's benchmark interest rate remained unchanged, although the ECB confirmed expectations of a gradual wind-down of its bond purchase programme by the end of the year.

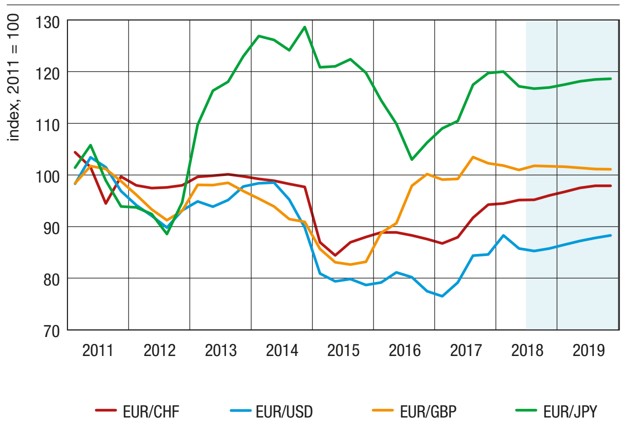
In the global foreign exchange market, the US dollar continued to weaken against the euro in early 2018, after depreciating in the second half of 2017. At the beginning of February, the exchange rate stood at EUR/USD 1.25, the highest level since December 2014. This was, for the most part, driven by the positive economic performance in the euro area and expectations there would be no further strengthening of the ECB's expansionary monetary policy. The US dollar/euro exchange rate remained relatively stable until mid-April, after which it appreciated and dropped to EUR/USD 1.15 at end-May. This was a result of good economic performance in the US and weaker than expected economic indicators in the euro area, as well as political events in Italy. At the same time, the Swiss franc weakened against the euro amid negative short-term interest rates and low long-term yields. In mid-May, the exchange rate stood at EUR/CHF 1.20, the highest level since January 2015. As a result of the growing risk aversion that ensued, the Swiss franc strengthened against the euro noticeably, lowering the exchange rate to EUR/CHF 1.15 at the month's end.

Financing conditions for European emerging markets, Croatia included, remained relatively favourable. However, the EMBI index began to rise again in mid-February, increasing by about 60 basis points by the beginning of June. This may primarily be attributed to political instability in certain countries, particularly Turkey.

Projected developments

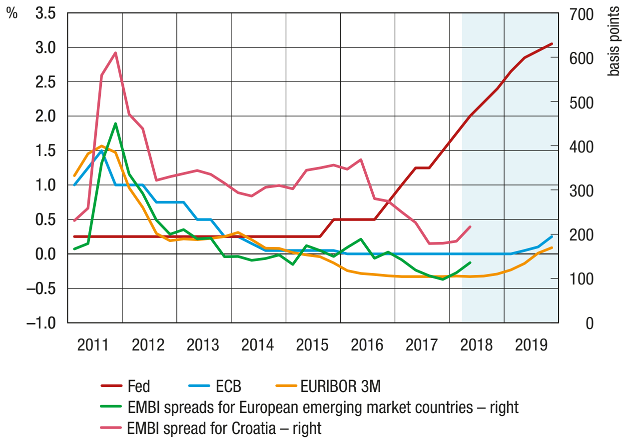
The projection is based on the assumptions of favourable outlooks for the growth of the global economy and trade, a moderate strengthening of the euro against major global currencies, the further increase of the US benchmark interest rate and the delayed increase of key euro area interest rates. Furthermore, bearing in mind the recent indicators, prices of raw materials, especially crude oil, are expected to remain at high levels.

Figure 2.2 Exchange rates of individual currencies against the euro



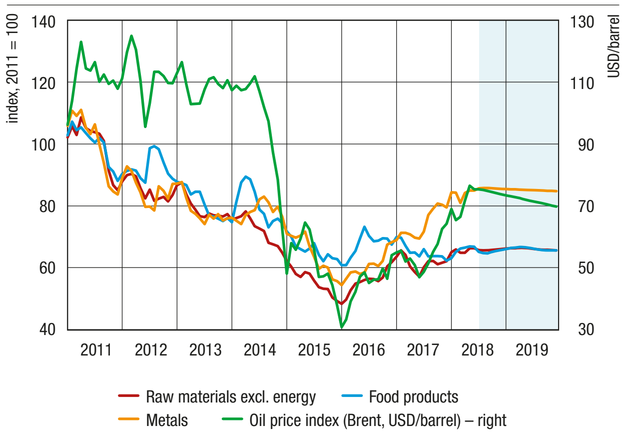
Note: A growth in the index indicates a depreciation of a currency against the euro.
Sources: Eurostat and Foreign Exchange Consensus Forecasts (June 2018).

Figure 2.3 Benchmark interest rates and the average yield spread on bonds of European emerging market countries
end of period



Source: Bloomberg (forecast), 5 June 2018.

Figure 2.4 Prices of raw materials on the international market



Sources: HWWI, IMF (April 2018), prices of oil: Bloomberg (Brent crude oil futures, 30 May 2018) and CNB estimates.

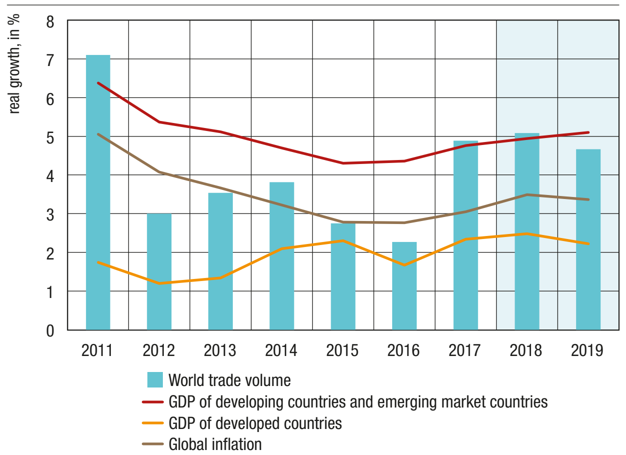
In the global foreign exchange market, the US dollar could weaken considerably against the euro in 2018 compared with 2017, as forecast by the Foreign Exchange Consensus Forecast in June 2018. The average dollar/euro exchange rate might stand at EUR/USD 1.20 in 2018. The exchange rate of the Swiss franc against the euro might also be considerably weaker in 2018 than in 2017, and might stand at EUR/CHF 1.17.

As regards benchmark interest rates, the second half of 2018 is expected to see a further tightening of the Fed's monetary policy, backed by recent favourable economic developments and rising inflation. The current year could see the benchmark interest rate raised four times in total (by one percentage point), while from 2019 onwards, it is expected to increase three more times. Despite a slight slowdown of activity in the euro area in recent months, the ECB announced that it would wind down the bond purchase programme by the end of the year. The volume of monthly purchase will first be tapered to EUR 15bn as of September. The first increase of ECB benchmark rates is not expected before the second quarter of 2019, and could be less sharp than expected.

As for the prices of raw materials in the global market, recent market expectations point to a slight downward trend in the prices of crude oil by the end 2018 and in 2019. This could primarily be driven by an increase in the production of crude oil in the USA. On the other hand, a possible decrease in oil supply due to growing geopolitical tensions, disruptions in the supply of oil from Iran and Venezuela and a possible extension of the oil output cut agreed by OPEC countries and other producers could put upward pressure on oil prices. Market expectations regarding the prices of raw materials excluding energy do not point to any significant change in prices in the remaining part of the current year and in 2019. Ample stocks of food raw materials such as wheat could have a limiting effect on a possible rise in prices. However, growing global demand and, observed in the short term, increasing trade protectionism could push the prices of raw materials excluding energy upwards.

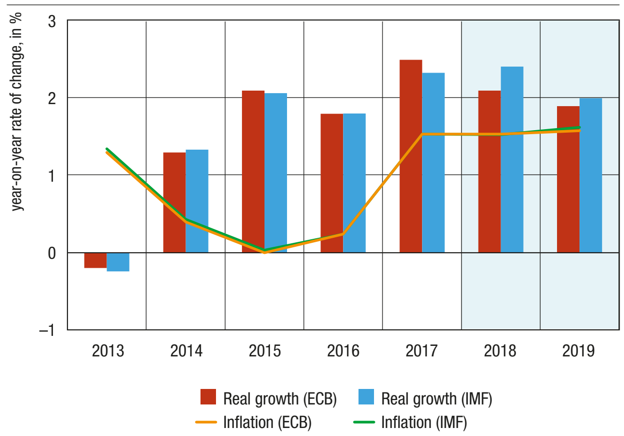
IMF projections regarding global economic activity (WEO, April 2018) suggest that global economic growth could pick up to 3.9% in 2018 and 2019, reaching the highest rate recorded since 2011. With increasing global demand, global trade could intensify further despite growing protectionism. The recent acceleration of global economic activity is primarily driven by developed countries, although their growth is expected to slow

Figure 2.5 Global economic developments



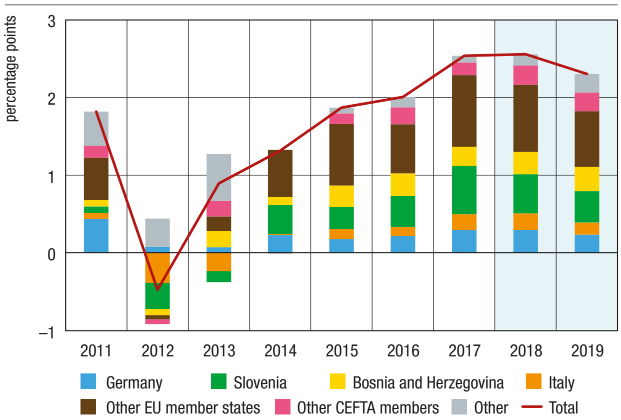
Source: IMF (WEO, April 2018).

Figure 2.6 Economic growth and inflation in the euro area



Sources: IMF (WEO, April 2018) and ECB (June 2018).

Figure 2.7 Foreign demand
contributions of Croatia's trading partners



Note: Foreign demand is calculated as the weighted average of real GDP growth of Croatia's trading partners, with their shares in Croatia's exports of goods used as weights.
Source: IMF (WEO, April 2018).

down gradually. The rate of growth in emerging market economies is twice as high, on average, as that of developed countries, and is expected to gain pace further in the upcoming period, with dynamic Asian markets at the forefront. Although monetary policy is expected to tighten further in certain large developed markets, global financing conditions will remain relatively favourable over the projection period, and inflation is not expected to increase significantly.

Despite the slowdown seen in the first quarter, the IMF estimates that the growth in the euro area in 2018 could pick up at the annual level, reaching 2.4%, and then slow down slightly to 2.0%. The growth will continue to be driven mostly by domestic demand, primarily personal consumption supported by favourable labour market developments and private sector investments encouraged by favourable financing conditions. Foreign demand will continue to positively contribute to growth owing to a continuous increase in global demand. However, 2019 could see a gradual slowdown as the current positive effects of accommodative monetary policy begin to wane. In addition, there are structural impediments to strong economic growth in many member states. The most recent ECB projections from June, which take into account the weaker performance seen at the beginning of the second quarter as well as growing political uncertainties, are somewhat less favourable than those of the IMF, forecasting a growth rate of 2.1% and 1.9% in 2018 and 2019 respectively. Owing to the recent hike in oil prices, inflation in the euro area could grow moderately; nevertheless, due to low inflationary expectations it will remain below the ECB target during the projection period (according to the latest ECB projections, inflation of 1.7% is expected in 2018 and 2019).

Economic growth in the USA could reach 2.9% by the end of 2018 and see but a minor slowdown in 2019 (2.7%). The growth of the US economy expected in 2018 derives from the positive short-term effects of the tax reform which could trigger a surge in private sector investments (for more information on the effects of the tax reform on the US economic activity, see Box 1 Tax reform in the USA and its potential macroeconomic effects). The strong growth will further be supported by personal consumption against the backdrop of almost full employment and increasing disposable income. Foreign demand will also encourage growth despite uncertainties regarding foreign trade policy. A gradual slowdown could ensue in 2019 due to the waning effects of the tax reform, considering that some measures are temporary in character, but also due to further monetary policy tightening.

Bearing in mind that global trade is expected to remain relatively dynamic over the projection period despite increasing protectionism, the growth of demand for Croatian export products could remain strong as well, although it is expected to subside gradually towards the end of the projection period (Figure 2.7). Among Croatia's major trading partners, strong demand in the current year is expected to originate from the euro area members currently recording the fastest long-term rates of growth. The rate of growth could exceed 4% in Slovenia in 2018, while Italy, Austria and Germany are expected to maintain favourable growth dynamics throughout the year. Still, it is reasonable to expect that the dynamics of their growth will slow down towards the end of the projection period. On the other hand, this does not hold true for certain countries of the South East region that have only begun to recover from adverse weather conditions that damaged their economies in 2017.

The positive outlook on global growth is exposed to significant risks that are balanced in the short-term, but predominantly negative in the medium term. In the short term, strong cyclical recovery, particularly that in the USA, driven by the tax reform, could provide additional stimulus to global economy. However, the strengthening of protectionist trade policies remains the most significant negative risk for the global economy in the medium term. Foreign trade relations between large markets deteriorated over the past several months, particularly after the US, in contrast to earlier expectations, expanded the application of tariffs on the import of iron and steel to include EU countries as well as Canada and Mexico early in June 2018. In response, duties have been announced on imports from the US, mainly on traditional American products. Although the direct effects of such measures on global trade might remain limited for now, the mere speculation over a possible escalation of global trade war fuels uncertainty and puts the global economy in danger. In addition to reducing potential growth, restrictions on free trade could result in accelerated global inflation, which could trigger a faster normalisation of monetary policies and result in deteriorated financing conditions, particularly affecting emerging market economies and highly indebted countries.

In the context of the European Union, uncertainties regarding Brexit and increasing political instability in Italy should be added to risks mentioned above. As regards Brexit, short-term uncertainty was reduced after a 21-month transition period was agreed in March 2018. The period will ensue after the United Kingdom officially leaves the European Union on 29 March 2019. However, there are still many uncertainties as to the political and trade relations to be established after the transition period expires. Italy is witnessing increasing political instability following the elections held in March. Since it is individually the largest Croatian trading partner and one of the most significant foreign investors, any longer period of instability in the country could be a significant source of risk for the Croatian economy as well.

Box 1 Tax reform in the USA and its potential macroeconomic effects

In early 2018, a new tax law entered into force in the United States of America, introducing numerous tax reliefs for US citizens and enterprises. The comprehensive tax reform was envisaged to continue and support the US expansionary fiscal policy. In the short term, the reform is expected to have positive effects on the growth of the US economy; however, in the medium term, it may fail to produce positive macroeconomic effects due to the expected deterioration of public finance conditions and the planned gradual abolition of certain stimulative measures. Although the US tax reform is not expected to have any significant direct effects on the economy of Croatia, it could affect Croatia indirectly through spillover effects deriving from its impact on the economic activity of EU member states. However, such effects are difficult to assess.

At the end of 2017, the United States Senate adopted significant amendments to the tax system with the aim of reducing the tax burden, primarily that of enterprises, and simplifying the tax system. The most substantial changes include: (a) the reduction of the standard corporate tax rate from 35% to 21%, allowing the deduction of new investments from the corporate tax base in the following five years; (b) the reduction of individual income tax rates for almost all income groups, as well as an increase in standard deductions and child tax credits; and (c) the transition to the so-called (modified) territorial tax regime, which includes the abolition of tax on the repatriation of profit generated abroad by foreign subsidiaries of domestic enterprises with a one-off tax paid on previously accumulated profit at a lower rate.

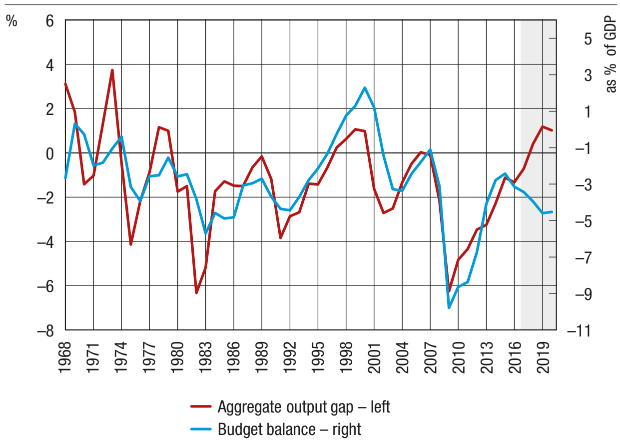
Most available assessments made by various institutions agree that in the short term, the reforms are likely to have considerable positive effects on the US economy. GDP level is expected to grow by 0.5% – 1.3% (Table 1) over a period of three years. The growth would primarily reflect the expected increase in personal consumption attributable to the rise in the disposable income of households brought about by individual income tax reductions, as well as the increase in investments owing to the tax disburdening of enterprises. The rise in investments should lead to an increase in labour productivity, which could ultimately result in an additional rise in wages, and, consequently, in disposable income[1].

In the long term, the reform may fail to produce positive effects on the level of GDP. Such estimates are partly linked to the expected increase in public debt (Table 1), which could increase interest rates for the government and enterprises and have a negative impact on real economic activity. The disappearance of positive effects is also reflected in the planned abolition of particular stimulative measures.

Some analyses point to the flaws of the reform in terms of its effect on the economic cycle and inequality. Specifically, considering that the US economy is currently experiencing a relatively strong economic upturn and almost full employment, expansionary fiscal policy may cause the economy to overheat, i.e. have a pro-cyclical effect, clashing with recommendations according to which fiscal policy should mitigate cyclical movements and strive for balanced economic growth. Observing historical data, it is evident that the current policy deviates noticeably from its predecessors (Figure 1). Furthermore, the reform primarily benefits employed persons with higher incomes, leading to increasing inequality. According to the US Tax Policy Center, more than half of all tax reliefs are likely to benefit the wealthiest 1% of the population.

The increase in aggregate demand in the USA due to expansionary fiscal policy could have a positive impact on the aggregate demand in the EU. Stronger domestic demand in the USA could increase the demand for imported goods, which may have a favourable effect on the exports of EU member states. Moreover, the reform could lead to greater demand for the dollar and result in the appreciation of the real exchange rate of the dollar against the euro[2], which would increase EU price

Figure 1 Aggregate output gap and budget balance of the USA



Sources: Congressional Budget Office and CNB calculations.

Table 1 Estimate of tax reform effects on the economic growth and public debt of the USA

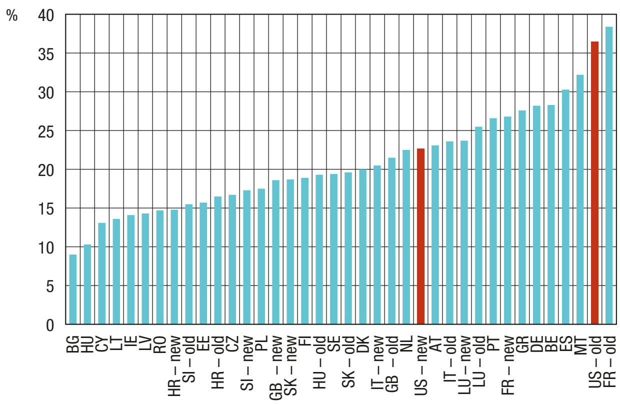
	Difference in GDP level in 2020 relative to the scenario without the reform	Difference in GDP level in 2027 relative to the scenario without the reform	Public debt growth until 2027
Tax Foundation	1.3	1.7	5
Tax Policy Center	0.5	0.0	5
Penn Wharton Budget Model	–	0.5 – 1.0	6.4 – 6.8
Joint Commitee on Taxation	0.8 – 0.9	0.1 – 0.2	5
Deutsche Bank	0.63	–0.11	6.1
IMF	1.20	–	–

Source: Publications of the respective institutions.

1 Although it is still too early to draw conclusions, the data on the economic developments in the USA in the first quarter of the current year show that there has not been any significant acceleration in the growth of wages and investments as yet. At the same time, prices of shares went up and the repurchases of corporate equity share were recorded.

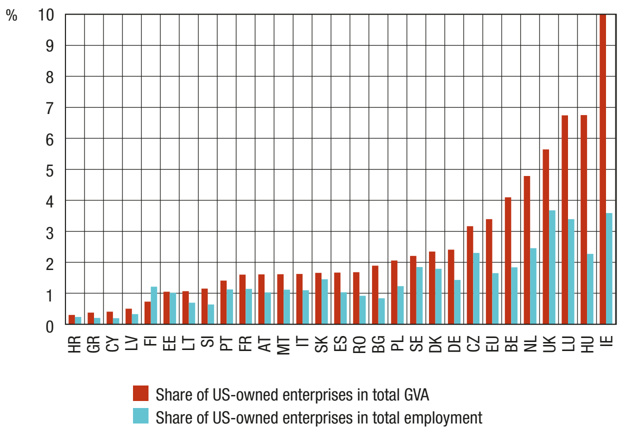
2 This has not been observed in the movements of the EUR/USD exchange rate yet.

Figure 2 Effective average tax rates on profitable investments



Note: Old rates refer to calculations based on regulations in force until 31 December 2016, while new rates are based on subsequently adopted regulations.
Source: Spengel et al. (2017).

Figure 3 The share of enterprises owned by the US in total GVA/number of employed persons



Source: Eurostat.

competitiveness and provide additional impetus to exports to the USA. However, recent empirical literature suggests that the spillover of US fiscal shocks to other countries is relatively low in intensity.[3]

The tax reform could, however, have negative effects on the EU through the outflow of capital to the USA. Tax changes, primarily those related to the reduction of the standard corporate tax rate, greatly reduced the tax burden of enterprises, raising the tax attractiveness of the USA in terms of investment. According to Spengel et al. (2017)[4], taking into account taxes affecting corporate investment decisions and rules regulating the tax base level, the effective average tax rate before the reform was higher than the rates prevailing in almost all EU member states. After the reform, the effective average tax rate hovers around the average of EU countries (Figure 2). The tax attractiveness of the USA thus became higher than that of many EU countries in terms of investments, including the economically most significant member states – Germany and France, which may result in an outflow of net foreign direct investments from the EU to the USA.

In addition to raising the USA's attractiveness for investments, the tax reform could also affect the decisions of enterprises regarding the transfer of profit to the USA. By transitioning to the so-called (modified) territorial taxation principle, the tax on the repatriation of profits generated by US foreign subsidiaries abroad, which resulted in the strong accumulation of profit in foreign accounts, was abolished. Previously accumulated profit will be subject to a one-off tax at a lower rate regardless of whether it will be transferred to the USA or not. Multinational corporations are thus no longer motivated to keep their profits in foreign accounts to evade taxation in case of profit transfer to the USA. The amount of earnings accumulated overseas is estimated at about USD 2.6 trillion (around 13% of US GDP)[5]. A similar one-off exemption from the taxation of foreign profits was granted in 2005, after which multinational corporations withdrew around two thirds of previously accumulated funds[6]. Furthermore, lower tax rates in the USA could result in multinational corporations transferring their profits to the USA through transfer pricing manipulation, as well as affect their financing strategies. Spengel et al. (2017) suggest that, after the reform, the optimal strategy for corporations located in EU countries that have a heavier tax burden than the USA is to finance foreign direct investments in the USA by their own capital so as to ensure that the profit remains in the USA, where the tax burden is lower. On the other hand, the optimal strategy for US corporations to finance their foreign direct investments in EU member states with a heavy tax burden is to borrow among themselves, ensuring that the interest on the debt is paid in the USA and thus subject to a lower tax rate. It is necessary to note that, besides incentivising the transfer of profits to the USA, measures discouraging the transfer of profits from the USA to countries with a lower tax burden were also adopted[7]

The tax reform is not expected to have significant direct effects on Croatia due to the low volume of trade in goods between Croatia and the USA and the small number of domestic enterprises in US ownership (Figure 3). Nevertheless, it could have indirect effects on Croatia through its impact on the economic developments in Croatia's major trading partners that are more closely connected to the US economy. The aforementioned effects are very difficult to assess, especially considering that some EU member states could introduce their own tax changes to restore their tax competitiveness relative to the USA.

3 Natoli, F., and L. Metelli (2018): *The international transmission of US fiscal shocks*, Munich Personal RePEc Archive, MPRA Paper No. 84207.
4 Spengel et al. (2017): *Analysis of US Corporate Tax Reform Proposals and their Effects for Europe and Germany*, Zentrum für Europäische Wirtschaftsforschung, Mannheim.
5 US Joint Committee on Taxation.
6 http://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=1665.
7 This refers to the so-called GILT (Global Intangible Low-Taxed Income) and BEAT (Base Erosion Anti-Abuse Tax) measures.

Box 2 Possible effects of an increase in the prices of crude oil on the economic developments in Croatia

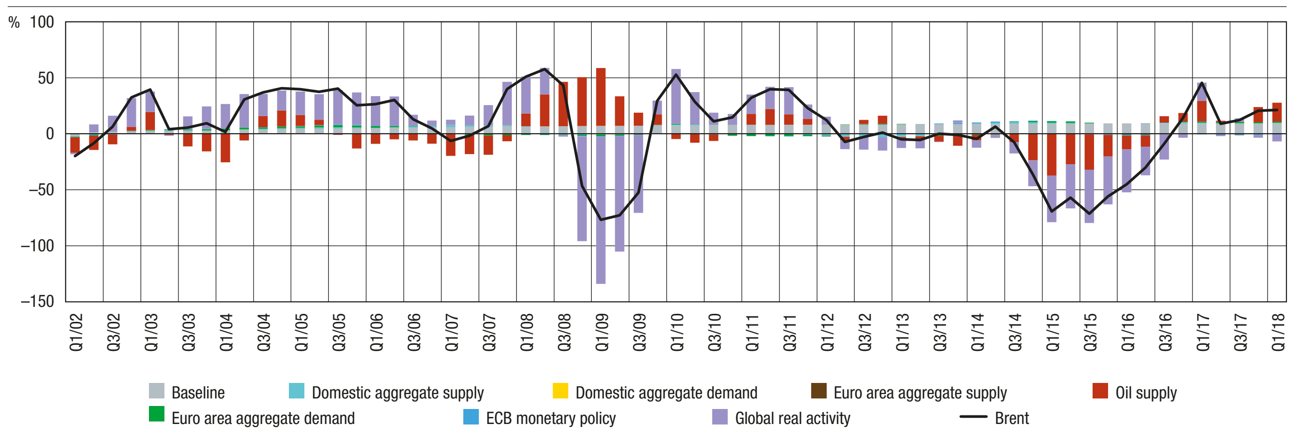
In order to estimate the possible effects of the currently high crude oil prices on the developments in the domestic GDP and prices, changes in oil prices on the global market should be observed within the context of global supply and demand movements.[8] *Even though a rise in global crude oil prices resulting from negative (recessionary) shocks on the oil supply side*[9] *should be associated with an increase in consumer prices and a drop in real activity, this does not necessarily apply when the increase in the prices of oil derives from intensified global real activity. In this box, we define various scenarios of crude oil price movements and analyse their impact on the domestic economy. The empirical results confirm the theoretical assumptions according to which a further sharp increase in the prices of crude oil in 2018, caused by shocks on the oil supply side, could strengthen inflationary pressures and negative risks related to the dynamics of domestic real activity.*

In May 2018, the prices of Brent crude oil were around 15% higher than in March, hovering around USD 76.5. This was mostly due to the expected decline in global oil supply. The most significant factors contributing to the increase in crude oil prices include the adjustment of the supply from OPEC (and other countries participating in the agreement) to the agreed crude oil production curb, geopolitical tensions in the Middle East, the reduction in crude oil stockpiles in the USA over the past several months and the drop in the production of crude oil in Venezuela as a result of a severe political and economic crisis. Furthermore, the announcement of the reintroduction of US economic sanctions on Iran is an additional geopolitical risk that drove crude oil prices up in May this year.

The increase in oil prices could affect the domestic economy through several transmission channels. For example, a rise in global oil prices has a direct effect on domestic consumer prices through the higher prices of refined petroleum products such as petrol. In addition, growing crude oil prices lead to higher production expenses and lower profit margins in industries in which oil is a factor of production, which, in turn, may result in upward pressures on the prices of final products in such industries. Moreover, an increase in oil prices may bring about higher production costs through a decrease in labour productivity as well. The latter may lead to a simultaneous drop in potential domestic output, which, coupled with a decline in domestic demand (as a result of lower real disposable income of households), could trigger an economic downturn.

To estimate the effects of a rise in global market crude oil prices on the domestic economy, it is first necessary to identify the reasons behind such changes, i.e. to determine whether the observed price change was caused by oil supply shocks or other shocks (for example, by a global real activity shock). For that purpose, a structural VAR model was estimated for the domestic economy with the identification of shocks based on zero and sign restrictions.[10] The model consists of a foreign sector, including the Brent crude oil price in the global market expressed in USD, the global economic activity indicator (excluding the euro area), consumer prices, the measure of economic activity and the euro area interest rate, and a domestic sector represented by the consumer price index (CPI) and real activity (GDP). The historical decomposition of global crude oil prices provided in Figure 1 and derived from the VAR model suggests that, in the past six months, the prices of crude oil were under the dominant effect of supply shocks, while the total increase in oil prices was not unusually strong.[11] The historical decomposition shown here is key for estimating the macroeconomic effects of oil price movements considering that the intensity and the direction of the spillover of crude oil price changes on the domestic GDP and inflation depend on the combination of supply and demand shocks generating oil price movements at a given moment.

Figure 1 Historical decomposition of oil prices in the global market
annual growth



Notes: The black line indicates the actual annual rate of oil price increase, while coloured bars indicate the contributions of various shocks to that rate. Annual growth rates shown in the figure are approximated by logarithmic differences.
Sources: CNB and authors' calculations.

8 See Kilian, L. (2009): *Not All Oil Price Shocks Are Alike: Disentangling Demand and Supply Shocks in the Crude Oil Market*, American Economic Review, 99(3), pp. 1053-69; Kilian, L., and D. P. Murphy (2014): *The role of inventories and speculative trading in the global market for crude oil*, Journal of Applied Econometrics, 29, pp. 454-478; Peersman, G., and I. Van Robays (2009): *Oil and the Euro Area Economy*, Economic Policy, 24(60), pp. 603-651.

9 Strategic decisions of OPEC countries on the volume of crude oil production, introduction of new production techniques, discovery of new oil fields, etc.

10 Model details are provided in Jovičić, G., and D. Kunovac (2017): *What is Driving Inflation and GDP in a Small European Economy: The Case of Croatia*, Working Papers 49, The Croatian National Bank, Croatia.

11 A recent ECB analysis *Are the recent oil price increases set to last?* (ECB Economic Bulletin, Issue 2/2018, available at https://www.ecb.europa.eu/pub/economic-bulletin/html/eb201802.en.html) also explains most of oil price dynamics by oil supply shocks.

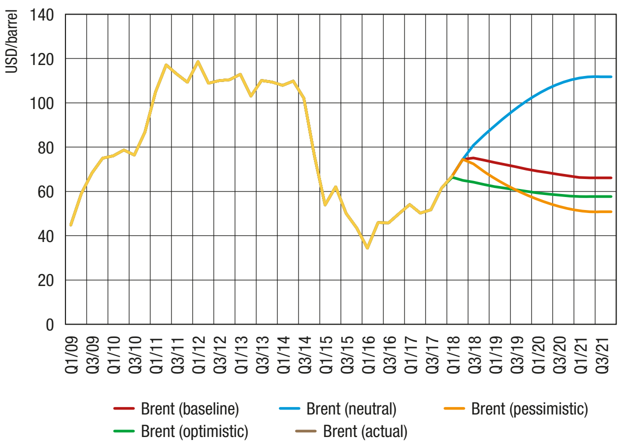
Consequently, the assessment of the effects of oil price changes on macroeconomic variables in the observed projection horizon (from June 2018 to end-2021) may greatly depend on the assumed combination of the aforementioned shocks.

Simulation of macroeconomic effects of oil price changes on the domestic economy

In order to assess the macroeconomic risks arising to the domestic economy (domestic GDP and consumer prices) from oil price changes, different VAR model specifications, including alternative paths of crude oil prices, were used.[12] Methodologically, conditional projections for arbitrarily defined crude oil price movements (paths) were determined by three different (alternative) scenarios: neutral, pessimistic and optimistic. In the neutral scenario, prices of crude oil correspond to crude oil futures prices in the crude oil market from May 2018[13], while the remaining two scenarios (pessimistic and optimistic) include more pronounced changes (rise and fall, respectively) in crude oil prices. For each alternative scenario, we assume that oil prices are predominantly generated by shocks on the oil supply side which increase crude oil prices and the overall inflation in the euro area and reduce economic activity in the euro area and the rest of the world. The three alternative scenarios are then compared with the baseline scenario, which corresponds to the projection of crude oil prices based on futures contracts from March 2018, which does not include the recent price increase. The main features of each scenario are provided in Table 1, and corresponding price paths are shown in Figure 2.[14]

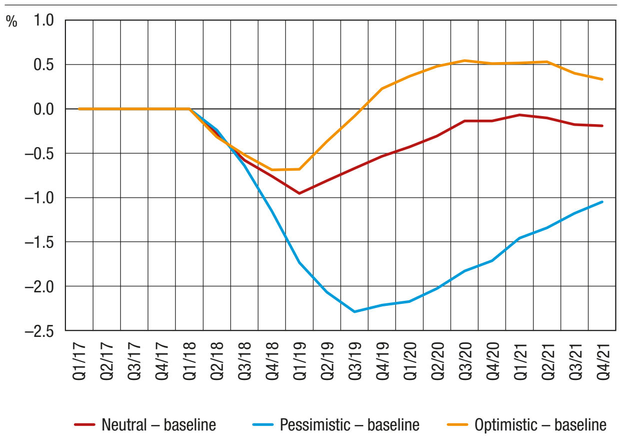
Figure 3 shows the extent to which the projections of domestic real activity based on alternative scenarios deviate from the baseline scenario which assumes no significant change in the prices of crude oil after March 2018. In line with the model identification, obtained results point to several conclusions. In case of a (likely) materialisation of the neutral scenario, real activity would be somewhat lower than that in the baseline scenario – results would be revised by –0.5% in 2018.[15] The less likely path of oil prices in the pessimistic scenario would result in significantly lower real activity than in the baseline scenario. In contrast to the negative effect of the two scenarios mentioned above on forecast real activity, the optimistic scenario would have a positive effect on domestic real activity, except in the short term. The effects of different oil price movement scenarios on domestic consumer prices are shown in Figure 4. In line with the structural identification of shocks in the global market, lower oil prices result in lower rates of growth in domestic consumer prices. In all three scenarios, the projection for 2018 is higher than the one in the baseline scenario – +0.3% for the neutral and the pessimistic scenario and +0.2% for the optimistic scenario.

Figure 2 Crude oil price in different scenarios



Source: CNB.

Figure 3 Deviations of projected inter-annual rates of change in the domestic GDP based on different scenarios
alternative scenarios versus baseline scenario



Sources: CNB and authors' calculations.

The direction of the effects obtained is in line with the relevant expert literature, but caution is advised in their interpretation. Macroeconomic effects were estimated under the assumption that oil prices stand under the dominant influence of

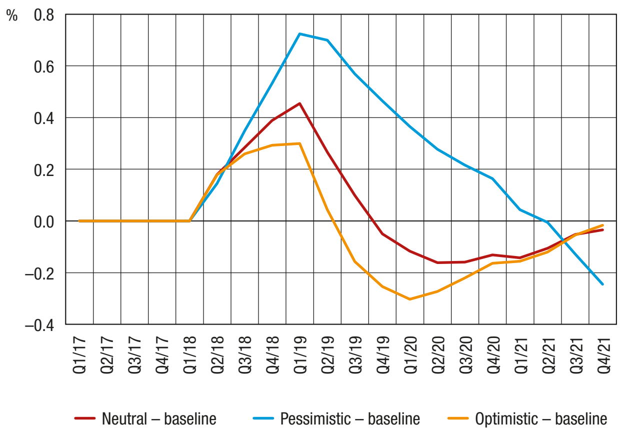
Table 1 Description of different scenarios

Scenario	Description	Dominant shock
Baseline	Crude oil price in line with the futures price from March 2018	Oil supply
Neutral	Crude oil price in line with the futures price from May 2018	Oil supply
Pessimistic	Crude oil price rising to USD 112	Oil supply
Optimistic	Crude oil price gradually falling to USD 50	Oil supply

Source: CNB.

12 For more details on the application of the conditional forecast models, see Waggoner, D. F., and T. Zha (1999): *Conditional forecasts in dynamic multivariate models*, Review of Economics and Statistics, 81(4), pp. 639-651; Bańbura, M., D. Giannone, and M. Lenza (2015): *Conditional forecasts and scenario analysis with vector autoregressions for large cross-sections*, International Journal of Forecasting, 31(3), pp. 739-756; Antolin-Diaz, J., I. Petrella, and J. Rubio-Ramirez (2017): *Structural scenario analysis and stress testing with vector autoregressions*, Documentos de trabajo (FEDEA), 13, pp. 1-40.
13 More precisely, futures prices on 30 May 2018.
14 Since prices of oil in the second quarter of 2018 are only available for April and May, the same results are used in that quarter (in line with the neutral scenario) in all three alternative scenarios (neutral, pessimistic and optimistic).
15 The figures were obtained as an average of the deviation of inter-annual rates shown in Figure 3 for the last three quarters of 2018.

Figure 4 Deviations of projected inter-annual rates of change in domestic prices based on different scenarios
alternative scenarios versus baseline scenario



Sources: CNB and authors' calculations.

shocks on the oil supply side over the entire projection horizon, while Figure 1 suggests that the assumption is overemphasised – demand shocks have frequently been the main determinant of crude oil price movements. If, in addition to the oil supply shock, the global real activity shock is included to determine the path of oil prices, the inter-annual GDP rate revision would be negligible in all three scenarios (up to +0.1%), while the effect on domestic prices would be similar. Therefore, the results should be interpreted as the upper limit of the effects of oil price changes on the projection, greatly determined by the assumed dominance of supply side shocks. In addition, quantification also depends on and reflects the arbitrarily chosen scenarios (paths) of oil price movements defining the alternative scenarios.

3 Aggregate supply and demand

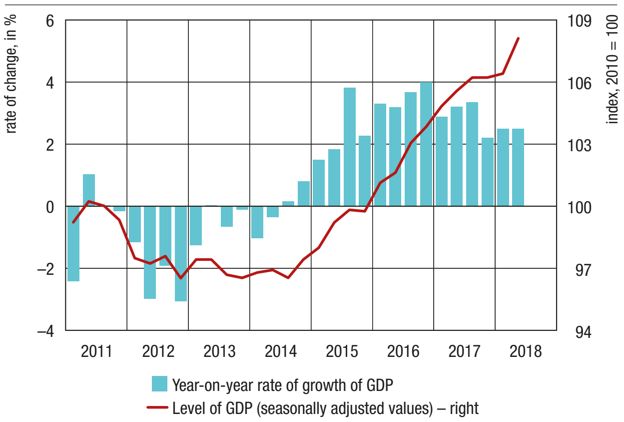
In early 2018, economic activity saw a slight increase at the quarterly level (0.2%) after real GDP stagnated in late 2017. The low rate of economic growth is primarily a result of unfavourable developments in the trade of goods, while all components of domestic demand recorded a rise. Available monthly indicators for April suggest that economic growth picked up in the second quarter of the current year.

Observed at the annual level, real GDP grew by 2.5% in the first quarter of 2018 reflecting the continued growth in all components of domestic demand, with personal consumption contributing the most to the increase in total economic activity. On the other hand, total exports dropped at the annual level due to a decline in the exports of goods. In spite of that, total imports grew sharply reflecting the stronger domestic demand, resulting in a noticeably negative contribution of net foreign demand to economic growth. The production side of the GDP calculation shows that gross value added grew by 1.9% annually, with an increase recorded in all activities except financial and insurance activities.

Aggregate demand

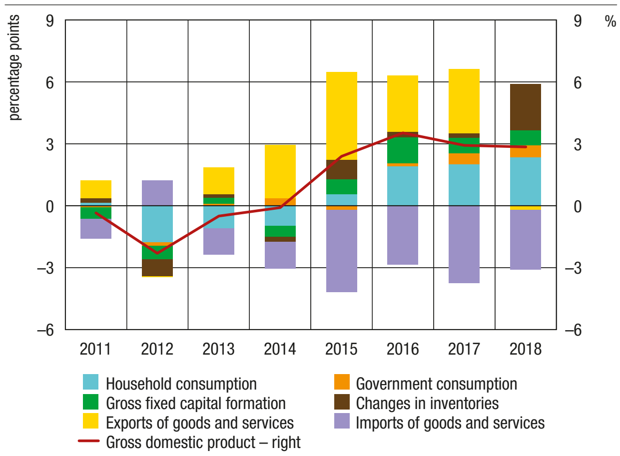
Real exports of goods and services continued to grow at the quarterly level in the first quarter of 2018, albeit at a slightly lower pace than in the preceding quarter. The slowdown was a result of a stagnation in the exports of goods from the end of 2017, with nominal data on the trade in goods pointing to unfavourable trends in all main industrial groupings. Despite the increase at the quarterly level, due to the high base, total exports were 0.5% lower than in the same period the year before, exclusively as a result of a drop in the exports of goods (–1.5%), the

Figure 3.1 Gross domestic product
real values



Note: Data for the second quarter of 2018 are estimated with the use of the CNB's monthly indicator of real economic activity, on the basis of data published until 30 May 2018.
Source: CBS (seasonally adjusted by the CNB).

Figure 3.2 GDP rate of change
contributions by components



Note: Data for 2018 refer to the first quarter.
Source: CBS.

first decrease recorded at the annual level since the beginning of 2013.[16] On the other hand, exports of services grew by 2.1% from the first quarter of 2017 and thus mitigated the decline in total exports.

At the beginning of 2018, personal consumption was 0.7% higher than in the previous quarter, the steady upward trend in household consumption that began in 2015 thus continuing. Such developments reflect favourable labour market trends, which mainly refers to the continued rise in employment and in real net wages, but also to stronger household borrowing. Moreover, despite dropping in March this year, consumer confidence remained at high levels, which had a favourable impact on the propensity to consume. Household consumption increased by 3.9% at the annual level and thus provided the most significant contribution to economic growth among all GDP components.

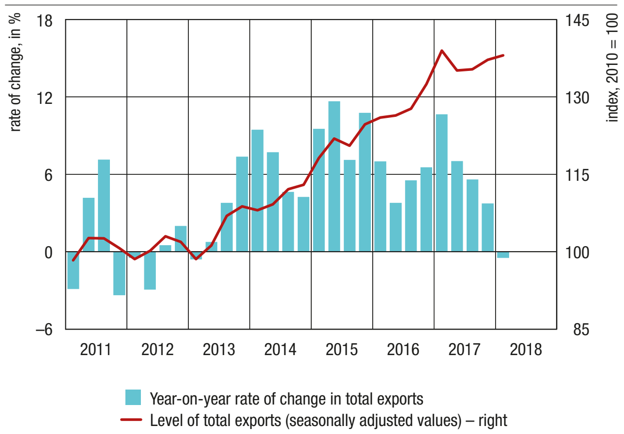
Investment activity intensified in the first three months of 2018, with a growth of 1.9% recorded at the quarterly level, following 0.9% at the end of 2017. Such developments were mostly the result of increased investments in the private sector, as suggested by monthly indicators on construction works on buildings and the nominal data on the imports of capital goods. On the other hand, the drop in civil engineering works points to the slower investment activity of the general government. Observed at an annual level, capital investments grew by 3.6% in the first quarter of the current year.

Government consumption increased by 0.4% in the first quarter of 2018 relative to the previous three months. An increase of 2.8% was recorded at an annual level, most likely attributable to a rise in the number of civil servants and government employees.

Although the first quarter of the current year saw a slowdown in total exports, the increase in the imports of goods and services picked up at the quarterly level as a result of a continued rise in domestic demand. The growth rate of total imports stood at 2.9% at the beginning of 2018, and this was twice as high as the rate recorded in the last quarter of 2017, when an increase of 1.4% was recorded.

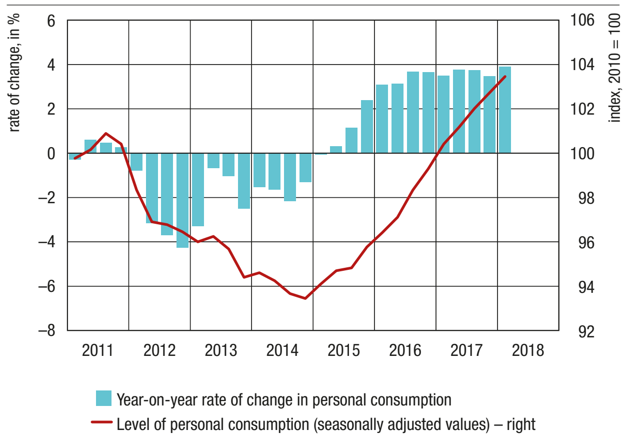
Nominal data on the trade in goods show that imports grew

Figure 3.3 Exports of goods and services
real values



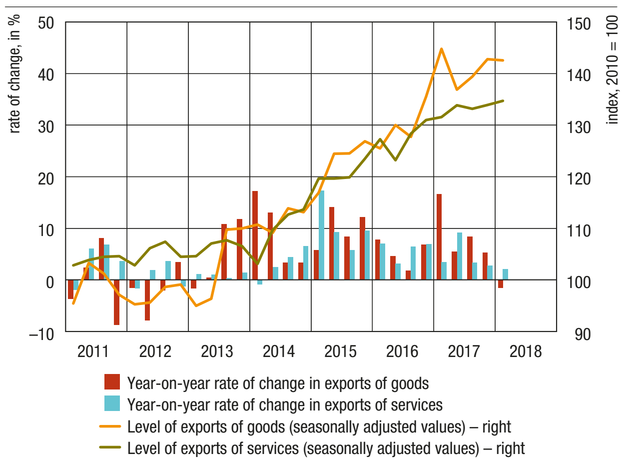
Source: CBS (seasonally adjusted by the CNB).

Figure 3.5 Personal consumption
real values



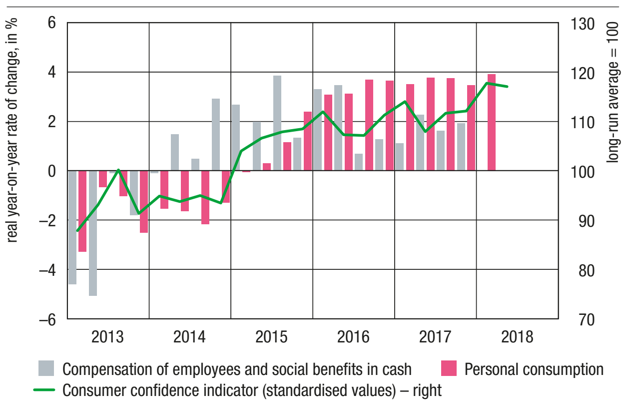
Source: CBS (seasonally adjusted by the CNB).

Figure 3.4 Real exports of goods and services



Source: CBS (seasonally adjusted by the CNB).

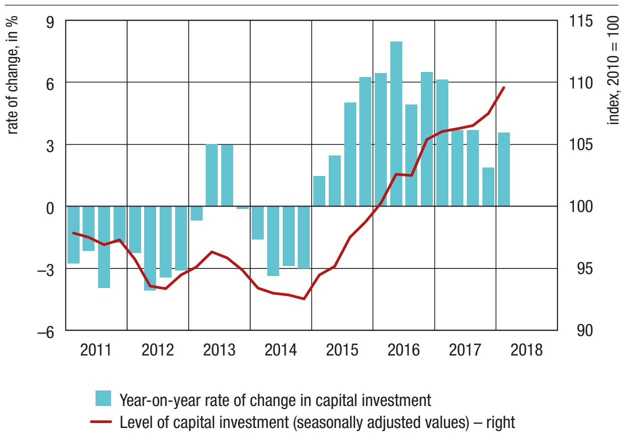
Figure 3.6 Determinants of personal consumption
real values and index



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 May 2018.
Sources: CBS, Ipsos and CNB.

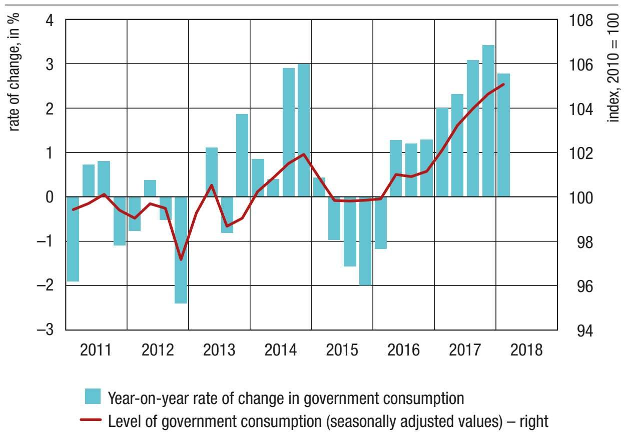
16 It is necessary to note that, according to the first data, foreign trade in goods saw a strong increase in April 2018.

Figure 3.7 Gross fixed capital formation
real values



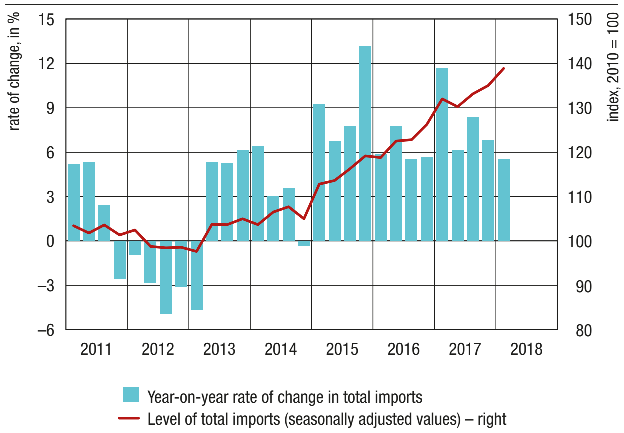
Source: CBS (seasonally adjusted by the CNB).

Figure 3.8 Government consumption
real values



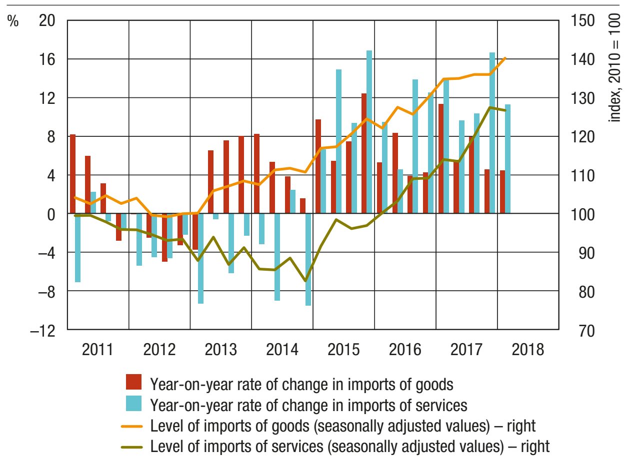
Source: CBS (seasonally adjusted by the CNB).

Figure 3.9 Imports of goods and services
real values



Source: CBS (seasonally adjusted by the CNB).

Figure 3.10 Real imports of goods and services



Source: CBS (seasonally adjusted by the CNB).

in all main industrial groupings at the quarterly level, with the exception of non-durable consumer goods. Observed at the annual level, total imports increased by 5.5% with a rise recorded in the imports of both goods and services. The negative contribution of net foreign demand to total economic growth was significantly higher than in 2017 (–3.1 percentage points).

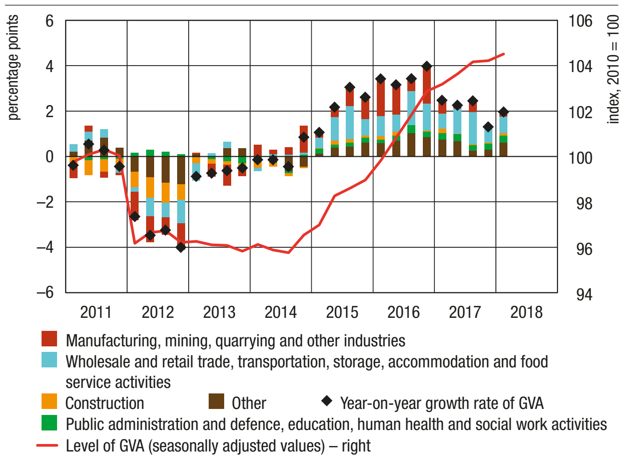
Aggregate supply

In the first quarter of 2018, GVA increased slightly (0.3%) from the preceding quarter. At the annual level, GVA saw broad-based growth of 1.9% in the first quarter. The most substantial increase from the same period the year before was recorded in retail trade and transportation and storage, which may be attributed to the continued growth in personal consumption. On the other hand, an annual decline was recorded only in finance and insurance activities, while agriculture, forestry and fishing stagnated.

The GDP nowcasting model based on currently available monthly data shows that real economic activity growth could pick up in the second quarter of 2018 compared with the beginning of the year. Real retail trade turnover increased by 0.9% in April from the average recorded in the first quarter of the current year, while at the same time, construction activity also grew by 1.7%. On the other hand, industrial production was down by 2.3% in April from the preceding quarter average. Broken down by main industrial groupings, the data show that production dropped in all MIG components except capital goods.

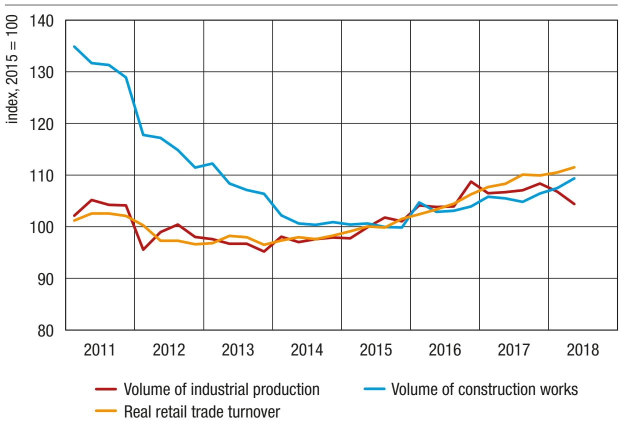
Data for the second quarter of 2018 show that, after deteriorating considerably in March, household confidence improved in the period from April to June this year, with the household confidence index still at a high level. This may primarily be attributed to positive expectations regarding the overall economic situation in Croatia in the following 12 months compared with the current state of affairs as well as to expectations regarding employment trends. As regards business confidence, compared with the first quarter of the current year, expectations improved significantly in construction, which has been witnessing a continuous increase in optimism since early 2014. Furthermore, expectations of business entities improved in trade as well, while in industry, they deteriorated. Expectations in services stagnated at the quarterly level, although June saw a substantial fall in confidence.

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



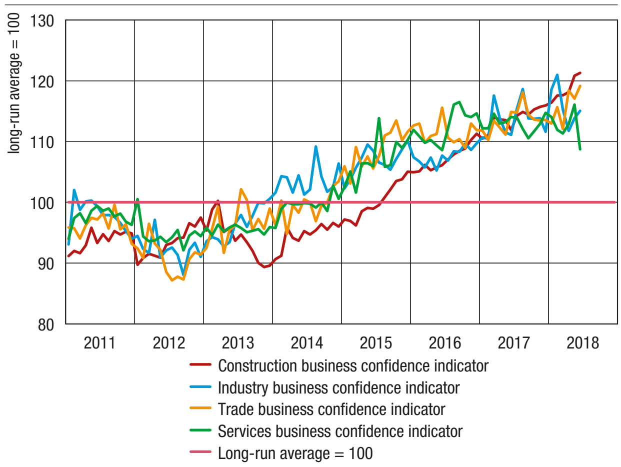
Source: CBS (seasonally adjusted by the CNB).

Figure 3.12 Short-term economic indicators
seasonally adjusted values



Notes: Quarterly data are calculated as an average of monthly data. Data on industry and trade in the second quarter of 2018 refer to April.
Source: CBS (seasonally adjusted by the CNB).

Figure 3.13 Business confidence indicators
standardised seasonally adjusted values



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

Projected developments

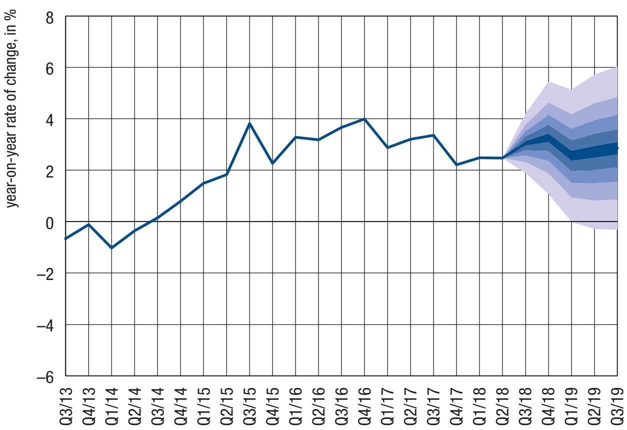
Economic activity may continue to trend upwards in 2018 at a similar pace as in 2017, with the real GDP growth rate expected to reach 2.8%. Economic growth could primarily be driven by a rise in the exports of goods and services, although any increase is expected to be slower than in 2017. All domestic demand components are expected to provide a positive contribution to the trend, whereby strong domestic demand could result in a further rise in imports, causing the negative contribution of net foreign demand to increase from the year before. In 2019, economic activity could expand at a similar pace as in 2018, with a steady and broadly based growth of real GDP.

The rise in total exports could decelerate to 4.9% in 2018 (compared with 6.4% in 2017) due to the expected slowdown in the economic growth of Croatia's major trading partners. The growth in the exports of services, particularly those in tourism, is also estimated more conservatively. Among domestic demand components, the most significant contribution to real GDP growth in 2018 may again come from personal consumption, which could grow by 3.6%. Such expectations are a result of continued favourable developments in the labour market, which could result in a further rise in the real disposable income of households. In addition, household borrowing is expected to continue, having an additional positive effect on household consumption. Capital investments could gain pace in the current year and grow by 6.4%, resulting in a more significant positive contribution of gross fixed capital formation to economic growth in 2018 than in 2017. Following a drop in 2017, this year public investments could increase noticeably as a result of the realisation of projects financed by EU funds coupled with a further rise in private investments. A positive contribution to GDP growth could also come from government consumption, which could grow by 2.5%, mainly as a result of the expected increase in the number of persons employed in the public sector and growing expenditures on intermediate consumption. The lower than expected increase in total exports compared with 2017 could be reflected in a slowdown in the growth of imports of goods and services (7.1% versus 8.1% in 2017). Nevertheless, the negative contribution of net foreign demand is expected to be higher than in 2017 (–1.0 percentage point compared with –0.6 percentage points in 2017).

In 2019, real GDP could continue to grow at a similar pace as in 2018, with a projected growth rate of 2.8%. Investment activity is expected to intensify, reflecting the expectations of increased investments in both the private and the public sector. Personal consumption is expected to grow further, but at a slightly slower pace than that estimated for 2018. Government spending might also positively contribute to GDP growth. Although a slower increase in the exports of both goods and services is expected in 2019 than in 2018, foreign demand is still likely to remain the main driver of economic growth. The slowdown in domestic and foreign demand expected in 2019 could lead to a slower rise in total imports, which could in turn reduce the negative contribution of net foreign demand to GDP growth (–0.6 percentage points).

It is estimated that the risks to GDP projections in the projection period are balanced. On the one hand, exports of tourist services might grow more than currently expected. Also, the Croatian government announced further tax cuts as of the beginning of 2019, which might provide a boost to economic activity. On the other hand, the adverse impact of financial problems in the Agrokor Group on investment activity and personal consumption might be stronger than currently projected, although this risk is not as pronounced as in late 2017. The lingering weaknesses in the operation of other domestic companies that

Figure 3.14 Projection of real GDP dynamics



Sources: CBS and CNB.

have not been restructured might have an unfavourable effect on aggregate export performance, which was poor in early 2018. Downside risks arise also from the external environment, mainly from the strengthening of American trade protectionism and political instabilities in Italy, which might result in a lower than expected growth of the Italian economy. Furthermore, the relatively poor use of capital transfers from EU funds in 2017 and early 2018 points to risks that project financing from EU funds might fall short of current projections, also implying a lower than expected increase in investment. Finally, potential further growth in the prices of refined petroleum products might have a negative effect on overall economic activity in Croatia (for more on the quantification of effects in various scenarios of an increase in crude oil prices on domestic GDP, see Box 2 Possible effects of an increase in the prices of crude oil on the economic developments in Croatia).

4 Labour market

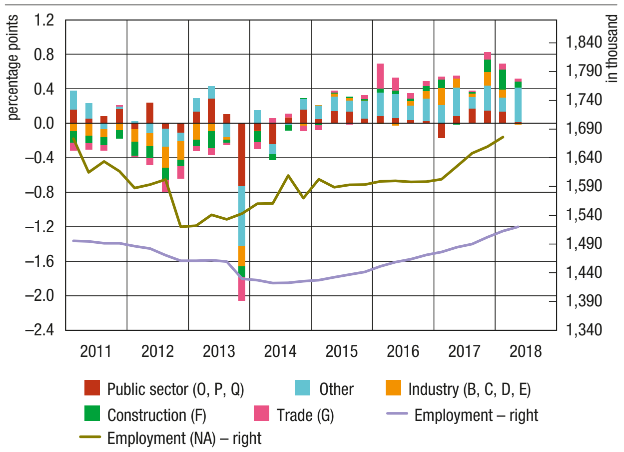
Employment and unemployment

In the second quarter of 2018, the number of employed persons grew from the average for the previous quarter, but its quarter-on-quarter increase slowed down steadily (Figure 4.1). Employment grew by 0.5% in April and May from the first quarter, with the largest contribution to growth coming from private sector service activities associated with tourism (accommodation and food service activities and trade). On the other hand, the slight parallel decrease in employment in industry made a negative contribution to movements in total employment.

April and May were marked not only by employment growth but also by the continued decrease in the number of unemployed persons, which gradually accelerated in the first five months. Administrative data show that unemployment figures went below 150,000 in May 2018 (seasonally adjusted data). The unemployment decrease in April and May was slightly more influenced by outflows from the CES register for other reasons (mainly removal from the register because of non-compliance with the legal provisions and registration cancellation) than by the number of newly employed persons (Figure 4.2), the former being also significant early in the year. Such trends are probably partly due to further emigration of the working age population (for more details on emigration flows from Croatia see Box 3 Dynamics and characteristics of emigration from Croatia and other new EU member states to the old member states).

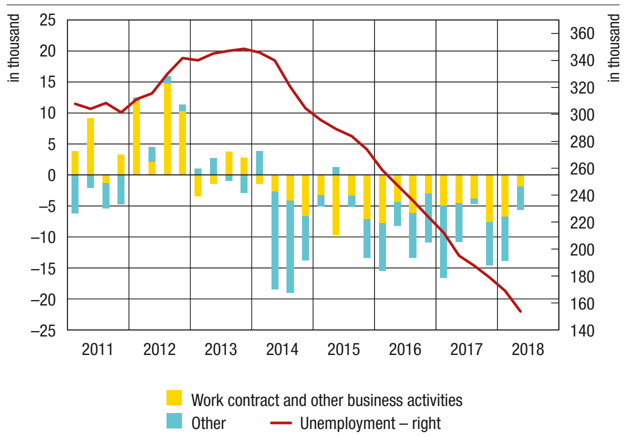
In line with the described movements in unemployment, the registered unemployment rate steadily decreased, falling to 10.2% according to the latest available data for April (seasonally adjusted data), which is one percentage point less than at

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



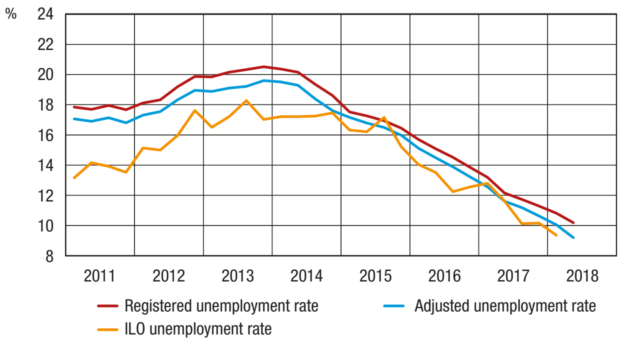
Note: Data for the second quarter of 2018 refer to April and May.
Sources: Eurostat and CPII (seasonally adjusted by the CNB).

Figure 4.2 Total unemployment and net unemployment inflows
seasonally adjusted data



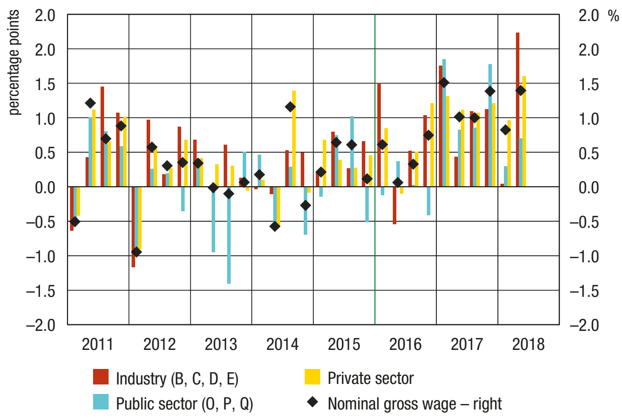
Note: Data for the second quarter of 2018 refer to April and May.
Source: CES (seasonally adjusted by the CNB).

Figure 4.3 Unemployment rates
seasonally adjusted data



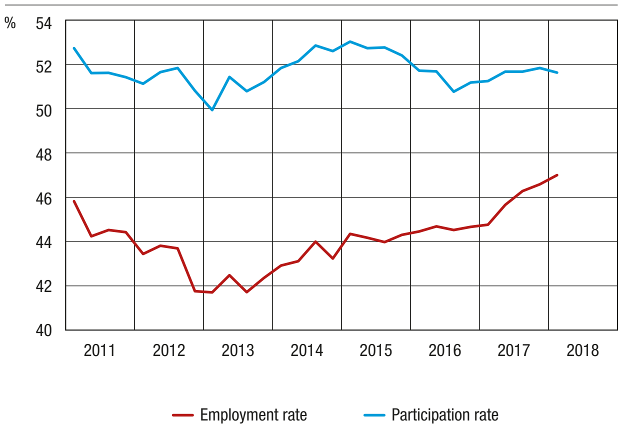
Notes: The adjusted unemployment rate is the CNB estimate and is calculated as the share of the number of registered unemployed persons in the working age population estimated as the sum of unemployed persons and persons insured with the CPII. Since January 2015, the calculation of the registered unemployment rate published by the CBS has been made using the data on employed persons from the JOPPD form. The registered unemployment rate data for the second quarter of 2018 refer to April, while data for the adjusted rate refer to April and May.
Sources: CBS, CES and CNB calculations (seasonally adjusted by the CNB).

Figure 4.5 Average nominal gross wage by NCA activities
seasonally adjusted data, quarterly rate of change



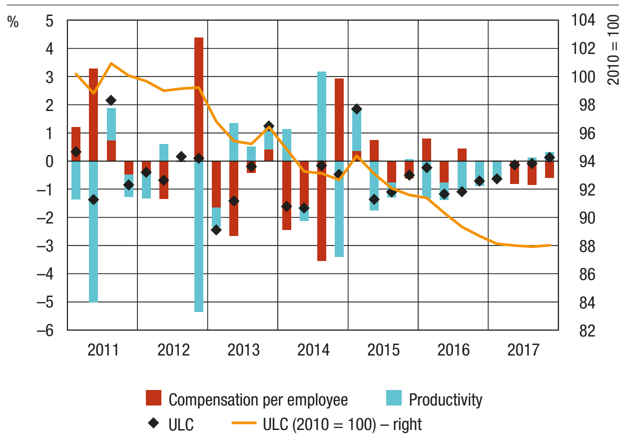
Notes: Data on the average nominal gross wage by activity refer to data from the RAD-1 form, and from January 2016 to data from the JOPPD form. Data for the second quarter of 2018 refer to April.
Sources: CBS and CNB calculations (seasonally adjusted by the CNB).

Figure 4.4 Labour Force Survey
seasonally adjusted series



Source: CBS (seasonally adjusted by the CNB).

Figure 4.6 Compensation per employee, productivity and unit labour costs
seasonally adjusted data, quarterly rate of change and levels (2010 = 100)



Note: Productivity growth carries a negative sign.
Sources: CBS, CPII and Eurostat (seasonally adjusted by the CNB).

end-December 2017 (Figure 4.4).[17] The Labour Force Survey data available for the first quarter of 2018 suggest that the ILO unemployment rate continued to fall, from 10.2% in the last quarter of 2017 to 9.4% for the period (Figure 4.3).

In line with the decrease in the unemployment rate, the Labour Force Survey data point to a further increase in the number of employed persons, with the employment rate rising to 47% in the first quarter of 2018. In the same period, the participation rate stood at 51.6% (Figure 4.4).

Wages and unit labour costs

After a slowdown at the beginning of the year, wage growth again picked up steam early in the second quarter, so that the average nominal gross wage was 1.4% higher in April than in the quarter before. In that period, the average wage went up 1.6% in the private sector and 0.7% in the public sector (Figure 4.5). Real wage growth was slightly more moderate as consumer prices grew mildly in the same period.

The strong increase in wages in early 2018 indicates that unit labour costs grew in the first quarter of 2018, continuing the trends seen in late 2017, when unit labour costs began to grow after decreasing steadily for two years (national accounts data on employee compensation for the first quarter of 2018 were not available at the time of writing).

Projected developments

The movement in the number of employed persons in the first five months of 2018 and the expected further growth of economic activity suggest that employment might increase by 2.2% at the entire 2018 level. Favourable expectations regarding employment trends over the summer months are also supported by data from the survey on business expectations (Figure 4.7) as employment is expected to go up in the following three months in all activities, particularly construction and trade. At the same time, unemployment figures might drop, and the ILO unemployment rate might fall to 9.7% in 2018.

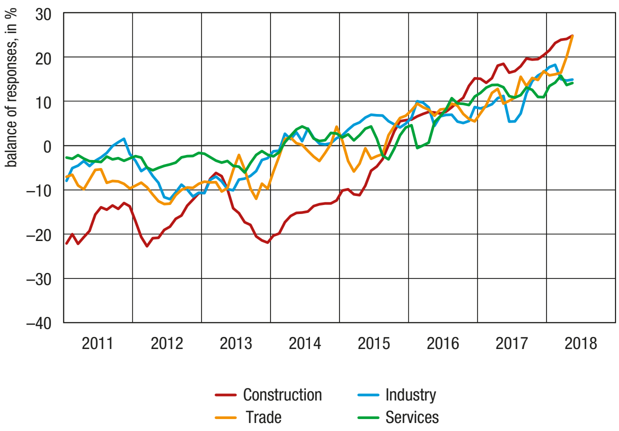
17 The adjusted registered unemployment rate that is based on data on the number of persons insured with the CPII, instead on data from the JOPPD form collected and processed by the CBS, is also available for April and May, when it stood at 9.2%.

Table 4.1 Projection of labour market indicators for 2018 and 2019
year-on-year rate of change

	2012	2013	2014	2015	2016	2017	2018	2019
Number of employed persons – CPII								
Number of employed persons – national accounts	–3.6	–2.6	2.7	1.2	0.3	2.2	2.2	1.9
Unemployment rate (ILO)	15.9	17.3	17.3	16.2	13.1	11.2	9.7	8.8
Average nominal gross wage	1.0	0.8	0.2	1.3	1.9	3.9	4.2	3.7
ULC	–1.0	–3.1	–2.6	–0.8	–3.3	–1.8	3.6	2.8
Productivity	1.4	2.2	–2.7	1.1	3.2	0.7	0.6	0.9

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

Figure 4.7 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).

As regards labour costs, gross wages are expected to continue to grow sharply in 2018 (4.2%). It seems that the more vigorous increase in wages in some sectors over the first four months of 2018 reflects the mounting problem of labour shortage associated with emigration of the working age population. The wage increases will also continue in the public sector due to the whole-year effect of the decision on the increase in wages of civil servants and government employees in 2017. Real wages will grow more moderately in 2018 (2.5%) than nominal wages, due to the expected acceleration in consumer price growth triggered by the rise in crude oil prices in the global markets.

Favourable developments in the labour market are expected to continue into 2019. The number of employed persons should continue to rise (1.9%) in line with the expected GDP growth, while the ILO unemployment rate might fall to 8.8% thanks to the steady drop in the number out of work. In 2019 wages might grow at a pace similar to that in 2018.

Box 3 Dynamics and characteristics of emigration from Croatia and other new EU member states to the old member states

This Box summarises the selected findings of the research on emigration flows from Croatia and other new EU member states to the old member states in the period from 2000 to 2016.[18] Emigration from Croatia picked up following the EU accession in 2013 and the opening of the labour markets of other member states. As official statistics can hardly present the magnitude of emigration due to methodological limitations, this Box provides an analysis of various data sources and compares emigration flows using data from national statistical offices of origin countries as well as indirect emigration flows, resorting to figures from the national statistical offices of the selected destination countries. Indirect emigration flows indicate that the intensity of Croatia's emigration flows to the old EU member states is stronger than suggested by CBS data and is comparable to emigration flows prevailing in the least economically developed EU member states. The econometric analysis carried out showed that, apart from the lifting of regulatory barriers to the free movement of labour, the scale of emigration is strongly influenced by economic and non-economic factors.

Croatia became a full member of the EU In July 2013. As a result of accession to the single market, which guarantees the free movement of goods, services, capital and labour, emigration flows to the old member states intensified strongly.

An analysis of official migration statistics published by the Croatian Bureau of Statistics shows that, immediately after the onset of the global economic crisis, Croatia shifted from being a net immigration country to a net emigration country, with the migration balance significantly worsening after the EU accession and the related partial[19] opening of the labour markets of other member states (Figure 1).

Detailed CBS data on the main social and demographic characteristics of migrants show an almost equal share of male and female emigrants throughout the period. As regards the age structure, the largest number of migrants are in the 25–40 years age group, though it should be noted that the average age of a Croatian migrant dropped sharply after the EU accession (the

18 Based on the paper *Dynamics and Determinants of Migration – The Case of Croatia and Experience of New EU Member States* by Ivana Draženović, Marina Kunovac and Dominik Pripužić presented at the 24th Dubrovnik Economic Conference and available at the CNB website.

19 Belgium, Italy, Germany and Luxembourg opened their labour markets to workers from Croatia in 2015 and the Netherlands and the United Kingdom in 2018, while Austria continues to apply transitional provisions preventing the free movement of workers.

average age of emigrants was 33.6 years in 2016, down from 41.5 years in the period from 2001 to 2013). An analysis of the geographical origin of migrants shows that counties with higher unemployment also witnessed stronger emigration flows, with this phenomenon being particularly evident in Eastern and Central Croatia (Figure 2).

According to the data on destination countries, Germany, Austria and Ireland were the main destinations after EU accession, accounting for nearly 85% of Croatian emigrants (Figure 3).

Official data by other new EU member states indicate some considerable similarity of migrants from these countries and Croatia in terms of social and demographic characteristics. The average emigrant from new member states is in their early thirties, i.e. younger than the median age of the domicile population, with the gender structure being relatively balanced. Germany stands out as the main destination of emigrants from new member states, and is also one of the three most attractive destinations in all countries, followed by Austria and the United Kingdom.

The migration literature argues that in most cases official emigration data in the country of origin (based on the self-reporting of emigration by emigrants themselves) underestimate actual emigration figures due to the relatively complex administrative procedure, the absence of incentives to report emigration and the possible loss of some social security benefits. For this reason, included also were statistical data on emigrants from Croatia and other new member states from Western European destination countries. As mirror statistics of destination countries may overestimate the volume of migrations if the citizenship principle is used to determine the origin of emigrants, a "narrower" coverage, i.e. the principle of the country of birth or the country of previous residence, was taken into account instead of the citizenship principle.[20] This minimised the impact of migrants with dual citizenship (e.g. they may originate from Bosnia and Herzegovina, but may be registered as Croatian migrants due to their Croatian citizenship). However, as the effect of dual citizenship on emigration flows cannot be fully eliminated, mirror statistics should be interpreted as a possible upper bound for total emigration flows.

As regards Croatia, indirect emigration flows indicate considerable differences in total emigration from Croatia to the old EU member states from 2013 to 2016. Mirror statistics show that in this period 230,000 persons left Croatia to move to the 11 EU countries, while total emigration according to CBS data stands at 102,000.[21,22] However, this difference is expected to decrease in the forthcoming period, primarily due to changes in tax regulations in early 2017, which induced migrants to regulate their residency status for tax purposes to avoid double income taxation (unofficial data suggest that around 80,000 persons emigrated from Croatia in 2017, which is comparable to the figures obtained from mirror statistics for 2015 and 2016).[23]

A comparison of indirect emigration flows in new EU member states showed that the population outflow from Croatia is

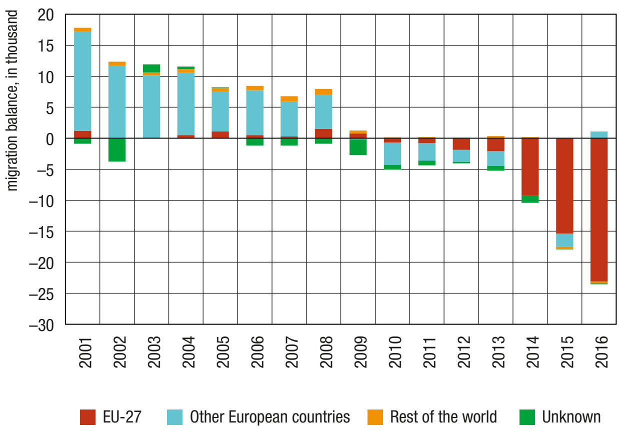
20 The birth country principle is used for the Netherlands, Italy, UK and Belgium, the country of previous residence principle is used for Germany and Denmark, and the citizenship principle is used for Sweden, Finland, Luxembourg and Austria.

21 Due to data availability, mirror statistics were obtained for the following 11 old EU member states: Austria, Belgium, Denmark, Finland, Germany, Ireland, Italy, Luxembourg, the Netherlands, Sweden and the United Kingdom.

22 Indirect statistics also point to an increase in the number of migrants returning to Croatia. According to data from national statistical offices of destination countries, net emigration from Croatia is estimated to be around 150,000 persons from 2013 to 2016.

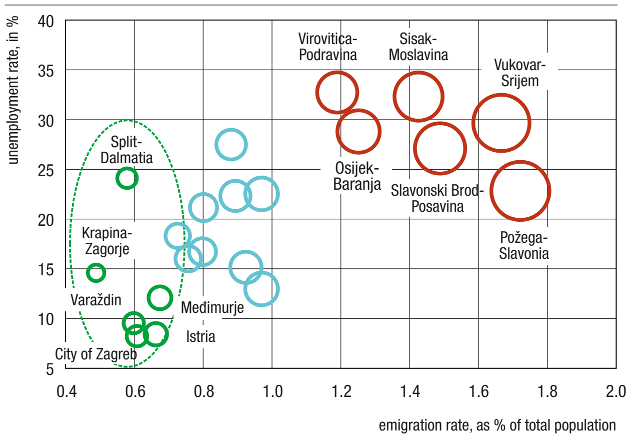
23 https://www.jutarnji.hr/vijesti/hrvatska/kolinda-opet-kritizirala-vladu-rekli-su-da-pretjerujem-kad-sam-rekla-da-smo-u-izvanrednom-stanju-nema-se-vise-vremena-treba-nam-konkretan-plan/7250496/

Figure 1 Net migration of Croatian population
difference between the number of immigrants and the number of emigrants



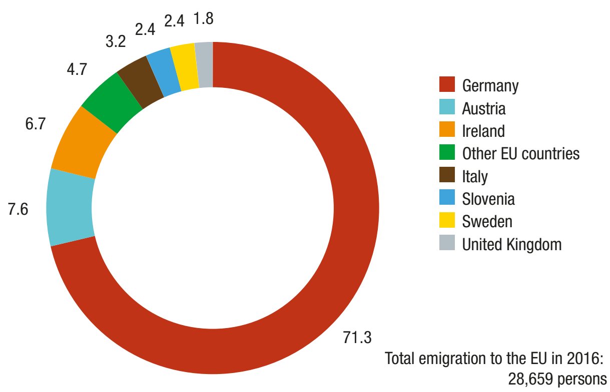
Source: CBS.

Figure 2 Unemployment rate and the share of emigrants
by county in 2016



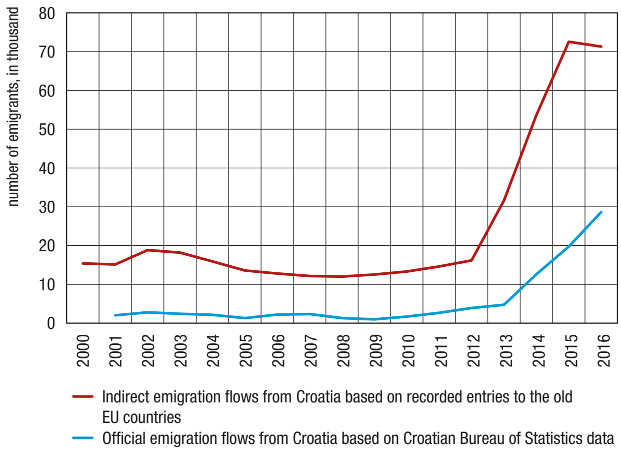
Note: The size of a circle corresponds to the emigration rate as % of the total population of the county.
Source: CBS.

Figure 3 Croatian emigrants by destination country
in 2016



Note: Germany and Italy applied the transitional provisions on free movement to Croatian citizens up to 2015 and the United Kingdom applied them until June 2018, while Austria continues to apply such provisions.
Source: CBS.

Figure 4 Comparison between indirect and registered migration flows from Croatia

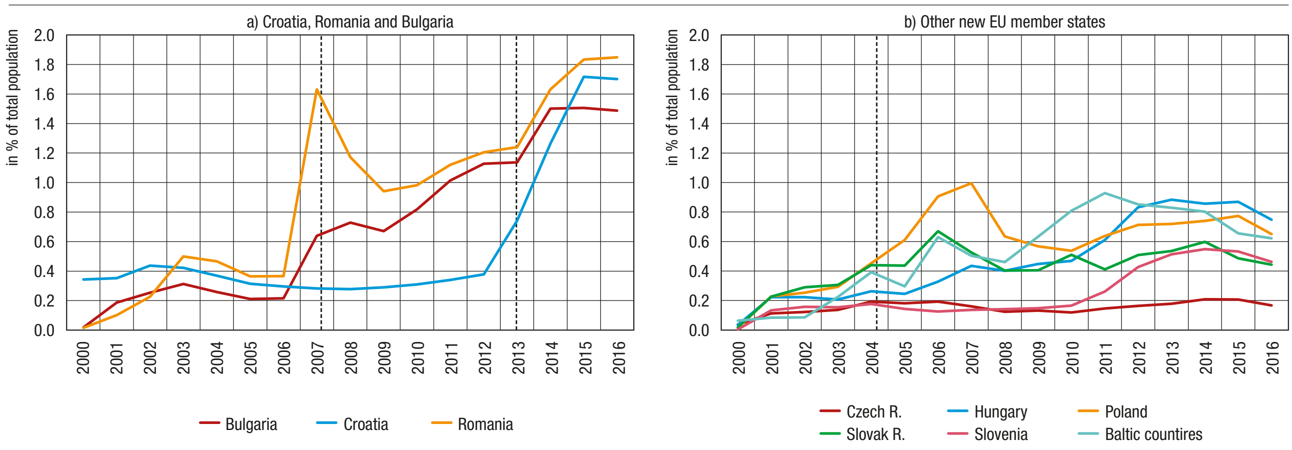


Sources: CBS and national statistical offices of the old EU member states.

comparable to the outflows from less developed new EU member states, such as Bulgaria and Romania (Figure 5). Mirror statistics also suggest that the rise in emigration from new to the old EU member states is not a short-term phenomenon as stronger migration flows in most member states remained at new, higher levels. However, it is possible that the migration dynamics was influenced by the global economic crisis, which hit strongly almost all countries in the sample in the observed period. A formal econometric analysis was made to establish the determinants of emigration trends.

Results of the econometric analysis by use of a gravity model show that the lifting of regulatory barriers to the free movement of labour towards other EU member states following the EU accession was the most important determinant of emigration from new to the old EU member states in the observed period, raising the level of emigration in the range of 30% to 60%, depending on the specification of the models employed. In addition, decisions on migration are also influenced by (long-term and short-term) economic drivers, as well as the quality of institutions and the education structure of the origin-country population.

Figure 5 Emigration flows from new EU member states according to mirror statistics of the 11 old EU member states



Note: Dashed lines denote the year of EU accession.
Source: National statistical offices of the old EU member states.

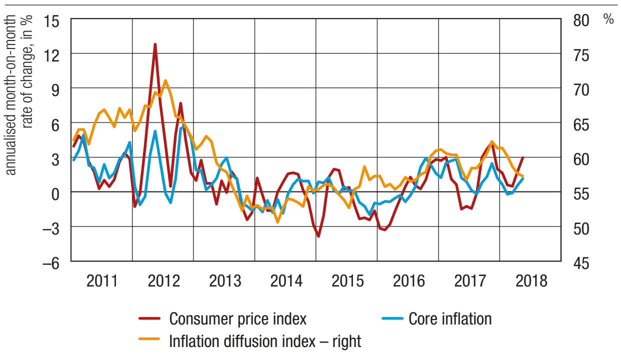
5 Inflation

Consumer price inflation accelerated in the first five months of 2018. The upward pressure on prices stemmed mostly from the external environment, i.e. the rise in crude oil prices in the global market. The mounting of inflationary pressures is also evident in the indicators of current trends in overall and core inflation, which rose markedly after March (Figure 5.1). The inflation diffusion index shrank at the same time, suggesting that in the total number of products there was a decrease in the number of products with price increases, though it did not depart much from the average seen last year.

The annual consumer price inflation rate increased from 1.2% in December 2017 to 1.9% in May 2018, after dropping to 0.8% in February. Core inflation slowed down from 1.4% in December to 0.7% in February, where it held steady until May. The slowdown was mostly caused by the fall in the annual rate of change in the prices of clothing and footwear, some food products (particularly meat and milk), catering services and motor vehicles. The annual rate of change of industrial producer prices (excluding energy) also dropped, from 1.0% in December to 0.0% in May, mostly reflecting price decreases in the production of non-durable consumer goods (food products and beverages). Such developments probably mirror the fall in prices of these products in the global market in the second half of 2017, which passed through to producer prices in the domestic market with a time lag.

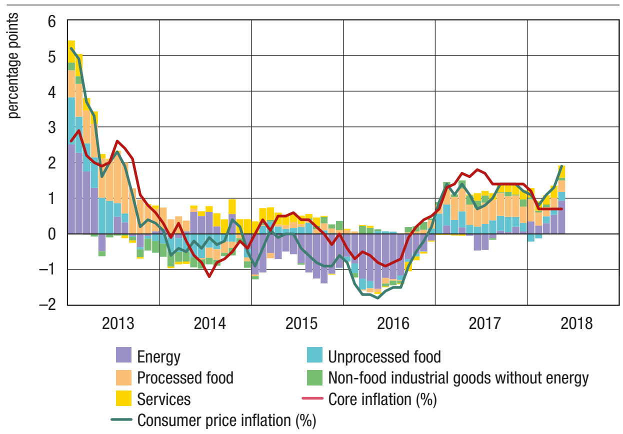
Broken down by main components, energy prices made the largest contribution to the rise in the annual inflation rate in the first five months of 2018 (Figure 5.2). The contribution of energy prices to overall inflation rose from 0.1 percentage point in December to 0.9 percentage points in May. This was mostly due to the rise in the prices of refined petroleum products, triggered by the growth in crude oil prices in the global market, and the waning of the effect of decreases in electricity prices in early 2017 on the annual rate of change in these prices. In addition,

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 whose prices increased 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, Eurostat and CNB calculations.

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



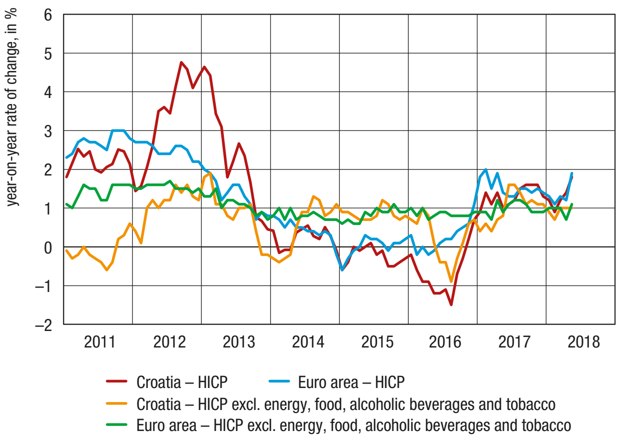
Note: Core inflation does not include agricultural product prices, energy prices and administered prices.
Sources: CBS and CNB calculations.

Table 5.1 Price indicators
year-on-year rate of change

	12/16	3/17	6/17	9/17	12/17	3/18	5/18
Consumer price index and its components							
Total index	0.2	1.1	0.7	1.4	1.2	1.1	1.9
Energy	–1.1	–0.1	–2.8	0.5	0.4	1.8	5.6
Unprocessed food	1.7	4.2	2.2	4.5	2.6	2.1	2.6
Processed food	1.0	2.8	2.3	2.8	2.0	1.1	1.4
Non-food industrial goods without energy	0.2	0.3	0.8	0.1	0.8	0.3	0.3
Services	–0.1	–0.1	0.8	0.9	1.0	1.0	1.3
Other price indicators							
Core inflation	0.5	1.4	1.8	1.4	1.4	0.7	0.7
Index of industrial producer prices on the domestic market	–0.1	1.1	0.4	2.2	2.1	1.2	2.9
Index of industrial producer prices on the domestic market (excl. energy)	–0.9	0.1	0.5	0.9	1.0	0.5	0.0
Harmonised index of consumer prices	0.7	1.1	1.1	1.6	1.3	1.2	1.8
Harmonised index of consumer prices at constant tax rates	0.6	1.0	1.0	1.6	1.2	1.1	1.7

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

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



Sources: CBS and Eurostat.

the contribution of services prices to the overall annual rate of inflation also grew, albeit to a lesser extent. The main reason was the increase in the annual rates of change in the prices of communication and transportation, and the disappearance of the effect of the fall in the prices of refuse collection in early 2017 on the annual rate of change in these prices.

Processed food and non-food industrial goods without energy were the components whose contribution to the overall annual inflation rate decreased in the first five months of 2018. The fall in the contribution of processed food was largely the outcome of the waning of the effect of the increase in the prices of milk, and oil and fats in the first five months of 2017. Domestic market prices of butter also decreased in the current period, but remained considerably higher than in May 2017. Such trends reflect the circumstance that butter prices in the EU market, which had dropped in the last quarter of 2017, started to grow again in February. Furthermore, the decline in the contribution of non-food industrial goods without energy was mostly due to the trends in the prices of clothing and footwear and motor vehicles, which went steadily down from the beginning of the year. The annual rate of change in the prices of unprocessed food products was the same in May as in December. The rise in the annual rate of change in the prices of agricultural products was offset by the fall in the annual rate of change in meat prices, probably also due to the notable slump in pork prices in the EU market.

Euro area inflation also picked up, from 1.4% in December to 1.9% in May (Figure 5.3). As in Croatia, this was mostly attributable to energy prices, due to the rise in crude oil prices in the global market. The contribution of services prices also grew notably, the contribution of processed and non-processed food products grew much less, whereas the contribution of the prices of non-food industrial goods without energy decreased. Core inflation (which excludes the prices of energy, food, alcoholic beverages and tobacco) accelerated from 0.9% in December to 1.1% in May, spurred mostly by the rise in services prices.

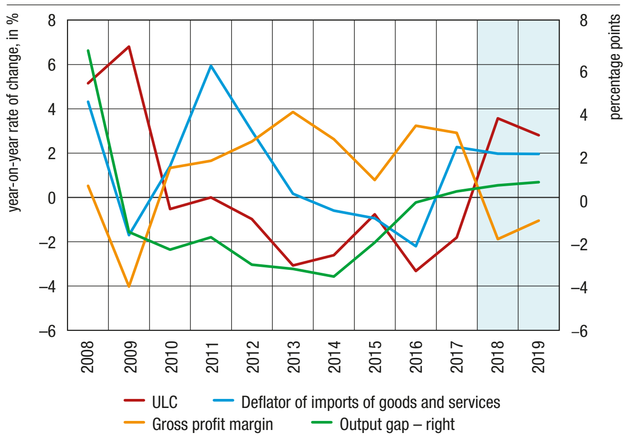
The annual inflation rate in Croatia, measured by the HICP, rose from 1.3% in December to 1.8% in May. The main reason for this was the faster annual increase in energy prices, primarily spurred by the rise in the prices of refined petroleum products and the disappearance of the effect of the reduction in electricity prices in early 2017. As a result, inflation was 0.1 percentage point lower in May in Croatia than in the euro area, the same as in December. Core inflation (measured by the HICP excluding energy, food, alcoholic beverages and tobacco prices) edged down in Croatia, from 1.1% in December to 1.0% in May, and was only slightly lower than that in the euro area.

Projected developments

The average annual inflation is projected to go up from 1.1% in 2017 to 1.7% in 2018, mostly owing to the notable increase in the annual growth of energy prices. The contribution of the consumer price index excluding food and energy is also expected to grow marginally, while the contribution of food prices to overall inflation might be lower than in 2017. The projected increase in the annual rate of change in energy prices is largely a result of the rise in domestic retail prices of refined petroleum products triggered by the rise in global crude oil prices in the first half of 2018. It is estimated that the contribution of refined petroleum products to overall inflation might reach around 1.0 percentage point in mid-2018. Trends in spot market prices of Brent crude oil suggest that these prices might drop slightly in the second half of 2018. The projected acceleration in the annual growth of consumer prices excluding food and energy in 2018 largely reflects indirect effects of the previous increase in the prices of crude oil and other raw materials in the global market, and domestic factors, such as the foreseen increase in unit labour costs and personal consumption, supported by favourable trends in the labour market, i.e. wage growth and decrease in unemployment. By contrast, the projected slowdown in the average annual growth in food prices mostly reflects the waning of the effects of sharp increases in vegetable prices in early 2017 and partly the negative pass-through effect of a noticeable decrease in the prices of some food products in late 2017 (milk, dairy products and oil and fats). However, as there are some upward pressures on food prices coming from the growing prices of food raw materials in the global market in the first half of this year, the annual growth rate of food prices is expected to be higher at end-2018 than at end-2017.

The average annual consumer price inflation rate might drop to 1.6% in 2019. This may be mostly caused by the slower annual increase in energy prices (in particular refined petroleum products), which in turn may be the outcome of trends in the global market as the average price of a barrel of Brent crude oil is expected to fall in 2019. By contrast, the annual increase in food prices is projected to accelerate in 2019, spurred by the

Figure 5.4 Domestic and foreign inflation indicators

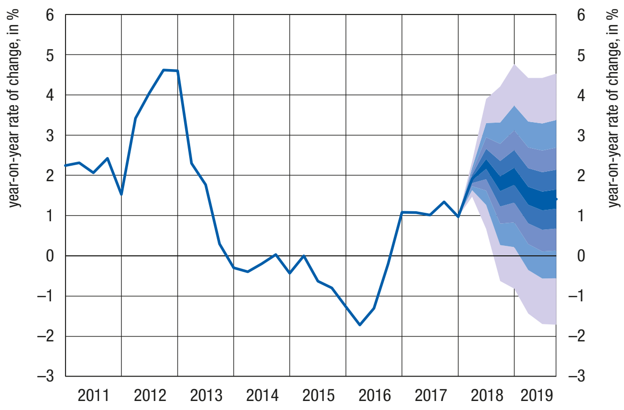


Note: Gross profit margin is calculated as the difference between the annual rate of change of the GDP deflator and the annual rate of change of unit labour costs.
Sources: Eurostat, CBS and CNB calculations.

expected mild growth in food product prices in the global market. The average annual growth in the consumer price index excluding food and energy might continue to trend up slightly (to 1.3%) amid the expected acceleration in euro area core inflation, the rising positive domestic output gap and the pass-through of previous increases in the prices of refined petroleum products to the prices of products in whose production they are extensively used. Also, the rise in unit labour costs in the domestic economy might be relatively strong in 2019 as well, albeit less intense than in 2018.

It is estimated that the risks of lower than projected or higher than projected inflation are balanced. Risks of a higher than projected inflation rate include a potential stronger growth in the prices of oil and other raw materials in the global market, triggered by mounting geopolitical tensions and further disruptions in the supply of crude oil from key producers in Iran and Venezuela, and, in the short-run, the strengthening of trade protectionism. In addition, weather adversities could boost agricultural product prices. Risks that might lead to lower than projected inflation include lower prices of crude oil and other raw materials (in case of a possible significant slump in global economic growth and/or a larger than expected growth in oil production, particularly in the US). Also, a lower inflation in 2019 might be due to administrative measures, such as the second stage of the tax reform, which, it has been announced, will include tax cuts for entrepreneurs and/or citizens.

Figure 5.5 Projection of consumer price inflation

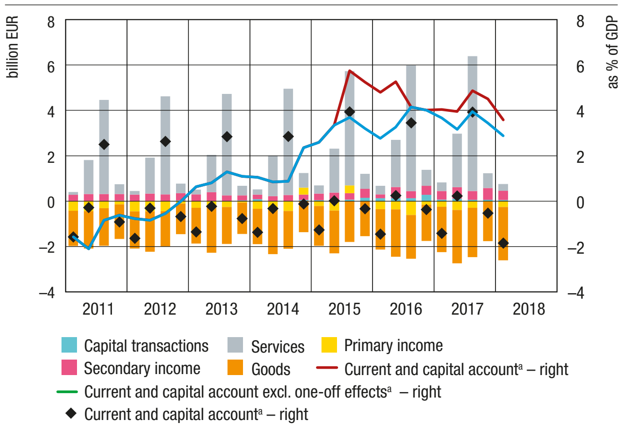


Sources: CBS and CNB calculations.

6 Current and capital account

The current and capital account deficit rose sharply in the first quarter of 2018 from the same period of the previous year. This was mainly due to unfavourable developments in foreign trade in goods as a result of a fall in exports. Although to a lesser extent, the balance of foreign trade in services also worsened. At the same time, the balance in the primary income account and the sum of balances in the secondary income account and in the account of capital transactions held steady. If cumulative results in the previous year are observed, in the first quarter of 2018 the surplus in the current and capital account stood at 3.6% of GDP (or 2.9% of GDP if one-off effects of Agrokor on bank profit are excluded).

Figure 6.1 Current and capital account balance and its structure



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

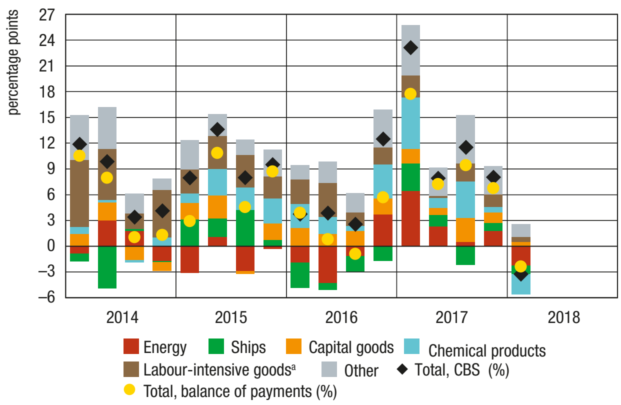
Foreign trade and competitiveness

According to CBS data, in the first quarter of 2018 the foreign trade deficit rose by over one fourth from the same period of the previous year[24]. Such very unfavourable developments in foreign trade in goods were largely driven by a worsening of the balance of trade in medical and pharmaceutical products and a widening of the deficit in the trade in oil and refined petroleum products, mostly attributable to an increase in the quantities imported and to a lesser extent to higher prices. In addition, the balance of trade in road vehicles and ships also deteriorated considerably. The balance improved only in a few product categories, in particular trade in electricity and natural and manufactured gas.

Total goods exports fell by 3.0% on an annual level in the first three months of 2018, primarily attributable to the unfavourable effect of the base period and the very sharp growth of exports (25.7%) in the same period of the previous year. The last year's growth in exports was fuelled particularly by energy, medical and pharmaceutical products and other transport equipment (mostly ships). It is exactly these products that contributed the most to this year's fall in exports. Particularly sharp was the fall in exports of electricity to Bosnia and Herzegovina, followed by a fall in the exports of medical and pharmaceutical products to the USA and ships to Sweden and Cyprus. If energy products, medical and pharmaceutical products and ships are excluded, goods exports rose by 3.9% on an annual level in the first three months of 2018, although this increase is still a considerable slowdown from the previous year. Such developments may be explained by a slowdown in economic activity in Croatia's main

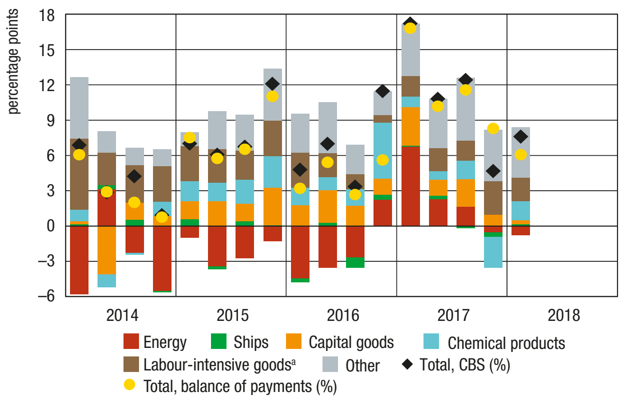
24 The annual growth in the deficit in the goods account according to balance of payments data was slower and stood at 17.4%, since data adjustments for the purposes of balance of payments compilation resulted in a small fall in goods exports and a slower growth of goods imports at the beginning of the year than suggested by CBS foreign trade statistics.

Figure 6.2 Goods exports
year-on-year rate of change and contributions



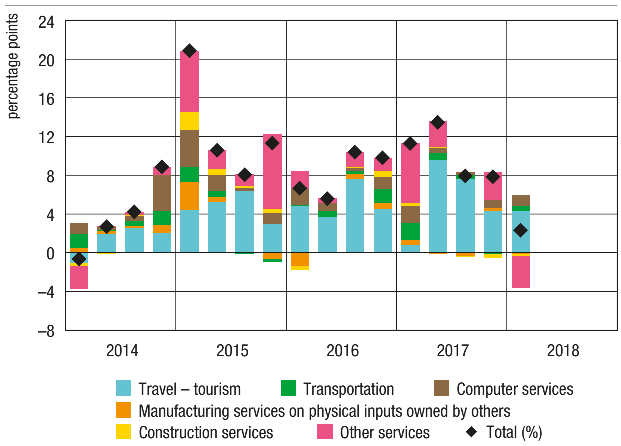
[a] Labour-intensive goods (according to the SITC) include: textile, wearing apparel, footwear, leather, paper, cork and wood, furniture, manufactures of metals and non-metallic mineral manufactures, prefabricated buildings and manufactured articles n.e.c.
Sources: CBS and CNB.

Figure 6.3 Goods imports
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.

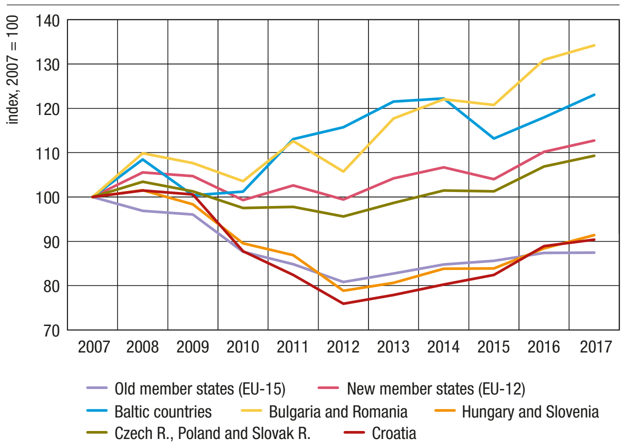
foreign trading partner countries earlier this year, particularly in Germany, which had an unfavourable effect on the export results of other Central and Eastern European countries. The first data on developments in foreign trade in goods for April 2018 suggest a sharp rise in Croatian goods exports of 16.1% from the same period of the previous year.

By contrast, goods imports continued to grow relatively sharply owing to favourable developments in the labour market and strengthening of personal consumption, despite a considerable slowdown in the growth of imports from the previous year. In the first quarter of 2018, total goods imports rose by 7.6% on an annual level, despite lower imports of energy products. A sharp rise in imports of oil and refined petroleum products was offset by an even sharper fall in imports of electricity. At the same time, the growth in imports of the narrow aggregate (excluding energy products) stood at 9.8% and was broadly based. Worth noting in particular were the growth in imports of road vehicles from the Czech Republic and France, metal industry products from Italy, Germany and Russia, medical and pharmaceutical products from South Korea and scientific and control instruments from China.

As well as in foreign trade in goods, unfavourable developments were recorded in the foreign trade in services. In the first quarter of 2018, net exports of services declined by approximately one fifth from the same period of the previous year, influenced by lower net income from travel and other services as tourism consumption abroad by residents continued to rise sharply, exceeding the growth in income from consumption by foreign guests. And while the expenditures from travel services rose by 40.9% in the first three months of 2018, on an annual level, revenues from travel services rose at the same time by 13.7%, largely influenced by Easter holidays that came earlier than in the previous year. Tourism volume indicators also improved considerably. The numbers of arrivals and of nights of foreign guests in commercial accommodation rose by almost one quarter and one third respectively, mainly attributable to tourists from Germany and Austria. As regards other services, a deterioration in the balance was seen in the trade in personal, cultural and recreational services, repair services and research and development services.

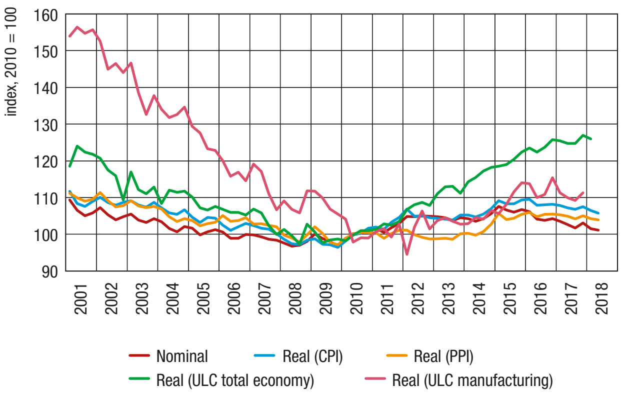
Despite favourable developments in tourism, the unfavourable results in goods exports earlier this year could start having an unfavourable impact on the Croatian share of the global market,

Figure 6.5 World market share of exports of goods and services



Source: Eurostat.

Figure 6.6 Nominal and real effective exchange rates of the kuna



Notes: A fall in the index indicates an effective appreciation of the kuna. In the second quarter of 2018, data on the real exchange rate deflated by consumer and producer prices refer to April and data on the nominal exchange rate to April and May.
Source: CNB.

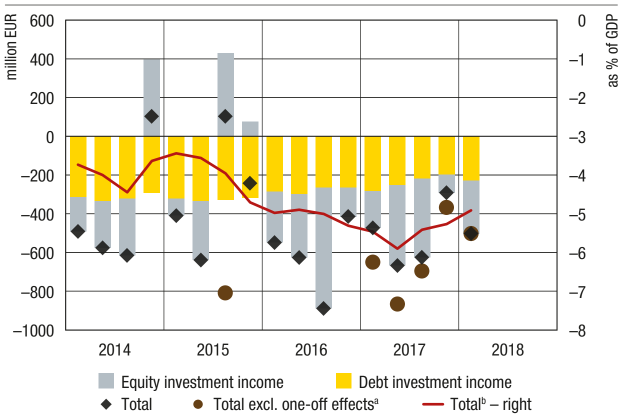
which has been growing strongly in the past several years. Although Croatia has been recording growth in the market share for five consecutive year owing to a considerable rise in goods exports since accession to the EU and a steady growth in revenues from tourism, it has yet not evened out the losses generated in the years following the outbreak of the crisis.

The fall in goods exports in the first quarter of 2018 was accompanied by a small deterioration in price and cost competitiveness of exports as the real effective exchange rates of the kuna deflated by consumer and producer prices appreciated slightly in the first quarter, and the similar trend continued in early second quarter. This was due to the appreciation of the nominal effective exchange rate of the kuna, only slightly mitigated by slightly more favourable developments in domestic prices compared to the prices of Croatia's main trading partners. Nevertheless, the cost competitiveness of Croatian exports continued to be better than it was several years ago.

Income and transactions with the EU

The deficit in the primary income account held steady in the first quarter of 2018 at the same level as in the previous year.

Figure 6.7 Investment income

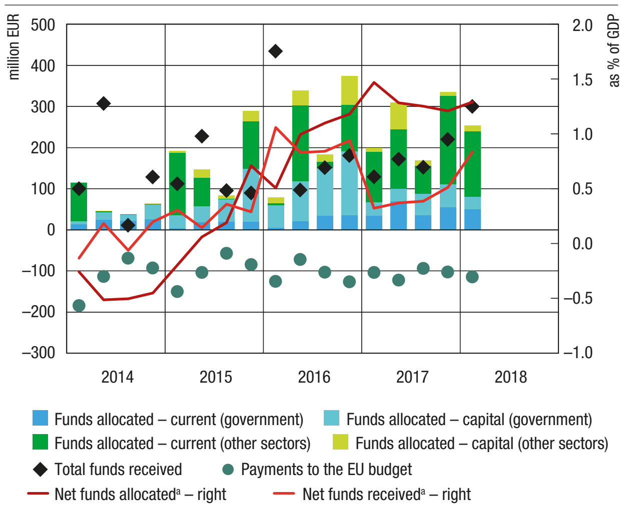


[a] One-off effects include conversion of CHF-linked loans in 2015 and bank provisions for loans to the Agrokor Group and affiliated enterprises in 2017.
[b] Sum of the last four quarters, excluding one-off effects.
Source: CNB.

The increase in net expenditures on equity investments was offset by the decline in net expenditures on debt investments and further growth in net revenues from compensation of employees abroad. With regard to income from direct equity investments, resident revenues from foreign investments shrank, particularly because of poorer business results in wholesaling. At the same time, the profit of non-resident-owned domestic business entities increased, particularly in financial activity (bank profit last year was negatively influenced by provisions for loans to the Agrokor Group and affiliated enterprises). By contrast, owing to a fall in interest rates and lower debt level, interest expenses on external debt of the domestic sectors decreased, particularly those of non-financial corporations (largely influenced by discontinued interest accrual on the old external debt of Agrokor).

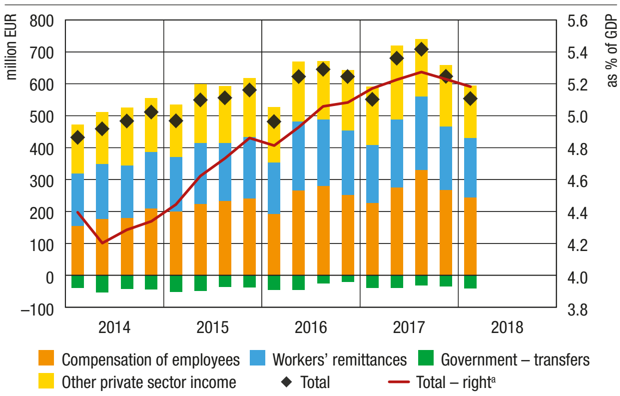
Total net revenues arising from transactions with the EU

Figure 6.8 Transactions with the EU budget



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

Figure 6.9 Other income, excluding investment income and transactions with the EU, net



[a] Sum of the last four available 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.

budget rose slightly in the first three months of 2018 from the same period of the previous year. End beneficiaries received slightly more current revenues, while the amount of capital revenues paid out held steady. Cumulatively, the surplus of funds utilised from EU funds over the payments to the EU budget, reported as the sum of the last four quarters, stood at 1.3% of GDP, a small increase from the end of 2017.

Other income, excluding income from investments and transactions with the EU budget, has not changed much from the same period of the previous year. A further small growth in net revenues from compensation of employees working abroad and personal transfers was accompanied by a fall in other income. Long-term trends and economic implications of inflows from personal remittances from abroad are analysed in more detail in Box 4 Personal remittances from abroad.

Projected developments

The current and capital account balance is expected to deteriorate further in the remaining part of the current year, largely owing to the widening of the deficit in foreign trade in goods and to a lesser extent to the rising deficit in the primary income account. Hence, throughout 2018, the surplus in the current and capital account might stand at 3.2% of GDP, a decline of 1.3 percentage points from 2017 (i.e. only 0.3 percentage points if the effect of provisions for loans to the Agrokor Group on bank profit last year is excluded).

In 2018, the foreign trade deficit in goods might rise by over one tenth, as a result of growth in net imports of energy products (particularly oil and refined petroleum products owing to a rise in crude oil prices on the global market) and a large net imports of other goods. Export growth is expected to be slower than in the previous year, reflecting the assumption of slower growth of foreign demand in the country's main trading partners, although it will remain relatively strong. The growth in goods imports could also be slightly slower than in the previous year but more pronounced than the growth in goods exports owing to further strengthening of domestic demand, further favourable developments in the labour market, placement recovery and the considerable import dependency of the domestic economy.

Unfavourable developments in trade in goods might be in part mitigated by further growth in net services exports, particularly owing to revenues from travel services. After very favourable developments in the last three years, the expectations are that in 2018, due to a high base, the growth in revenues from tourism will slow down, although it may still be considerable (7%). This assumption is based on positive economic developments in the main outbound markets, significant investments in accommodation capacities and improvement in tourist supply. This is expected to be accompanied by a further growth in tourism consumption abroad by residents.

In 2018, the deficit in the primary income account could widen as a result of growth in net expenditures on direct equity investment, mostly attributed to the growth in bank profit influenced last year by unfavourable provisions for loans to the Agrokor Group and affiliated enterprises. By contrast, the positive balance in the secondary income account and in the account of capital transactions might rise additionally, primarily because of a further growth in net revenues from transactions with the EU budget which might rise to 1.7% of GDP by the end of 2018. Compensation of employees and personal transfers from abroad are also expected to continue growing.

In 2019, the surplus in the current and capital account might shrink further to 2.8% of GDP, as a result of further widening of the foreign trade deficit. Despite expectations of further positive effects of EU accession on exports, the slowdown in foreign demand is expected to weaken the dynamics of goods exports. At the same time, imports growth might be somewhat more pronounced, mirroring the expectations of further growth in domestic demand.

Unlike foreign trade in goods, in 2019 the foreign trade in services is expected to have a positive impact on the current account and capital account balance. This is true in particular of the assumption of a further growth in revenues from tourism which, based on a conservative approach to growth projections due to the high sensitivity of tourism to changes in macroeconomic conditions and geopolitical situation, and factoring in the high base, is expected to stand at approximately 5%. The growth trend in tourism consumption abroad by residents could also continue, although at a slower pace than in the past few years. Further growth in net exports of other services is also expected to have a favourable impact on developments in foreign trade in services.

No significant changes are expected in the primary income account balance in 2019, although net revenues in the secondary income account and the capital account might rise additionally. The growth in expenditures on equity investments is expected to be small and so are interest expenses, given that the impact of interest rate growth is limited by the trend of deleveraging of the domestic sectors. In addition, it is assumed that EU funds absorption capacity will strengthen further and accordingly, net receipts from transactions with the EU budget are expected to grow further and to stand at approximately 2% of GDP by end-2019. Further growth in remittances from abroad is also expected to have a positive impact on income balance.

Downside risks to the projection of the current and capital account surplus include primarily the unfavourable impact of increased trade protectionism on global trade and growth, i.e. foreign demand for Croatian exports. They are compounded by the risk of rising political instability in Italy, the most important market for Croatian goods exports, and generally a faster slowdown in the economic growth of Croatia's main trading partners. The negative risk arises also from a possibly more pronounced growth in crude oil prices and more pronounced growth in interest rates and volatility in the global financial market. By contrast, there are also some upside risks associated with faster growth in revenues from tourism, particularly at the end of the projection period and a bigger withdrawal of funds from structural and cohesion funds of the EU.

Box 4 Personal remittances from abroad

Croatia stands out among new EU member states by the relatively large inflows from personal remittances, which have risen considerably in the past three years. However, the positive effect of these inflows on the national disposable income is largely cancelled out by outflows based on other income, primarily investment income. In Central and Eastern European countries, investment income outflows greatly exceed inflows from personal remittances, reflecting their faster economic growth and greater return on investments of non-residents than in Croatia. Even though personal remittances, as a stable funding source, act in a countercyclical fashion and support economic activity, they should not be observed separately from the emigration *flows from which they arise and which have negative long-term implications on economic growth potential.*

Emigration of population, either temporary or permanent, generates foreign financial flows that may result in considerable macroeconomic implications for the domestic economy. Statistically, transfers sent by emigrants to their countries of domicile are recorded in the current account of the balance of payments, in the sub-account secondary income, under item personal transfers. Personal transfers include all current transfers in cash or in kind received by resident households from non-resident natural persons, regardless of whether they are workers' remittances or other forms of aid. However, very often a broader concept of personal remittances is used which, in addition to personal transfers also includes compensation of employees. Compensation of employees is income received from legal persons by residents employed abroad. Unlike personal transfers recorded in the sub-account of the secondary income, compensation of employees is recorded in the sub-account of the primary income of the balance of payments.

Before data analysis, account should be taken of the limited availability of the sources of data and methodological changes[25], and of the fact that data relating to personal remittances are compiled on the basis of banking data and do not include physical transfer of cash.

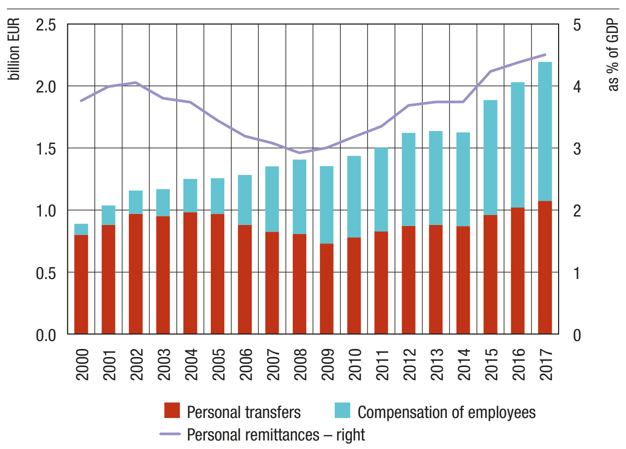
Inflows from personal transfers to Croatia from 2000 to 2017 were relatively stable nominally (Figure 1) but owing to a simultaneous growth in gross domestic product, their relative share in GDP fell by one third (from 3.4% to 2.2% of GDP). As regards their geographical structure, personal transfers from traditional emigration countries such as Germany, Switzerland, USA and Italy are dominant. By contrast, income from compensation of employees, which includes income of seafarers sailing on foreign ships, workers on drilling rigs, persons living in national border areas and working across the border, and other temporary workers abroad, rose more sharply throughout the period and its share in GDP rose from 0.4% in 2000 to 2.3% in 2017.

In total, the share of total income from personal remittances to Croatia rose from 3.8% of GDP in 2000 to 4.5% of GDP in 2017[26]. Its growth was particularly strong after Croatian accession to the European Union and the ensuing greater emigration flows[27]. Personal remittances are an important source of foreign exchange inflows, and their relative importance when compared to other forms of capital inflows is manifested in the fact that in the post-crisis period only the net inflows from personal remittances remained stable, and exceeded foreign direct, portfolio and other investments (Figure 2).

As a stable funding source, the inflow from personal remittances from abroad was able to mitigate to an extent the negative effects of recession in Croatia during the crisis, increasing the gross national disposable income[28]. It is worth noting that its positive impact on the national disposable income was mostly cancelled out by outflows based on other primary and secondary income (Figure 3). This is true in particular of income from foreign investments, i.e. dividend payments and reinvested earnings of foreign owners of domestic business entities and interest expenses on external debt. In addition to personal remittances, only income from the EU budget and foreign pensions have a somewhat more significant positive net impact on the national disposable income. In 2017, net receipts from each of these sources stood at 0.8% of GDP.

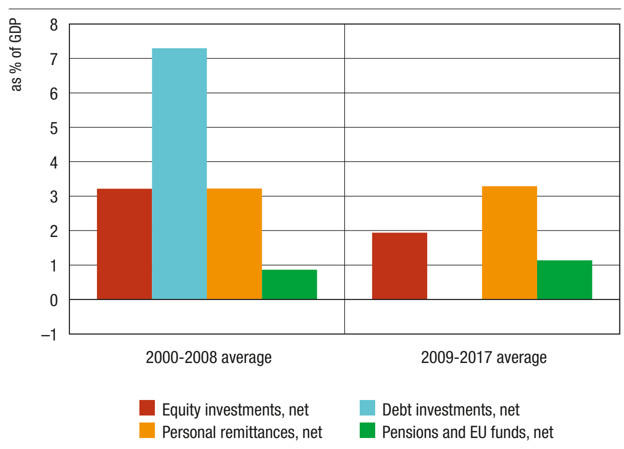
In other European transition countries, income from personal remittances is also an important and relatively stable source of national income. The average share of personal remittances from abroad in GDP of new EU member states tripled from 2000 to 2016, having risen from 1.0% to 3.0% of GDP. Although Croatia stands out as one of the countries with the largest inflows

Figure 1 Personal remittances to Croatia, revenues



Note: Personal remittances include personal transfers and compensation of employees.
Source: CNB.

Figure 2 Personal remittances and other foreign exchange inflows



Source: CNB.

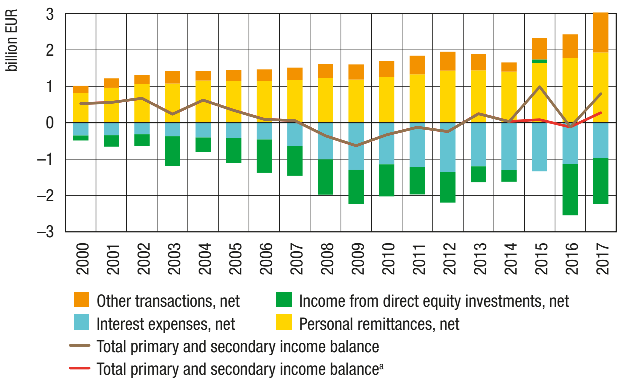
25 After 2011, instead of the ITRS (International Transactions Reporting System), aggregated banking data became the basis for data compilation. However, since 2015, these data no longer contain information on the foreign transaction ordering party (a legal or a natural person) on the basis of which transactions were divided into compensation of employees and personal transfers and since then this division is estimated on the basis of historical relationships. Total transactions in which the transaction-ordering party is a legal person include pensions too, but they are assessed separately based on CPII data and are also a component of the secondary income, but are not classified as personal remittances under the applicable Balance of Payments Manual. When they are excluded, the remaining amount of foreign transactions in which the transaction ordering party is a legal person constitutes compensation of employees.

26 However, personal remittances also generate expenditures, albeit relatively low ones. More precisely, the expenditures on personal remittances rose from 0.3% of GDP in 2000 to 0.6% of GDP in 2017.

27 See Box 3 Dynamics and characteristics of emigration from Croatia and other new EU member states to the old member states.

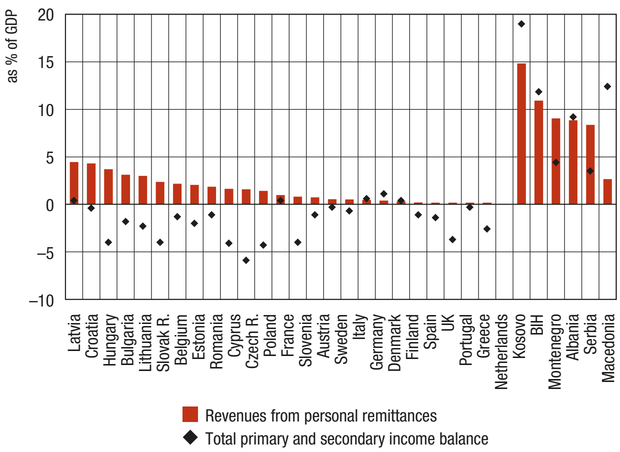
28 The gross national disposable income equals the gross domestic product increased by the balance of the primary and secondary income of the current account of the balance of payments.

Figure 3 Primary and secondary income balance



[a] Excluding one-off effects on bank profit (conversion of CHF-linked loans in 2015 and bank provisions for loans to the Agrokor Group in 2017).
Note: Other transactions include, among others, current transactions with the EU budget, pensions and other current transfers of the government and other sectors.
Source: CNB.

Figure 4 Selected European countries' personal remittances and primary and secondary income balance in 2016



Sources: World Development Indicators database and Eurostat.

from personal remittances in this group of countries, Lithuania, Latvia and Hungary recorded even greater inflows from this source. In the case of these countries, as in the case of Croatia, income from personal remittances in the post-crisis period largely exceeded net inflows from direct investments.

The importance of personal remittances is even more evident in non-EU Southeastern European transition countries. For instance, in Kosovo income from personal remittances from abroad amounts to a high 15% of GDP, and that in Bosnia and Herzegovina lags behind only slightly, followed by those of the other countries of the region. But in the cases of these countries, the relative importance of remittances diminishes as their economies converge towards a higher level of income.

Observed in the context of the national disposable income, unlike the case of Croatia which generally has a balanced primary and secondary income balance, most new EU member states steadily record a negative balance, which makes their gross national disposable income smaller than the gross domestic product (Figure 4). This is particularly evident in the Czech Republic, Hungary and Slovakia due to high expenditures on equity investments and interest expenses. In addition to a high level of accumulated foreign investments, relatively high yields generated by foreign investors in these countries also contribute to expenditures. The countries of Southeastern Europe again differ greatly in this sense. Due to a lower level of accumulated foreign liabilities, both equity and debt, and greater transfers to the public sector, the total primary and secondary income balance is highly positive in these countries, greatly increasing their gross national disposable income.

Remittances from abroad play a significant role in transition countries' economies because of their stability and countercyclical character, atypical of other forms of private capital flows. They may support domestic economic growth and macroeconomic stability through increased household consumption and enhanced household resilience during a crisis. However, their investment potential is rather limited and they may also have negative impacts on the labour market, primarily in the form of diminished initiative for employment on the part of remittance beneficiaries.

Over a long-term, the effects of remittances may not be observed separately from emigration flows and then negative macroeconomic effects may prevail. The 2016 IMF[29] analysis which included the countries of Central, Eastern and Southeastern Europe came to a similar conclusion. According to IMF findings, remittances from abroad since the early 1990s to an extent served to fuel consumption and investments in the observed countries, but the emigration of a largely young and educated workforce generally slowed down the economic growth and real convergence of these countries.

In the future, Croatia may expect to see again stable and rather ample foreign exchange inflows from personal remittances from abroad, and the increased outflow of population recorded in the past few years might only serve to amplify these inflows. Although this might result in positive short-term effects on aggregate household consumption, over a long term it will probably be the negative consequences of the emigration of the working age population, reflected in a reduction of potential economic growth, that will prevail.

7 Private sector financing

In general, domestic sectors' financing conditions continued to improve in the first half of 2018. The costs of short-term government borrowing were more favourable than in 2017 as suggested by the interest rate on one-year kuna T-bills which fell from 0.20% in December 2017 to a historically low 0.09% in February 2018, where it held steady until end-May. The interest rate on one-year euro T-bills also fell, from 0.01% in October 2017 to 0.00% in May 2018. In the first half of the year the government also enjoyed more favourable conditions for long-term borrowing on the domestic market, which is particularly evident

29 IMF (2016): *Emigration and Its Economic Impact on Eastern Europe*, IMF Staff Discussion Note.

in the yield curve for kuna bonds without a currency clause (Figure 7.1a), while the yield curve for kuna bonds with a currency clause in euro did not show any significant changes from the end of 2017 (Figure 7.1b). In June, the government also issued a 10-year eurobond of EUR 750m, yielding 2.898%.

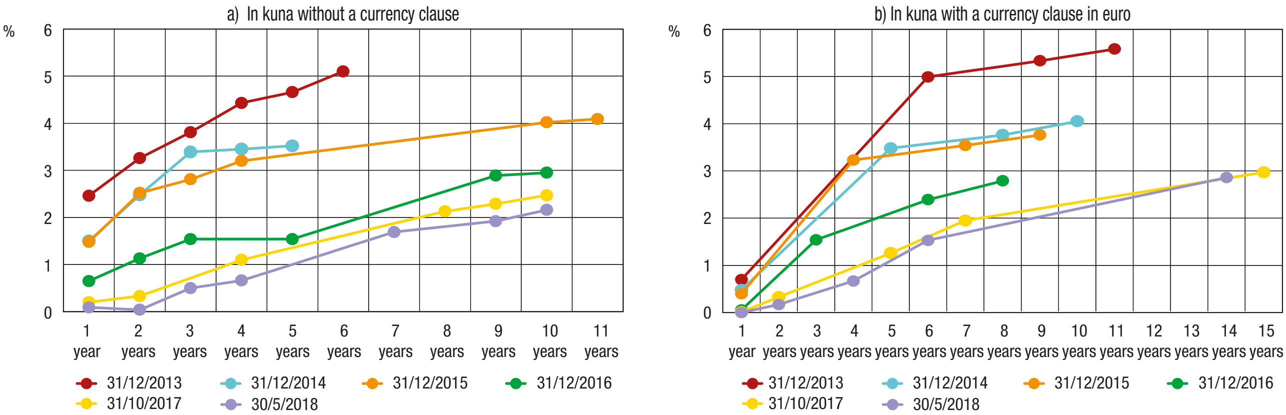
By contrast, the cost of government borrowing on the foreign market estimated on the basis of the sum of EMBI indices for Croatia and the yield on German government bonds rose slightly from 2.2% at the end of 2017 to 2.5% at the end of May 2018 (Figure 7.3). As regards the credit default swap, CDS, for Croatia, after falling by approximately 120 basis points in the previous year, it continued to fall in the first quarter of 2018 by a further 10 basis points to the level of approximately 85 basis points. However, during the second quarter, the risk premium for Croatia and other emerging market economies of Europe rose, again exceeding the level of 100 basis points. As regards rating agencies' perception of Croatian risk, in January 2018 Fitch upgraded Croatia's credit rating from 'BB' to 'BB+' with stable outlook. Standard&Poor's followed suit, upgrading Croatia's rating in March.

The costs of corporate financing continued to fall, albeit very slowly. The average interest rate on short-term corporate borrowing in April stood at end-last year level, while the interest rates on long-term corporate loans continued to fall throughout the first quarter, though rising only very slightly, in April to 3.2%, a decrease of 0.5 percentage points from the end of 2017 (Figures 7.2 and 7.3). The downward trend was particularly pronounced in interest rates on loans up to HRK 7.5m, although the interest rates on loans above HRK 7.5m were still lower than those on smaller amounts since loans of larger amounts are commonly used by larger companies with more collateral and better access to alternative financing (Figure 7.4).

The interest rates on household loans fell slightly from the end of the previous year. This is true of both short-term and long-term interest rates on housing loans and consumer and other loans, which fell by approximately 0.1 percentage point in the first four months of 2018 (Figures 7.2 and 7.3).

Favourable developments in interest rates on corporate and household financing were due to the very high liquidity in domestic and international financial markets and the lower funding costs of the Croatian banking system, with Euribor still in the negative territory (Figure 2.3), while the national reference rate

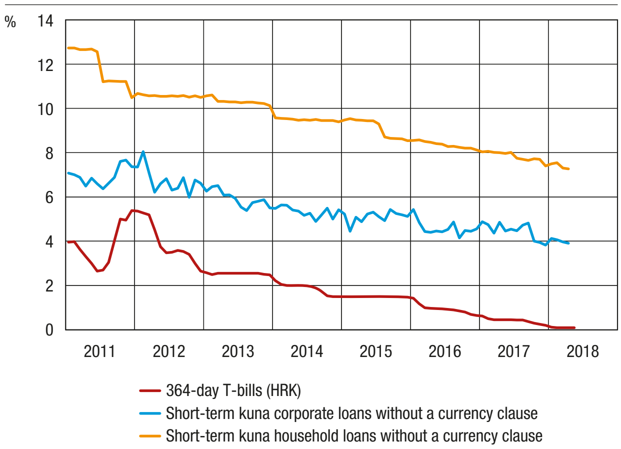
Figure 7.1 Yield-to-maturity on RC bonds



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

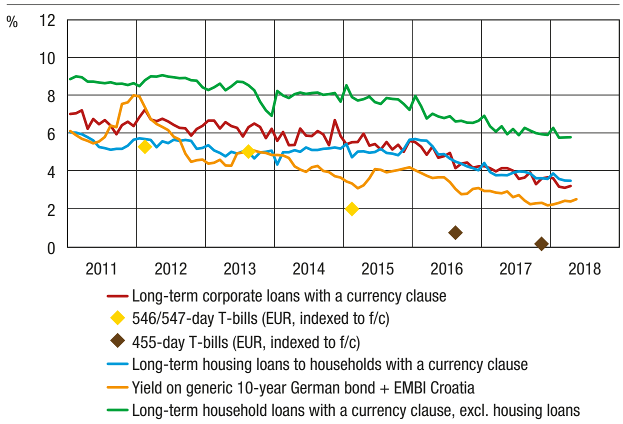
Notes: The dots show the achieved yields, while other values have been interpolated. Data for one-year yield refer to the achieved interest rate on one-year kuna T-bills with a currency clause in euro, while data for the end of 2016 and the end of 2017 refer to November and October respectively.
Source: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

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



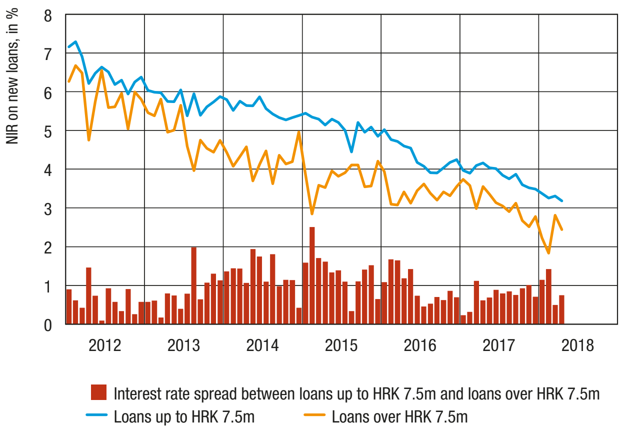
Sources: MoF and CNB.

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



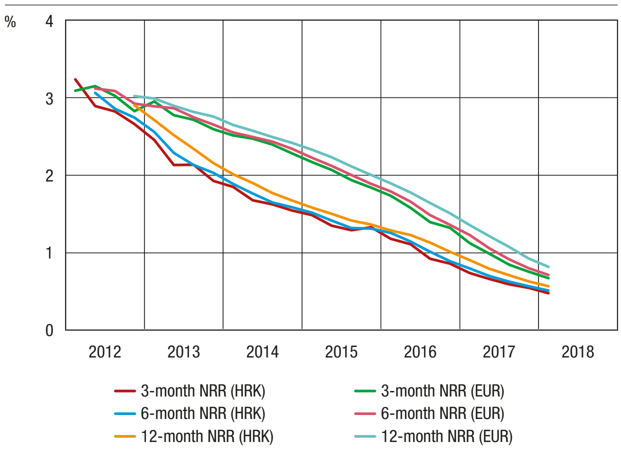
Note: EMBI, or the Emerging Market Bond Index, shows the spread between yields on government securities of emerging market economies, Croatia included, and risk-free securities issued by developed countries.
Sources: MoF, Bloomberg and CNB.

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



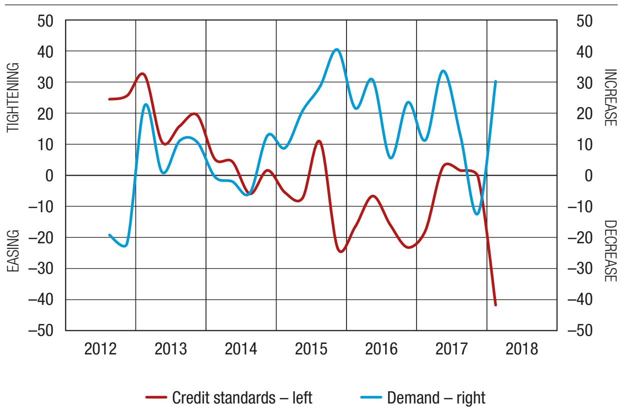
Source: CNB.

Figure 7.5 National reference rate (NRR)



Note: The rates shown refer to the rates for all natural and legal persons.
Source: HUB.

Figure 7.6 Credit standards and corporate demand for loans



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

(NRR)[30] continued to trend downwards (Figure 7.5).

Based on the results of the bank lending survey, credit standards for corporate loans also eased considerably in the first quarter of 2018 (Figure 7.6). If a slight tightening in the second and third quarter of 2017 is excluded, these developments are a continuation of an almost three-year long trend of easing of credit standards for corporate loans. The availability of bank financing on the market and favourable liquidity led to the easing of standards in early 2018, while the banks pointed to industry or individual company outlooks as the key factor that leads to the tightening of credit standards for corporate loans. At the same time, corporate demand for loans has been rising for several years, and this is true in particular of small and medium-sized enterprises. Demand growth was primarily driven by enterprises' needs to finance inventories and working capital as well as gross fixed capital formation.

As regards credit standards for household loans, after years of easing, they tightened considerably in the first quarter of 2018 (Figure 7.7), which may be associated with the use of the new Foreclosure Act and the Decision on the additional criteria for the assessment of consumer creditworthiness and on the procedure of collection of arrears and voluntary foreclosure which had an unfavourable effect on creditworthiness of part of the household sector. By contrast, the growth in demand for housing, consumer and other loans accelerated additionally in the first quarter of 2018. The increased demand for housing loans was mostly driven by a favourable real estate market outlook and consumer confidence while the consumption of durable consumer goods spurred growth in the demand for other types of household loans.

The total debt of non-financial corporations[31] rose in the first quarter of 2018. Corporate borrowing abroad and corporate borrowing from the domestic credit institutions rose, while other domestic financing fell slightly. As regards the annual dynamics, the growth in total corporate debt at the end of March stood at 1.2% (transaction-based), having held steady at levels similar to those in 2017 (Figure 7.8). The main driver of annual growth is private companies' borrowing in the country and abroad, while public enterprises reduced their external debt and slightly increased their domestic debt.

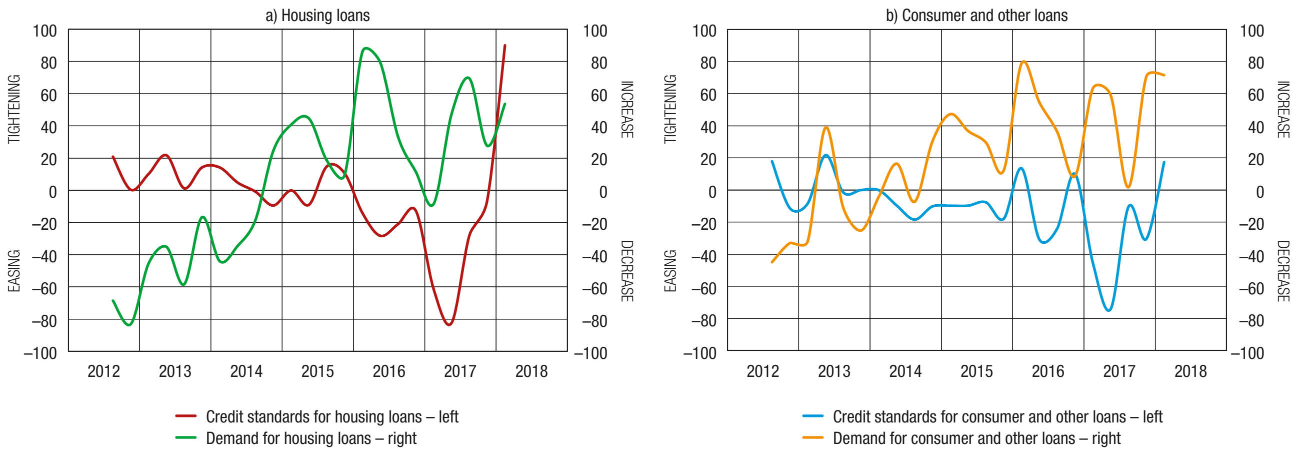
Domestic credit institutions' corporate placements increased by HRK 2.4bn in the first five months of 2018 (transaction-based, Figure 7.9), with their annual growth rate accelerating to 3.1% (transaction-based). By contrast, as regards the nominal stock of corporate placements, the annual growth rate remained negative (–1.3% at the end of May) which is mostly due to the sale of non-performing placements.

The annual growth of corporate placements was spread across different activities, with the biggest contribution to growth being made by service activities, particularly professional, scientific and technical activities and accommodation and food service activities. Real estate activities and manufacturing also witnessed a considerable growth in lending (Figure 7.10). By contrast, construction was the only activity that continued to deleverage. As regards corporate loans by purpose, all major groups of loans grew at the end of May at a similar annual rate of approximately 5%. Investment loans were the only group of loans whose growth slowed down from the previous year, while

30 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 the variable interest rate on loans, in accordance with Article 11a of the Credit Consumer Act (pursuant to the Act on Amendments to the Consumer Credit Act, OG 143/2013).

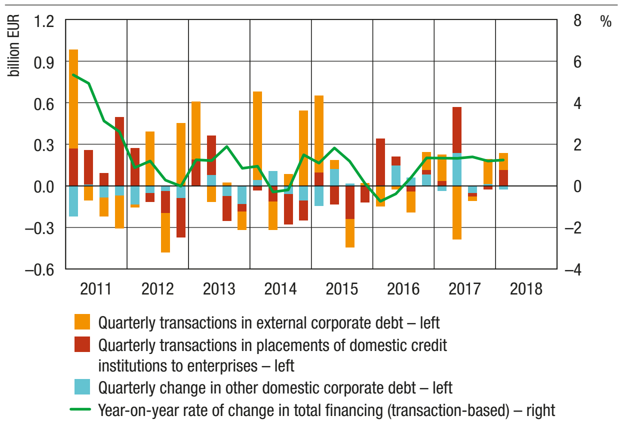
31 Non-financial corporations do not include public enterprises included in the general government sector.

Figure 7.7 Credit standards and household demand for loans



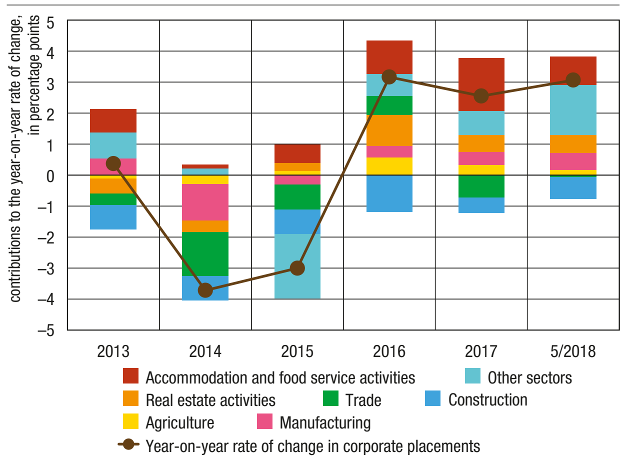
Note: Data show the net percentage of banks weighted by the share in total household loans.
Source: CNB.

Figure 7.8 Corporate financing



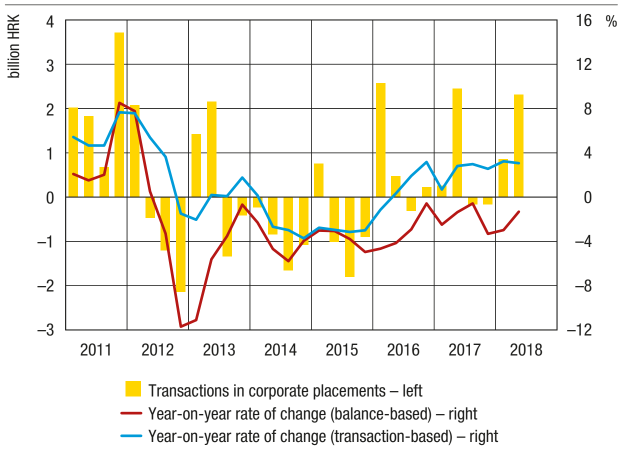
Notes: Other domestic financing includes borrowing from domestic leasing companies and the CBRD. Foreign debt excludes the effect of debt-equity swaps. All changes were calculated according to transactions (except for other domestic debt).
Sources: HANFA, CNB and CNB calculations.

Figure 7.10 Growth of corporate placements by activity
transaction-based



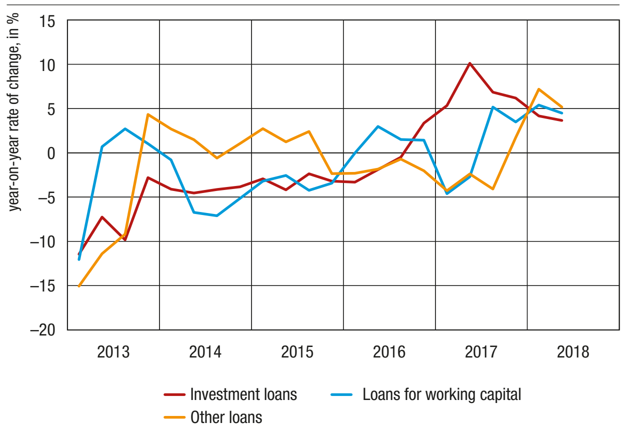
Source: CNB.

Figure 7.9 Corporate domestic placements of credit institutions



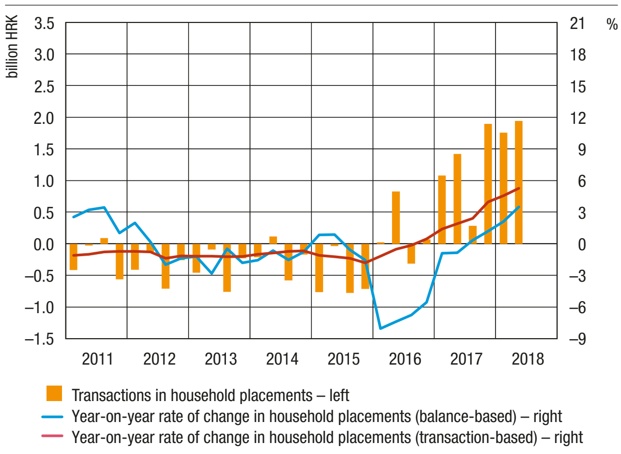
Note: Data are up to May 2018.
Source: CNB.

Figure 7.11 Growth of corporate loans by purpose
transaction-based



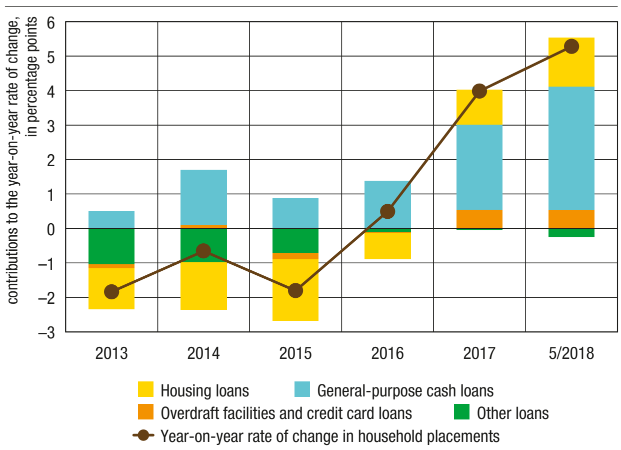
Note: Data are up to May 2018.
Source: CNB.

Figure 7.12 Household placements



Note: Data for the second quarter of 2018 are up to May.
Source: CNB.

Figure 7.13 Growth of household placements by loan type
transaction-based



Source: CNB.

the growth of loans for working capital and other loans accelerated considerably from the year before (Figure 7.11).

Household placements have been growing steadily since October 2016. In the first five months of 2018, they rose by HRK 3.7bn and their annual growth accelerated to 5.3% (transaction-based, Figure 7.12). In addition to favourable financing conditions, acceleration in household lending was also driven by favourable developments in the labour market and consumer confidence. As regards the structure of loans, all major types of loans grew annually (Figure 7.13), with general-purpose cash loans, which grew annually by over 10% in May, making the biggest positive contribution to these developments. The annual growth in housing loans accelerated steadily and stood at 3.2% at the end of May.

Projected developments

It is estimated that in 2018 total placements (government excluded) might grow by 4.6% on an annual level. This acceleration (in 2017 placements grew by 2.9%) is the result of faster growth of placements to corporates and households, which is in line with rising business and consumer confidence and further growth in investments and personal consumption. Household lending will also probably be strengthened by the announced further housing loans subsidies from 2018 until 2020. As regards their nominal stock, the growth of total placements in 2018 was slower than the growth based on transactions owing to a still considerable impact of the sale of non-performing placements. Similar trends in private sector lending might continue in 2019.

The risks to the realisation of the projected credit growth dynamics are balanced. The restructuring of the Agrokor Group and the spillover of the negative effects on the rest of the economy continue to pose a negative risk although this risk is smaller now that the settlement with creditors by the legally prescribed time limit is more certain. The risk of a slowdown in credit activity due to the potential negative effects of the Foreclosure Act and the Decision on the additional criteria for the assessment of consumer creditworthiness and on the procedure of collection of arrears and voluntary foreclosure is still present, however, recent developments suggest that these legislative changes have thus far had no negative impact on household lending dynamics. Furthermore, the increased price of borrowing as a result of growth in the interest rates of the largest central banks continues to pose a negative risk over a medium term. By contrast, further cleaning of the banks' balance sheets paves the way for faster credit growth over a medium term while the expected further growth of economic activity might start being reflected more strongly in the recovery of corporate and household lending.

Box 5 Loans by type of interest rate

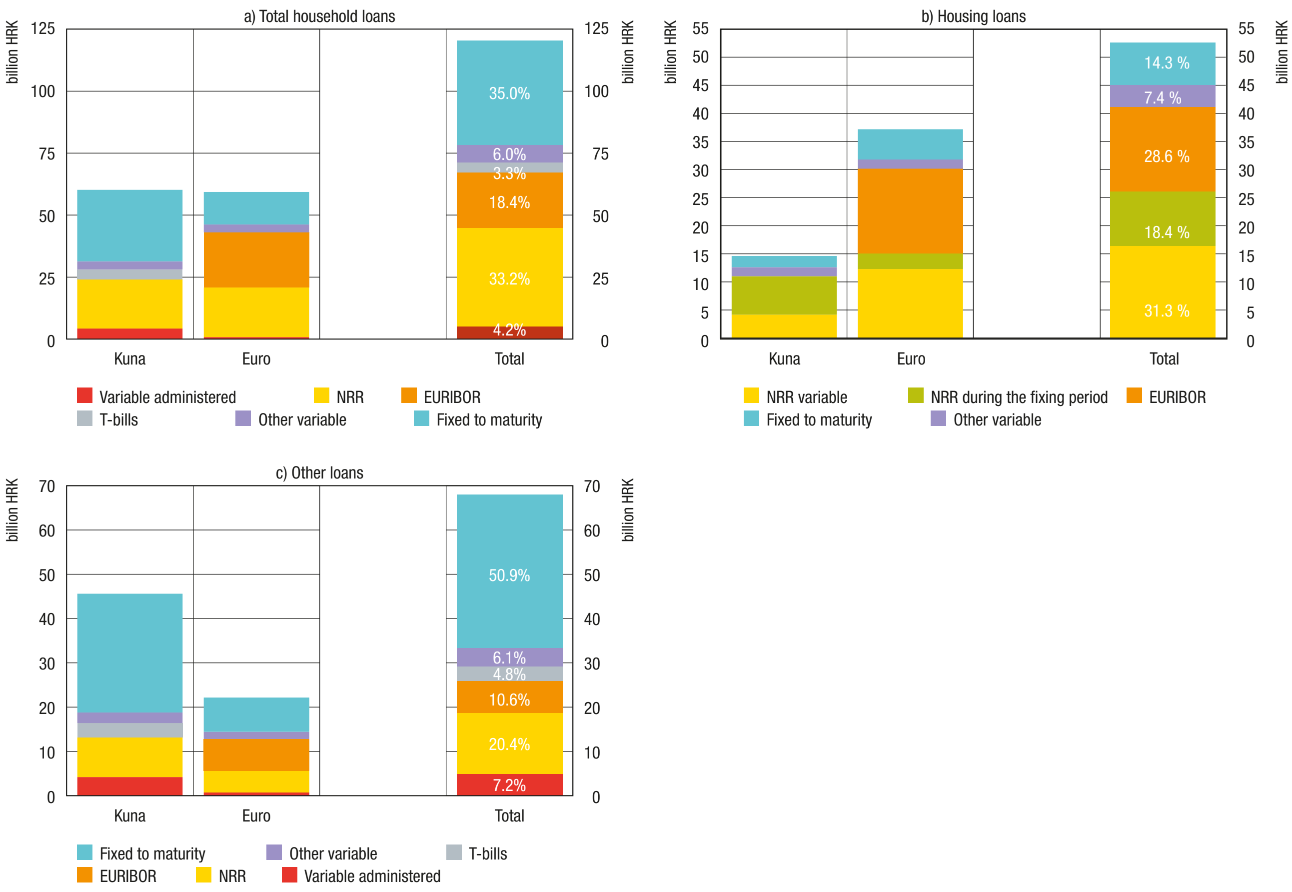
The analysis of the structure of bank loans by interest rate type (fixed or variable) shows that, despite increasing use of fixed interest rates in the case of newly-granted loans, around two thirds of the existing corporate and household loans still carry a variable interest rate, suggesting these sectors' high exposure to interest rate risk.

In October 2017, the CNB started the systematic collection of data on a monthly level on the types of interest rates on loans. Even though analyses of the structure of interest rates had also been made earlier, such as for instance the Interest rate survey conducted in mid-2016, the new statistics enables continuous monitoring of the structure of newly-granted loans, i.e. changes in the structure of total loans.

Interest rates are divided into fixed and variable, with the loans carrying a variable interest rate differing, based on a variable parameter that determines the developments in the interest rate. The parameters include EURIBOR, NRR, yields on T-bills of the MoF, LIBOR[32] and the average interest rate on household deposits in the relevant currency.[33] An interest rate may also be variable with no reference parameter included, i.e. it may be

32 EURIBOR, or the Euro Interbank Offered Rate is a reference rate determined on the European interbank market for the euro currency; the NRR is the national reference rate of the average cost of financing of the Croatian banking system; LIBOR, or the London Inter-Bank Offered Rate is the interest rate used by London banks to lend funds to one another.

Figure 1 Household loans by type of interest rate, stock as at end-April 2018



Source: CNB.

changed pursuant to creditors' administrative[34] decisions.

As regards total household loans, over one third of them carry a fixed interest rate to maturity, one third are tied to the NRR and approximately 18% are tied to the EURIBOR (Figure 1a).

A little less than one half of housing loans are tied to the NRR, while almost 30% of them are tied to the EURIBOR and approximately 14% carry a fixed-to-maturity interest rate (Figure 1b).

As regards the currencies, approximately 70% of housing loans are euro loans predominantly carrying variable interest rates tied in equal volumes to the NRR and EURIBOR, and in the case of kuna loans to the NRR. What is also characteristic of housing loans is that a considerable amount of loans is currently in the period of interest rate fixing shorter than the maturity. These loans amount to HRK 11.9bn or approximately 23% of housing loans. Approximately 58% of these loans are kuna housing loans which will, after expiry of the fixing period, be tied to the NRR, reflecting the increased demand for such loans seen in the past few years, which also witnessed a sharp rise in kuna housing loans. Only approximately HRK 0.8bn or (1.5% of housing loans) are accounted for by T-bills and the administered interest rate.[35]

Other household loans (non-housing loans) differ considerably from housing loans in terms of currency structure, with the kuna being the most widely represented currency, and in terms of interest rates (Figure 1c). Over one half of non-housing household loans carry a fixed-to-maturity interest rate, which is mostly associated with the average maturity of these loans being considerably shorter than that of housing loans. As regards the parameters for a variable interest rate, approximately 20% of non-housing loans are tied to the NRR and approximately 11% are tied to the EURIBOR. Approximately 7% of non-housing loans carry an administered interest rate. Most of these loans are transaction account overdraft facilities and credit card loans.

As regards total corporate loans[36], one third relate to a fixed-to-maturity interest rate (Figure 2a), being thus similar to household loans. Almost 28% of corporate loans are tied to the EURIBOR; other variable and administered interest rates also account for considerable shares of these loans.

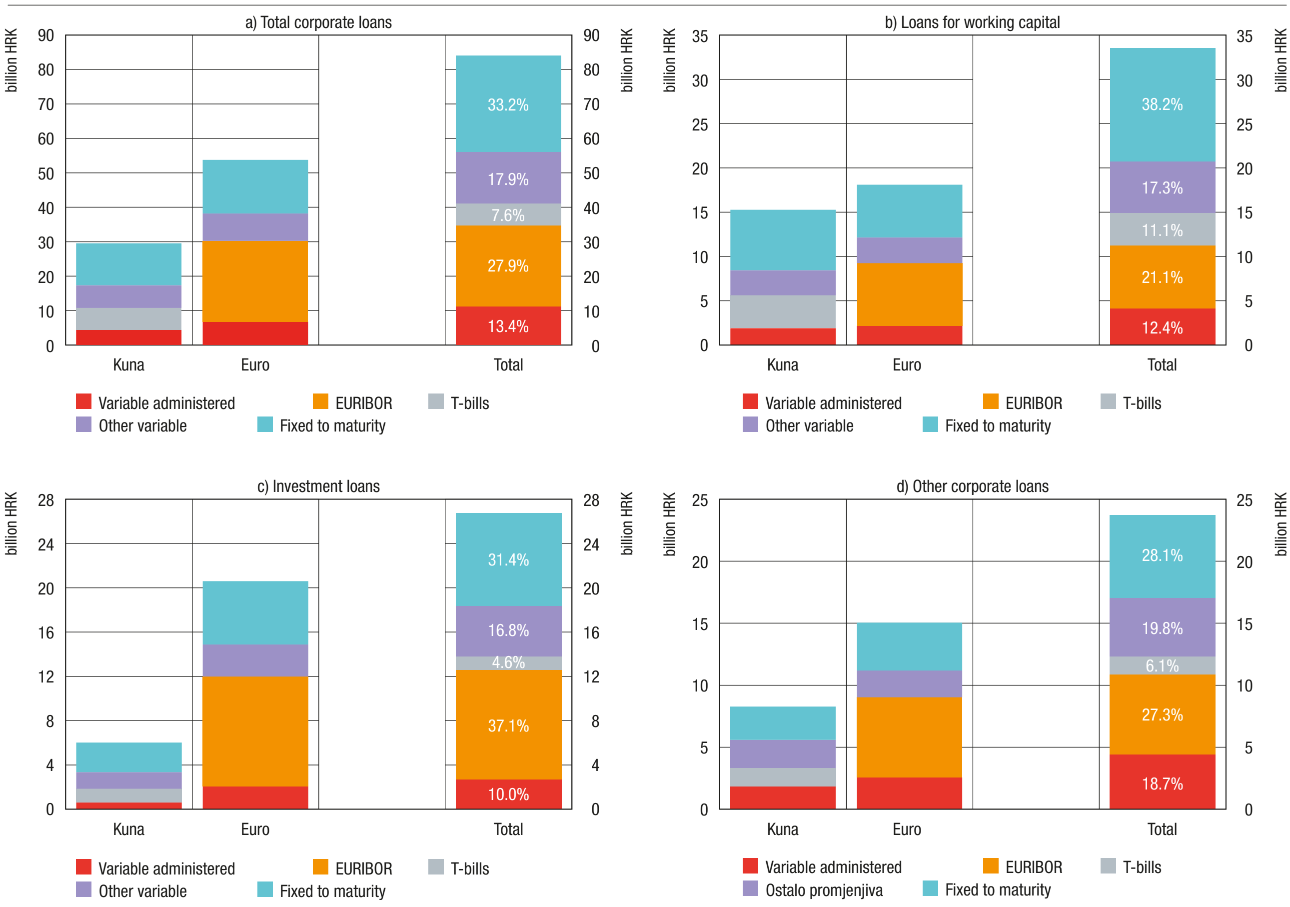
Loans for working capital account for the greatest share of loans to the corporate sector. Loans carrying a fixed-to-maturity interest rate account for 38% of these loans, while approximately 21% of loans carry a variable interest rate tied to the EURIBOR (Figure 2b). Administered interest rates also account for a considerable share (approximately 12%) and so do the interest

33 Loans currently undergoing initial interest rate fixing are included in a category in accordance with the relevant parameter that will be applicable following the expiry of the fixing period, with the exception of the NRR shown in Figure 1b.
34 The parameters for household loans are regulated by the Consumer Credit Act, which in Article 3 defines the exceptions, or the types of household loans to which the Act does not apply.
35 On account of their small share in housing loans, these items are included in the category "Other variable" in Figure 1.
36 The amount of corporate loans tied to the NRR is negligible and is therefore shown in figures under "Other variable".

rates tied to T-bill yields (approximately 11%).

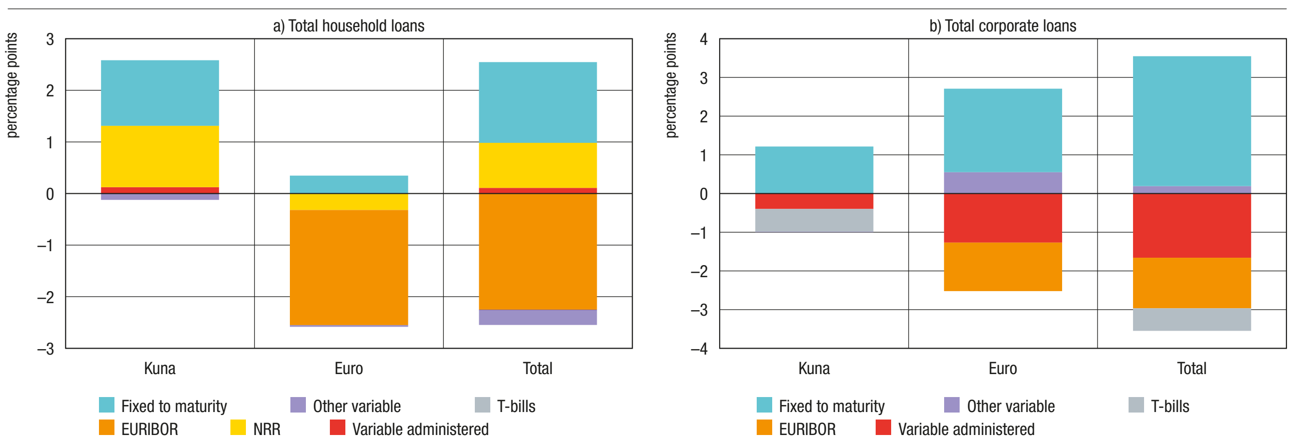
As regards investment loans (Figure 2c), variable interest rates tied to the EURIBOR account for their largest share or approximately 37%, largely attributable to the currency structure with euro loans being predominant and accounting for over three quarters of investment loans. The second largest group of investment loans consists of loans with a fixed-to-maturity interest rate (approximately 31%). The structure of interest rates of the remaining corporate loans (Figure 2d) does not differ on average from the previous two groups.

Figure 2 Corporate loans, stock at end-April 2018



Source: CNB.

Figure 3 Change of the shares of interest rate types in the structure of loans to households and corporates, end-October 2017 – end-April 2018



Source: CNB.

From end-October 2017 to end-April 2018, the structure of interest rates on household loans changed in favour of fixed interest rates whose share rose by 1.6 percentage points (Figure 3a). This can probably also be attributed to CNB initiatives aimed at consumer protection such as the Recommendation to mitigate interest rate and interest rate-induced credit risk in long-term consumer loans issued towards end-September 2017 and the Information list containing the offer of loans and the Decision on the content of and the form in which consumers are provided information prior to contracting banking services. The trend towards growth in kuna and fall in foreign currency lending present for several years continued, with kuna loans exceeding euro loans for the first time. This reflected also on the structure of interest rates with the share of EURIBOR declining by 2.3 percentage points.

As regards total corporate loans, the share of loans with fixed interest rates rose the most, by 3.4 percentage points (Figure 3b). By contrast, almost all types of variable interest rates recorded a fall in their shares, particularly those tied to the administered interest rates and EURIBOR.

The rise in the share of both corporate and household loans with a fixed interest rate is favourable from the point of view of their diminished credit risk[37]. Nevertheless, these sectors' exposure to the risk of interest rate growth is still large since about two thirds of the existing loans carry a variable interest rate. The importance of the amount of loans with a variable interest rate, particularly long-term loans, is now very pronounced since in the past few years the variable parameters were at historically low levels and are likely to rise in the future, which may prove to be a considerable source of interest rate risk[38] materialisation for debtors.

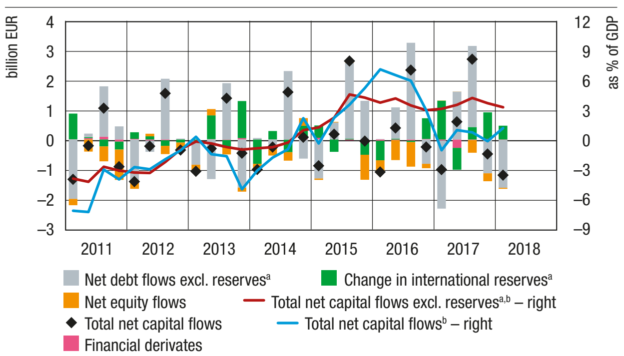
8 Foreign capital flows

A strong net capital inflow was recorded on the balance of payments financial account in the first quarter of 2018. If the change in gross international reserves is excluded[39], net foreign liabilities of domestic sectors grew by EUR 1.7bn, almost entirely due to an increase in net debt liabilities. A half of the increase in net debt liabilities reflects a significant decline in the assets of credit institutions within the TARGET2 system. On the other hand, since the central bank increased international reserves by foreign exchange interventions in the same period, total net capital inflow was somewhat lower, standing at EUR 1.2bn.

The slight net inflow of equity investments in the first quarter of 2018 is a result of a slightly faster growth of liabilities than that of assets of domestic sectors. The rise in liabilities is primarily attributable to the reinvested earnings of domestic enterprises owned by non-residents, which were significantly higher than in the same period last year, particularly in financial intermediation. While one-off effects of provisions for placements to the Agrokor Group tended to contribute significantly to the weaker performance of credit institutions in 2017, profits recovered in the first quarter of 2018 in accordance with expectations. On the other hand, negative new equity investments were recorded as a result of a decrease in the equity capital of a manufacturing company, which was, however, followed by borrowing from an affiliated enterprise. Remaining investments were primarily associated with real estate, consultancy and trade activities.

The considerable rise in net debt liabilities in the first quarter

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 mean 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

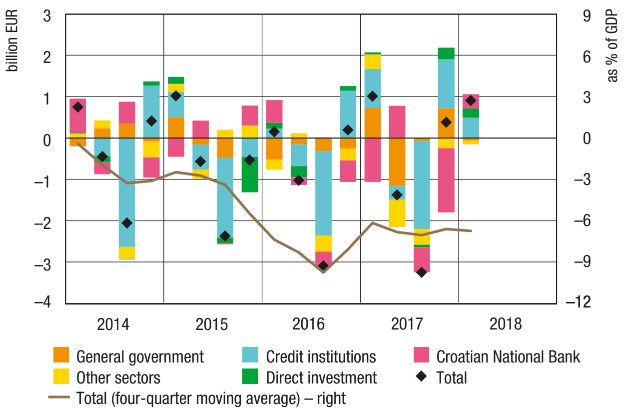
Note: Equity investment net of debt-to-equity transactions and round-tripping investments.
Source: CNB.

37 It should be noted that a reduction in the interest rate risk for bank clients through interest rate fixing leads to increased interest rate risk for the banks. However, the banks usually have easier access to markets in financial instruments they may use to hedge against such risks, so such trends should after all result in a reduction in the system exposure to interest rate risk.

38 Nevertheless, in the case of the household sector, this risk is partly mitigated by the Consumer Credit Act under which the speed of adjustment in variable interest rate depends also on the adjustment of the average interest rate on the market.

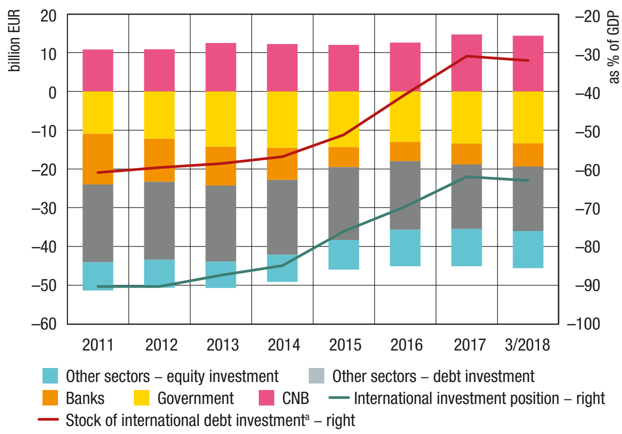
39 The investment of a share of international reserves in repo agreements resulted in an equivalent increase in gross international reserves and an increase in the external debt of the CNB.

Figure 8.3 Net external debt transactions by sectors



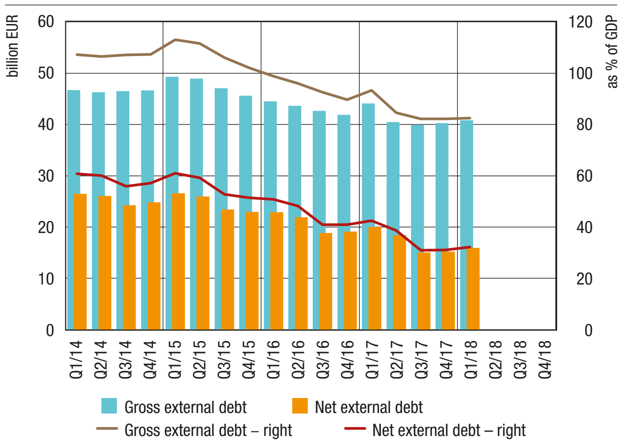
Notes: Transactions refer to the change in debt excluding cross-currency changes and other adjustments. Net external debt is calculated as the gross external debt stock net of foreign debt claims.
Source: CNB.

Figure 8.5 International investment position (net) by sectors



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

Figure 8.4 Stock of gross and net external debt



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

of 2018 (of EUR 1.6bn, CNB reserves and liabilities excluded) was driven by both a sharp decline in domestic sectors' foreign assets and an increase in their foreign liabilities. The net foreign position of banks and other domestic sectors that increased their debt to affiliated creditors (partly as a result of a transaction of a manufacturing company mentioned earlier) deteriorated the most. In contrast, slight deleveraging was seen only in the government sector.

The increase in the debt liabilities of domestic sectors resulted in the deterioration of relative indicators of external debt, partly mitigated by the favourable effect of cross-currency changes and other adjustments and the rise in nominal GDP. At end-March 2018, gross external debt stood at EUR 40.6bn or 82.1% of GDP, up by 0.3 percentage points from the end of 2017. Since external debt assets dropped at the same time, the deterioration of the relative indicator of net external debt was even more pronounced. Net external debt stood at EUR 15.9bn or 32.1% of GDP at the end of March 2018, up by 1.2 percentage points from the end of 2017.

Furthermore, Croatia's international investment position also deteriorated, down from –62.0% of GDP at the end of 2017 to –63.0% of GDP at the end of the first quarter of 2018. Such developments were brought about by a decline in foreign assets within TARGET2 and by the deterioration in the foreign position of banks, while the international investment position of the government and the non-financial corporate sector remained the same.

Projected developments

Net capital outflow is expected to continue for the fifth consecutive year, although at a slower pace than in 2017. The balance of payments financial account is expected to see a decline in net liabilities of EUR 1.2bn at the entire 2018 level, compared with EUR 1.8bn in 2017. The rise in equity liabilities could be more pronounced, but net deleveraging of domestic sectors might slow down in comparison with 2017. At the same time, a substantial increase in international reserves is expected, although smaller than in 2017.

Total net inflow of equity investments at the entire 2018 level could exceed the amount recorded last year, primarily reflecting the estimated considerable increase in credit institutions' reinvested earnings, and, to a smaller extent, the rise in the reinvested earnings of foreign-owned enterprises driven by a rise in their profitability. At the same time, new equity investments in Croatia are expected to grow only slightly, since foreign direct investments have only begun to recover slowly in 2018 at the global level, following a sharp decrease in 2017. Domestic structural deficiencies, particularly those linked to the business environment, additionally limit the inflow of equity investments in Croatia. Based on the results recorded over the past several years, they are mainly expected in the tourism, trade and real estate sectors.

In contrast to the rise in debt liabilities seen at the beginning of the year, the whole of 2018 is expected to see a continuation of the deleveraging trend and an improvement of the relative indicators of external debt. All domestic sectors are likely to reduce their debt liabilities, which could, coupled with the favourable effect of nominal GDP growth, result in a decrease in the gross external debt-to-GDP ratio to 76%. Similarly, relative indicators of net external debt and the international investment position should also improve further.

Net capital outflow could decline further in 2019. Domestic sectors are expected to continue to deleverage and relative indicators of external debt are likely to improve. Gross external debt could drop to about 70% of GDP by the end of the year, whereas new equity investments in Croatia could grow. Foreign investments are expected to increase as well, although to a lesser extent. At the same time, gross international reserves could also see a rise.

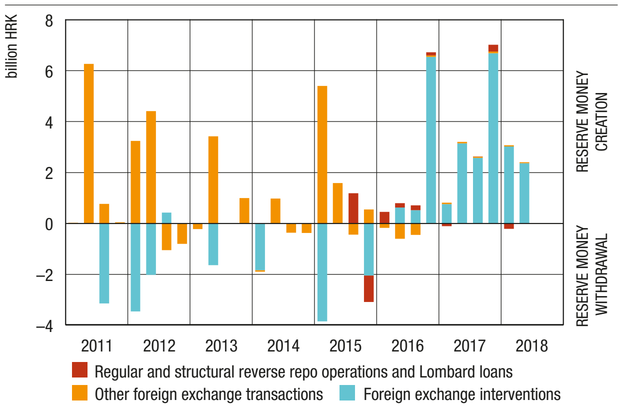
Risks associated with the projection of capital flows are mostly related to a possible tightening of global financing conditions and a deterioration in the investment climate. Further strengthening of trade protectionism and geopolitical tensions may additionally reduce the already modest expected growth in global foreign direct investments. Due to high foreign liabilities accumulated earlier, risks to Croatia's external position remain elevated despite their gradual decline over the past several years.

9 Monetary policy

The CNB continued to pursue an expansionary monetary policy in the first half of 2018, supporting high monetary system liquidity. Due to the appreciation pressures on the domestic currency, the central bank purchased from banks a total of EUR 726m from the beginning of 2018. Purchasing an additional EUR 14.7m from the Ministry of Finance, the CNB purchased EUR 740.7m net from the beginning of 2018 through to mid-June, creating HRK 5.5bn (Figure 9.1).

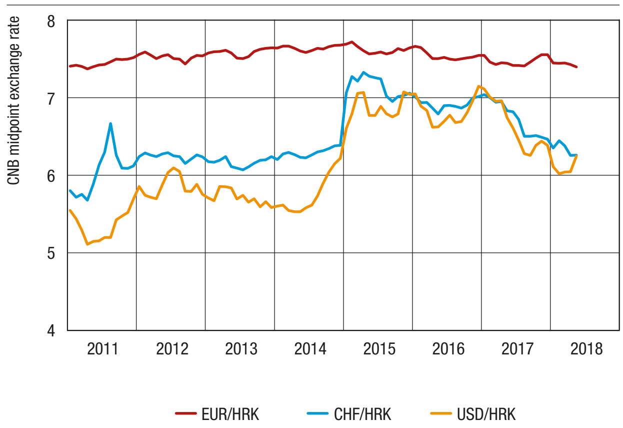
In addition to foreign exchange transactions, the CNB continued to conduct regular weekly reverse repo auctions at a fixed repo rate of 0.3%. However, in the conditions of large kuna liquidity surpluses in the monetary system, there was no interest on the part of banks for short-term kuna funds offered at these auctions from the beginning of 2018.

Figure 9.1 Flows of reserve money (M0) creation



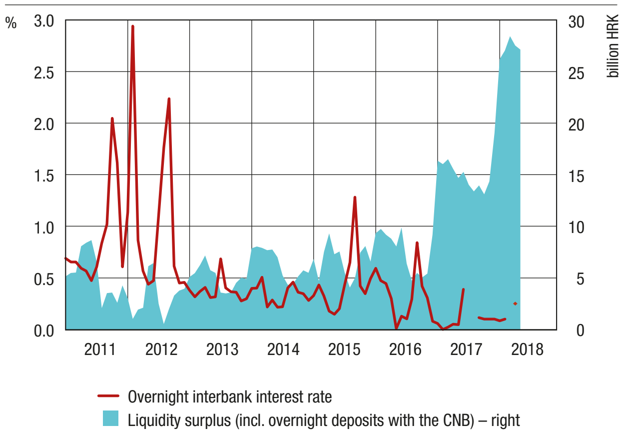
Notes: Other foreign exchange transactions include the purchase of foreign exchange from and the sale of foreign exchange to the MoF and the EC and foreign currency swaps with banks, where the positive values refer to the purchase of foreign exchange by the CNB. Data for the second quarter of 2018 are up to May.
Source: CNB.

Figure 9.3 Nominal exchange rates of the kuna against selected currencies



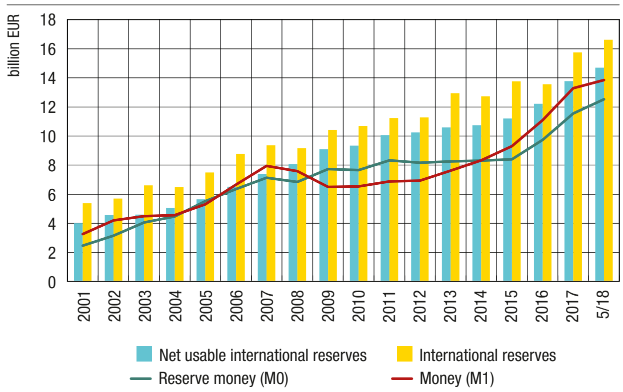
Source: CNB.

Figure 9.2 Bank liquidity and overnight interbank interest rate



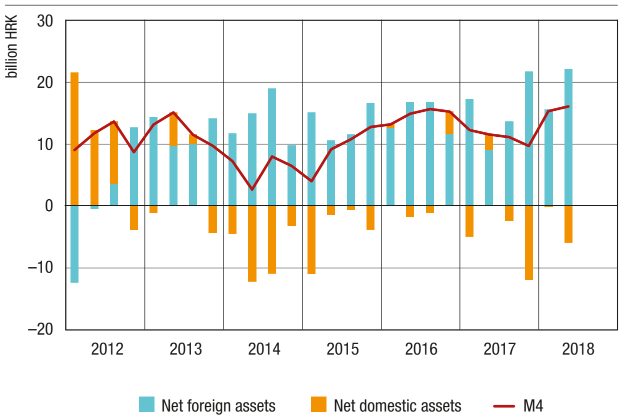
Source: CNB.

Figure 9.4 International reserves of the CNB and monetary aggregates



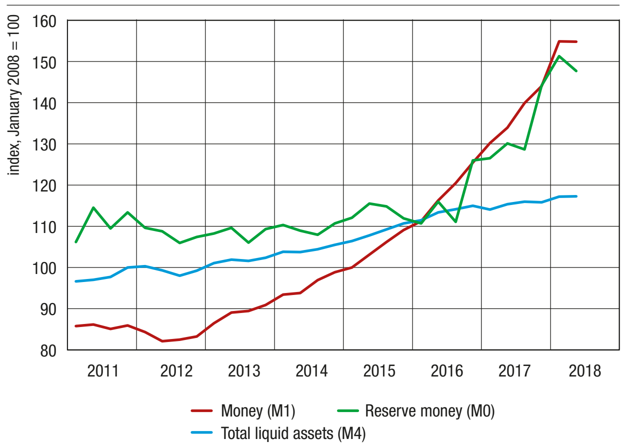
Notes: Net usable international reserves are defined as international reserves net of CNB foreign liabilities, reserve requirements in f/c, government foreign currency deposits and off-balance sheet liabilities (swaps). The most recent data available for M1 refers to the end of April 2018.
Source: CNB.

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



Notes: Absolute changes in the last twelve months excluding the exchange rate effect. Data for the second quarter of 2018 are up to April.
Source: CNB.

Figure 9.6 Real monetary aggregates
index of developments in seasonally adjusted values, deflated by the consumer price index



Note: Data for the second quarter of 2018 refer to the end of April.
Source: CNB.

The average surplus kuna liquidity in the first five months of 2018 rose to HRK 27.8bn, which is HRK 12.1bn more than the average surplus in 2017 (Figure 9.2). The rise in kuna liquidity in the system was mostly the result of reserve money creation by the purchase of foreign exchange from banks. Against this background, the average weighted interest rate in overnight interbank trade remained rather low with very little turnover. The interbank rate leaped to 0.25% in April, but this was a reflection of the only transaction made in that month, after which there was no trade in May.

Appreciation pressures on the kuna, which prevailed in the first five months of 2018, were eased by foreign exchange interventions of the CNB. The exchange rate of the kuna against the euro stood at EUR/HRK 7.38 at the end of May 2018, down by 0.5% from the end of May 2017, while the average exchange rate in the first five months of 2018 was 0.4% lower than in the same period of the previous year (Figure 9.3). Upward pressures on the kuna were driven by favourable macroeconomic developments, such as the reduction of fiscal risks and economic recovery, as well as the current account surplus, which reflected positive developments in goods exports, stronger inflows from EU funds and a successful start of the tourist season. On the other hand, the exchange rate of the kuna against the US dollar and the Swiss franc was notably lower at the end of this May than at the end of May 2017, due to the strengthening of the euro in global financial markets in 2017 and early 2018, notwithstanding the significant weakening of the euro against other major global currencies as of mid-April.

Gross international reserves of the Republic of Croatia stood at EUR 16.6bn (Figure 9.4), being EUR 0.9bn (5.5%) larger at end-May 2018 than at end-2017. Net usable reserves also went up in the same period, by EUR 0.9bn, amounting to EUR 14.7bn at the end of May. The growth in gross and net reserves was mostly due to purchases of foreign currency from banks and, to a lesser extent, the recent strengthening of the US dollar against the euro, as a portion of international reserves is held in that currency. Gross and net international reserves remained at higher levels than money (M1) and reserve money (M0).

The annual increase in total liquid assets (M4) picked up in the first four months of 2018 (Figure 9.5). This was the result of the steady rise in net foreign assets of the monetary system, whereas net domestic assets continued to decrease, largely owing to government's deleveraging with respect to banks.

As regards real monetary aggregates, their several-year upward trend continued in the first quarter of 2018 (Figure 9.6), but they held steady or decreased slightly in April, due to the rise in the consumer price index in that month. In terms of year-on-year changes, the real growth in total liquid assets (M4) was slightly faster than a year ago. On the other hand, the annual rates of growth in real money (M1) and real reserve money (M0) exceeded 20% in March and April 2018. As regards real money (M1), its increase was mostly driven by the upsurge in funds in transaction accounts, which may be associated with the fall in savings and time deposits in a setting of low interest rates, though the decrease slackened to a great extent from the beginning of the year. The rise in real reserve money primarily reflects large kuna liquidity surpluses created in CNB foreign exchange transactions.

The sustained expansionary monetary policy of the CNB will support economic growth, while inflation is expected to remain low. At the same time, the central bank will continue to pursue the policy of a stable exchange rate of the kuna against the euro and resort to foreign exchange interventions in line with exchange rate pressures.

10 Public finance

Strong fiscal adjustment continued throughout 2017, with the general government recording an annual surplus for the first time since data have been available under the ESA methodology. The general government surplus stood at HRK 2.8bn or 0.8% of GDP. The budget outturn was driven by an increase in revenues, mostly due to favourable cyclical trends, as well as a mild decrease on the expenditure side. As a result of the general government surplus and economic growth, the general government debt-to-GDP ratio continued to shrink on an annual basis, falling to 77.5% of GDP at the end of 2017.

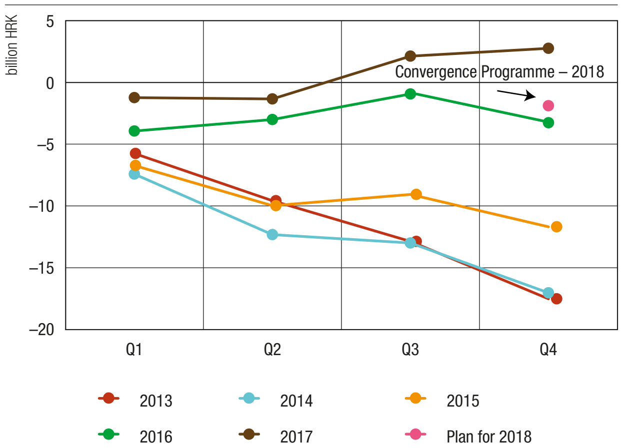
After the EU Council adopted a decision in 2017 on Croatia's exit from the excessive deficit procedure based on a proposal by the European Commission, Croatia became subject to the preventive arm of the Stability and Growth Pact. Taking into account the budget balance and the public debt level in 2017 as well as spring forecasts for 2018 and 2019, the European Commission assessed in May that Croatia complied with both requirements under the preventive arm (the benchmark for debt reduction and the medium-term budgetary objective).[40]

Under this year's Convergence Programme for Croatia, following the budget surplus in 2017, a deficit of –0.5% of GDP is expected in 2018, after which it might fall slightly, to –0.4% of GDP in 2019. At the same time, general government debt should continue to trend down. The projected deficit is a result of the rise in general government expenditure (as % of GDP), the dynamics of which is influenced by the upsurge in expenditures for subsidies, investments and other capital transfers. Further tax cuts are planned for 2019. Notwithstanding these expectations, in its spring forecasts the European Commission assessed that the general government balance might be much more favourable than envisaged under the Convergence Programme for Croatia, particularly since expenditures for investments and subsidies are expected to grow less, whereas the announced tax cuts are not incorporated as they have not been clearly explained.

Regarding the performance data available for 2018, MoF cash-basis data for the first quarter suggest that the deficit was slightly lower in early 2018 than in the same period of 2017, as revenues grew somewhat more than expenditures[41].

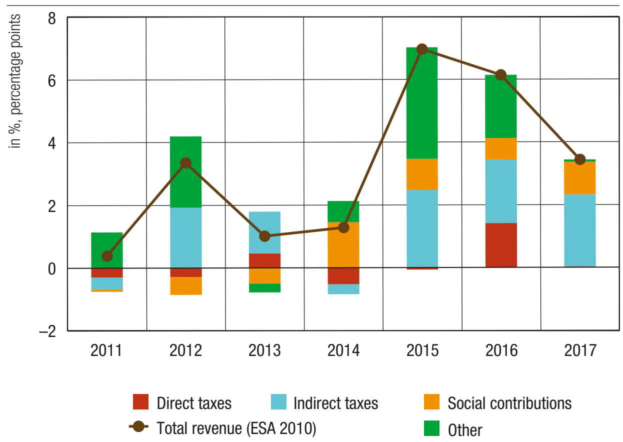
MoF data show that general government revenues (GFS 2001) grew annually by 6.4%. This was mostly due to revenues from social contributions supported by favourable developments in the labour market, followed by VAT revenues boosted by the ongoing recovery in personal consumption, and current aids from international organisations, which is probably associated with the funds received from the EU budget. Income and profit tax revenues also grew in the first quarter, as did excise revenues, primarily due to the rise in revenues from excises on tobacco products and alcohol. Only the category of other revenues

Figure 10.1 General government cumulative balance by quarters
ESA 2010



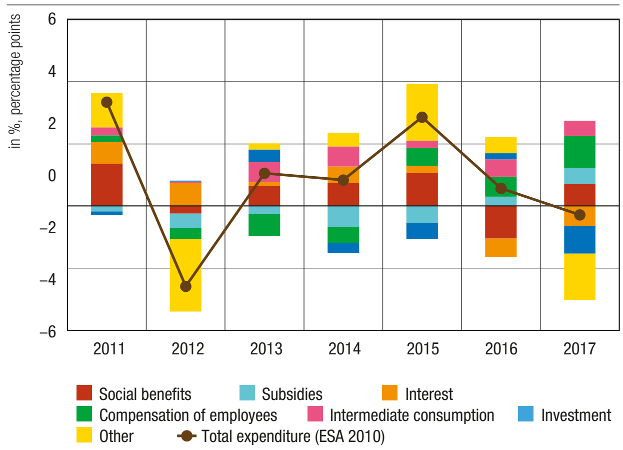
Sources: Eurostat and MoF (CNB calculations).

Figure 10.2 Consolidated general government revenue
ESA 2010, year-on-year rate of change and contributions



Source: Eurostat (CNB calculations).

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

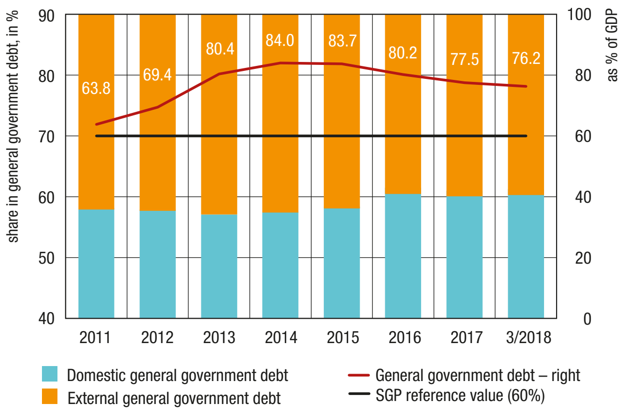


Source: Eurostat (CNB calculations).

40 Assessment of the 2018 Convergence Programme for Croatia, available at: https://ec.europa.eu/info/sites/info/files/economy-finance/11_hr_2018_cp_assessment.pdf.

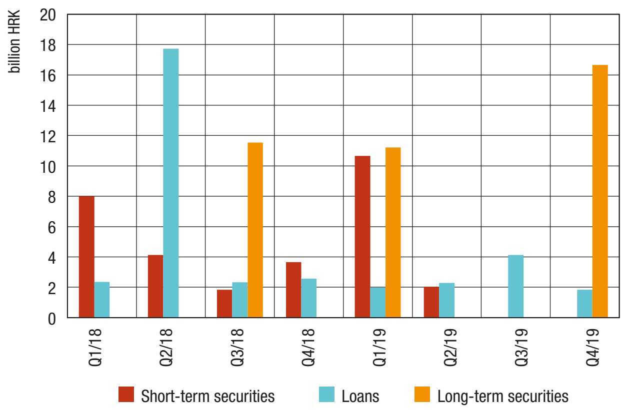
41 Nevertheless, available data on borrowing and changes in general government deposits, the coverage of which is in line with the ESA 2010 methodology, suggest that the first quarter deficit might be larger than in the same period of 2017.

Figure 10.4 General government debt
end-period stock



Note: Nominal GDP calculated as the sum of GDP for the third quarter of 2018 and the last three available quarterly data was used for the calculation of the relative indicator at the end of March 2018.
Source: CNB.

Figure 10.5 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 2018 and projection of the repayment of loans on the balance as at 31 March 2018.
Sources: MoF and CNB.

held steady on an annual level, influenced by rather divergent movements in individual components: revenues from assets were smaller, while revenues from the sale of goods and services were larger than in the same period of 2017.

Consolidated general government expenditures (GFS 2001) grew less on an annual basis than revenues, by 4.8% in the first quarter of 2018. This outturn in budget expenditures was mostly driven by expenditures for employee compensation, social benefits and other expenditure categories. Available data suggest that the rise in compensation of general government employees reflects the increase in the number of civil servants and government employees as well as the whole-year effect of public sector wage increases in 2017. The increase in social benefits was due to the regular adjustment of pensions and the slight increase in the number of pensioners and, to some extent, the rise in expenditures on health care. The growth in other expenditures may be associated mostly with a transfer of funds from the EU budget to beneficiaries outside the general budget. Most other expenditure categories recorded only moderate growth, with a slight decrease seen only in expenditures for subsidies.

General government debt stood at HRK 281.3bn at the end of March 2018 and, notwithstanding the general government deficit in the first quarter, it was HRK 2.0bn less than at the end of 2017. The debt reduction reflects the strengthening of the kuna against the euro and the US dollar in the same period and the use of government deposits transferred from 2017.

In the first quarter, the government carried out the second stage of the financial restructuring of the road sector (CM, ARZ, CR), by obtaining a syndicated loan of EUR 1.8bn in the domestic market to refinance a substantial portion of the remaining debt of these enterprises under much more favourable terms. The domestic financial market was again marked by favourable conditions and high liquidity with the result that T-bill auctions witnessed extremely low interest rates on kuna T-bills and, for the first time, zero interest rates on euro T-bills. As regards new borrowings in the international market, eurobonds worth EUR 750m issued in June were earmarked for refinancing the eurobonds maturing this July. This refinancing was made on much more favourable terms (annual coupon interest rate on new bonds is 2.7%, compared with 5.875% on bonds maturing in July). All this will lead to a further decline in interest expenses of the general government in the forthcoming period.

General government liabilities equal to 5.7% of GDP fall due in the second half of 2018. This mostly relates to liabilities arising from one domestic and one international bond issue, with the funds for eurobond repayment being already raised through the mentioned June issuance in the international capital market.

11 Deviations from the previous projection

The estimate of real global developments for 2018 is more positive than expected in the December 2017 projection. As global growth outstripped expectations in the period under review, the estimated global growth rate for 2018 was raised by 0.2 percentage points (Table 11.1). Among developed countries, the largest positive changes in expectations were seen in the US, thanks to increased optimism regarding tax reform effects. In addition, expectations for the euro area, including all Croatia's main trading partners, are also more favourable, due to better results in late 2017 and the first few months of 2018. As regards monetary policy, a more intense tightening of the Fed's monetary policy is expected in the course of 2018, while the first expected increase in the ECB's benchmark rate was moved from the first to the second quarter of 2019. The global inflation estimate for the current year has been revised marginally upwards, mostly due to higher oil prices.

Expectations of economic growth for 2018 have remained almost the same as in the December 2017 projection, so that real GDP might grow by 2.8% (vs the previously projected 2.9%). However, while the expected growth rate of overall economic activity has been revised slightly downwards, some changes were seen in the GDP structure. The most important correction was made in total exports, which might grow by 4.9% instead of the previously anticipated 5.8%. More precisely, while exports of

Table 11.1 Basic assumptions, deviations from the previous projection

	2018		
	Previous projection (12/2017)	Current projection	Deviation
GDP (real rate of change, in %)			
Rest of the world	3.7	3.9	0.2
Euro area	1.9	2.4	0.5
USA	2.3	2.9	0.6
Developing countries and emerging market countries	4.9	4.9	0.1
Central and Eastern European countries	3.5	4.3	0.7
Main trading partners of the Republic of Croatia	2.2	2.6	0.4
Prices			
Euro area HICP[a]	1.2	1.4	0.2
Oil prices (USD/barrel)[b]	61.1	72.7	11.6
Key interest rates			
EURIBOR 3M (end of year)[c]	–0.22	–0.29	–0.1
ECB main refinancing rate[c]	0.00	0.00	0.0
US federal funds target rate[c]	2.15	2.40	0.3

[a] ECB, June 2018. [b] Bloomberg, Brent crude oil futures. [c] Bloomberg.
Source: IMF (WEO, April 2018).

services exceeded projections in the first three months of 2018, exports of goods recorded a significant downturn, which is in contrast to projections. In addition, the expected growth rate of gross fixed capital formation was also lowered, in part due to poor results in the first quarter of 2018. Such developments may be associated with weaker than expected investment activity of the government, as reflected by the data on civil engineering works. The growth in investment might reach 6.4% in 2018 instead of the previously projected 7.1%. On the other hand, personal consumption growth has been revised upwards from the previous projection (3.6% vs 3.2%). The correction was mostly due to better results in early 2018 and more favourable projected developments in the labour market. In addition, expected growth in government consumption has been revised up as well, also thanks to better performance, so that the growth rate might be 2.5% (as against the previously projected 1.5%). Finally, while expectations of goods exports and capital investments worsened relative to the previous projection, the upsurge in personal consumption might be reflected in the continued growth in imports of goods and services. As a result, the expected growth rate of total imports has been revised down only slightly, from 7.4% to 7.1%. As the negative correction for total exports was more pronounced than for imports, the expected negative contribution of net foreign demand to economic growth was raised from –0.7 percentage points to –1.0 percentage point.

The average annual consumer price inflation rate for 2018 is estimated at 1.7%, which is 0.1 percentage point higher than projected in December 2017. The revision of the overall inflation rate predominantly reflects the significant upturn in the prices of refined petroleum products in the domestic market triggered by the notable increase in global crude oil prices in the first half of 2018. Therefore, the current projection for 2018 envisages higher annual growth in the prices of Brent crude oil (33.6% vs the previously projected 12.7%). By contrast, the estimated annual increase in food prices has been revised slightly down, reflecting the lower pass-through of prices from last year due to the notable decrease in the prices of several food products in December 2017. In addition, the projected average annual growth in consumer prices excluding food and energy in 2018 remained unchanged from the previous projection.

The surplus in the current and capital account in 2018 might fall short of previous expectations by 0.5 percentage points. The main factor for the downward revision is the reduced estimate for net exports of goods and services. The estimate for total exports of goods and services has not changed much as lower exports of goods (due to poorer performance in 2017 and early 2018) were for the most part offset by more favourable projections for services exports, primarily revenues from travel services. On the other hand, total imports might exceed previous expectations, among other things, due to larger imports of oil and refined petroleum products driven by higher crude oil prices, and the raised estimate of expenditures for resident tourist services. The deficit in the primary income account might also surpass previous projections, mostly due to larger projected profits of credit institutions.

The projection of the relative indicators of gross external debt at end-2018 has been revised upwards from the previous projection, mostly due to the larger debt at the end of 2017. At the same time, the upward revision of nominal GDP softened the negative effect of the larger debt balance on the relative indicator.

The projection for growth in credit institutions' placements to the private sector in 2018 exceeds previous expectations because of better lending performance in the first half of the year. Placements might grow by 4.6% in 2018, compared with the previously projected 4.1% (rates calculated on the basis of transactions). The more rapid increase is equally due to stronger lending to enterprises and households in the preceding part of the year. In addition, as regards household loans, also taken into account was the effect of the announced continued implementation of the government's housing loan subsidy programme to be seen in the last quarter of 2018. As regards changes in placements in nominal terms, current projections show an increase of 2.7% in 2018 (vs the previously expected 4.1%). The lower expected nominal stock of placements at the end of 2018 is due to the inclusion of realised and announced sales of non-performing bank placements in the projection.

The projected growth of total liquid assets (M4) in 2018 is higher than expected in the previous projection (5.3% relative to 4.5%, excluding the exchange rate effect), due to the better performance in the first half of the year. This is primarily related to the much sharper than foreseen increase in demand deposits caused by the steady fall in deposit interest rates and the economic recovery. On the other hand, foreign currency deposits dropped more than projected in the first half of the year.

Table 11.2 Domestic indicators, deviations from the previous projection

	2017			2018		
	Previous projection (12/2017)	Outturn	Deviation	Previous projection (12/2017)	Current projection	Deviation
National accounts (real rate of change, in %)						
GDP	3.1	2.9	–0.1	2.9	2.8	–0.1
Personal consumption	3.8	3.6	–0.2	3.2	3.6	0.3
Government consumption	1.7	2.7	1.0	1.5	2.5	1.0
Gross fixed capital formation	4.2	3.8	–0.4	7.1	6.4	–0.7
Exports of goods and services	6.6	6.4	–0.2	5.8	4.9	–0.8
Imports of goods and services	8.5	8.1	–0.3	7.4	7.1	–0.3
Labour market						
Number of employed persons (average rate of change, in %)	1.8	1.9	0.1	1.5	2.2	0.7
Registered unemployment rate	12.4	12.1	–0.3	11.3	10.0	–1.3
ILO unemployment rate	11.3	11.2	–0.1	10.2	9.7	–0.5
Prices						
Consumer price index (rate of change, in %)	1.2	1.1	–0.1	1.6	1.7	0.1
External sector						
Current account balance (as % of GDP)	3.7	3.9	0.2	2.5	2.3	–0.2
Current and capital account balance (as % of GDP)	4.5	4.5	0.0	3.7	3.2	–0.5
Gross external debt (as % of GDP)	79.9	81.8	1.8	74.9	75.8	0.8
Monetary developments (rate of change, in %)						
Total liquid assets – M4	4.5	2.1	–2.4	4.5	5.3	0.8
Total liquid assets – M4[a]	4.0	3.1	–0.9	4.5	5.3	0.8
Credit institution placements	0.6	–1.2	–1.8	4.1	2.7	–1.4
Credit institution placements[b]	3.0	2.9	–0.2	4.1	4.6	0.5

[a] Exchange rate effects excluded. [b] Rates of change are calculated on the basis of data on transactions.
Source: CNB.

12 Annex A: Macroeconomic projections of other institutions

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

	GDP		Household consumption		Gross fixed capital formation		Exports of goods and services		Imports of goods and services		Industrial production		Consumer prices	
	2017	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017	2018
Croatian National Bank (July 2018)	**2.8**	**2.8**	**3.6**	**3.1**	**6.4**	**6.7**	**4.9**	**4.7**	**7.1**	**6.0**	**–**	**–**	**1.7**	**1.6**
World Bank (June 2018)	2.6	2.7	–	–	–	–	–	–	–	–	–	–	–	–
The Institute of Economics, Zagreb (March 2018)	2.7	2.6	3.1	2.7	3.9	4.3	5.6	5.3	7.4	7.5	–	–	1.6	1.8
Eastern Europe Consensus Forecasts (May 2018)	2.7	2.7	2.9	2.6	5.1	5.1	–	–	–	–	2.4	2.6	1.5	1.8
European Bank for Reconstruction and Development (May 2018)	2.7	2.5	–	–	–	–	–	–	–	–	–	–	–	–
European Commission (May 2018)	2.8	2.7	3.1	2.9	6.2	6.0	4.8	4.6	6.6	6.0	–	–	1.4	1.5
Addiko Bank Economic Research[a] (April 2018)	3.0	3.0	3.2	2.8	6.0	6.5	7.1	5.1	8.5	6.5	3.4	3.5	1.4	1.7
International Monetary Fund (April 2018)	2.8	2.6	–	–	–	–	–	–	–	–	–	–	1.5	1.5
Ministry of Finance (April 2018)	2.8	2.7	2.9	2.8	6.7	6.3	5.3	5.2	7.4	6.8	–	–	1.4	1.4
Raiffeisen Research[a] (November 2017)	2.3	2.5	–	–	–	–	6.3	7.0	5.4	6.5	2.5	2.8	1.4	2.0

[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 Convergence Programme of the Republic of Croatia for the period 2018-2021.
Sources: Publications of the respective institutions.

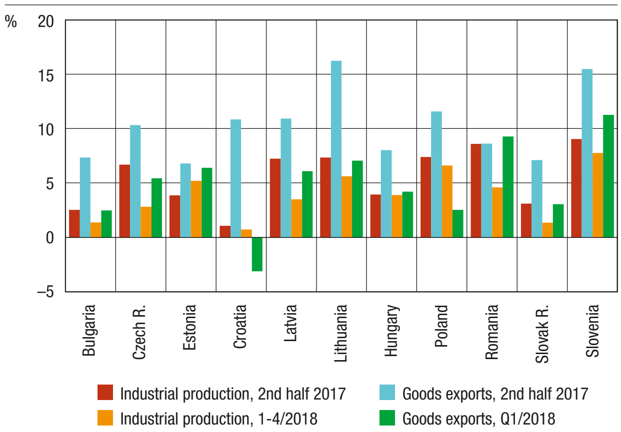
13 Annex B: Comparison of Croatia and selected countries

Table 13.1 Gross domestic product

	Year-on-year rate of change, original data			Quarter-on-quarter rate of change, seasonally adjusted data			
	2015	2016	2017	Q2/17	Q3/17	Q4/17	Q1/18
Bulgaria	3.6	3.9	3.6	1.0	0.9	0.7	–
Czech R.	5.3	2.6	4.4	2.4	0.7	0.8	–
Estonia	1.7	2.1	4.9	1.6	0.1	2.1	–0.1
Croatia	2.3	3.2	2.8	0.7	0.6	0.0	0.2
Latvia	3.0	2.2	4.5	1.4	1.6	0.4	1.6
Lithuania	2.0	2.3	3.8	0.7	0.5	1.4	0.8
Hungary	3.4	2.2	4.0	1.1	1.1	1.3	1.2
Poland	3.8	3.0	4.6	0.9	1.4	1.0	1.6
Romania	4.0	4.8	6.9	1.6	2.2	0.3	0.0
Slovak R.	3.9	3.3	3.4	–	–	–	–
Slovenia	2.3	3.1	5.0	1.3	1.1	1.9	0.6
Average[a]	**3.2**	**3.0**	**4.4**	**1.3**	**1.0**	**1.0**	**0.7**

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

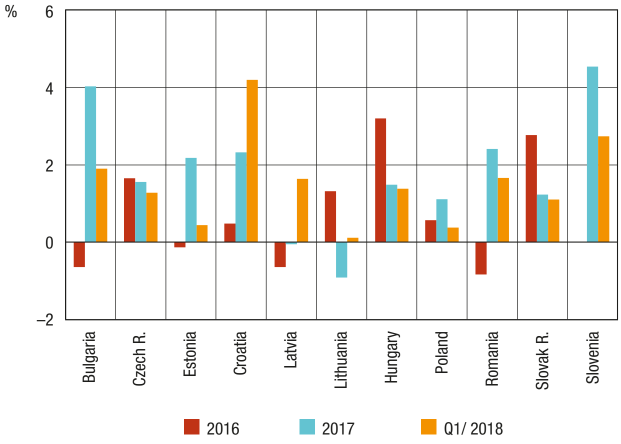
Figure 13.1 Industrial production and goods exports
year-on-year rate of change



Note: Industrial production for 2018 is calculated as the percentage change of industrial production in the January-April period of 2018 relative to the same period in 2017.
Sources: Eurostat and CBS.

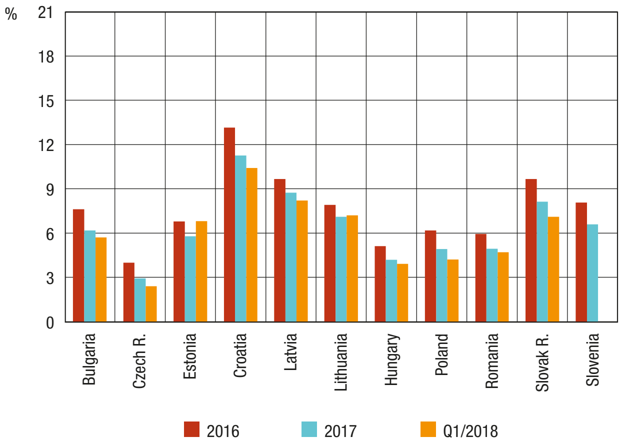
Figure 13.2 Labour Force Survey employment rate

year-on-year rate of change



Source: Eurostat.

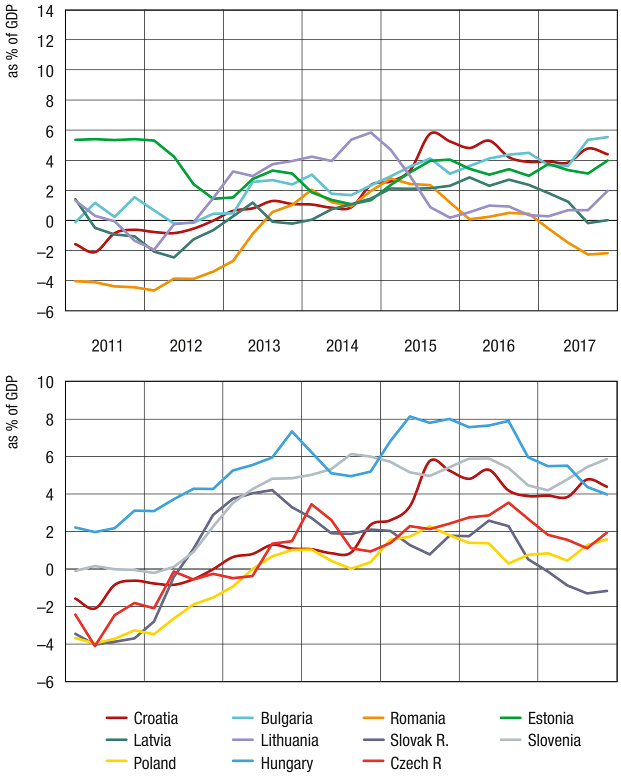
Figure 13.3 Labour Force Survey unemployment rate



Source: Eurostat.

Figure 13.4 Current and capital account balance

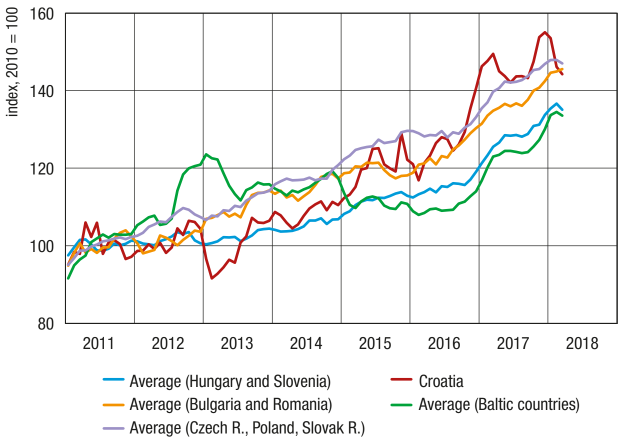
sum of the last four quarters



Sources: Eurostat and CNB.

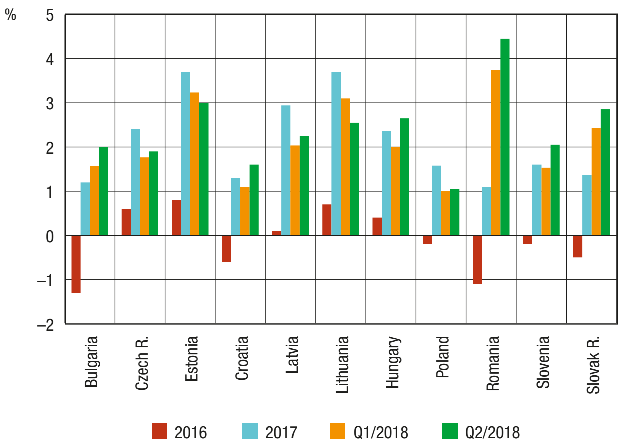
Figure 13.5 Goods exports

quarterly moving average, seasonally adjusted data



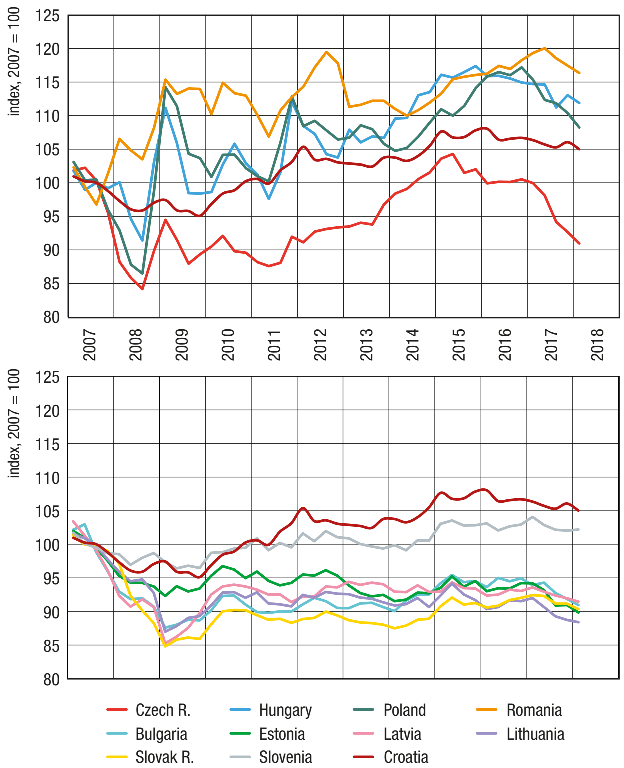
Sources: Eurostat and CNB.

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



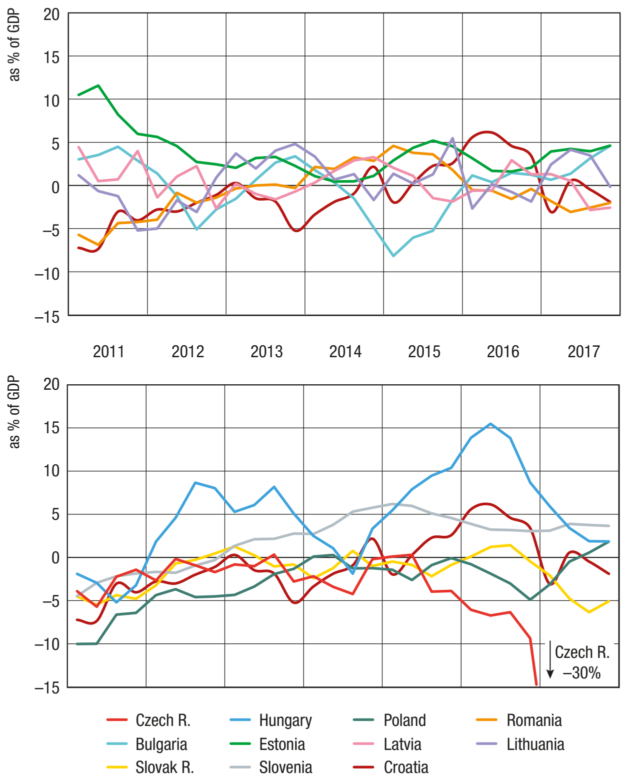
Note: Data for the second quarter of 2018 refer to April and May.
Source: Eurostat.

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



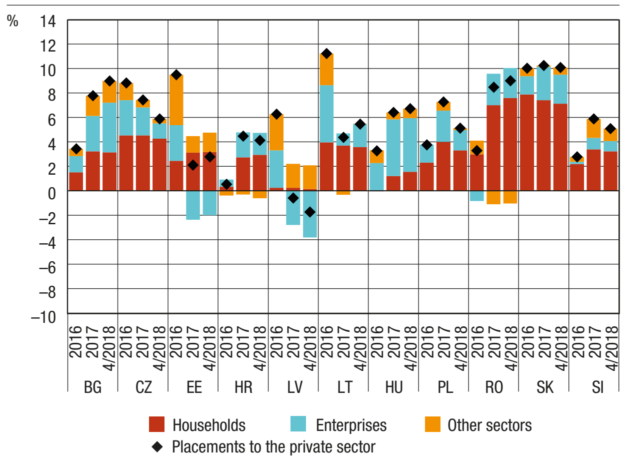
Notes: Data for 2018 refer to the first quarter. A fall in the index indicates a real effective appreciation.
Sources: BIS and CNB.

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.

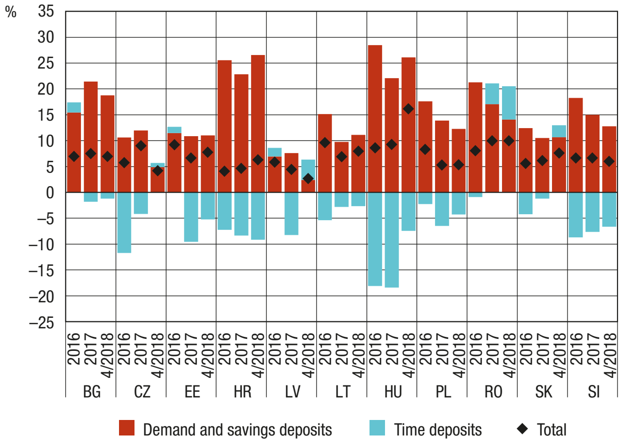
Figure 13.9 Bank placements to the private sector
contributions to the year-on-year rate of change, transaction-based



Sources: ECB and CNB.

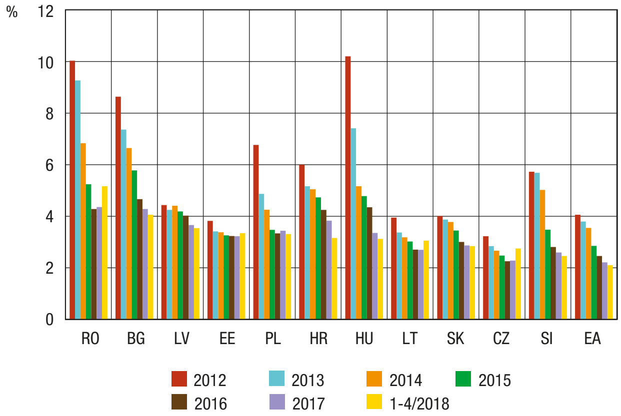
Figure 13.10 Private sector deposits

year-on-year rate of change, excluding the exchange rate effect



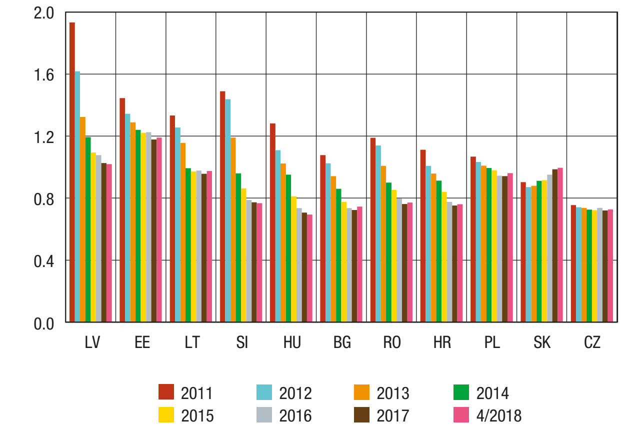
Sources: ECB and CNB.

Figure 13.13 Short-term interest rates on corporate loans



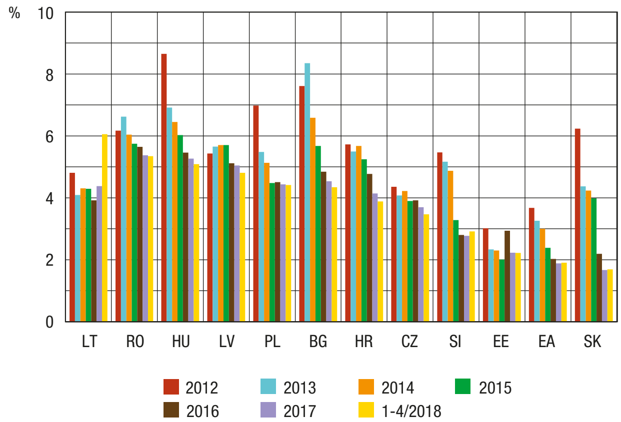
Note: Includes average interest rates on corporate loans up to EUR 1m and with a maturity of up to 1 year.
Source: ECB.

Figure 13.11 Placement to deposit ratio of the private sector



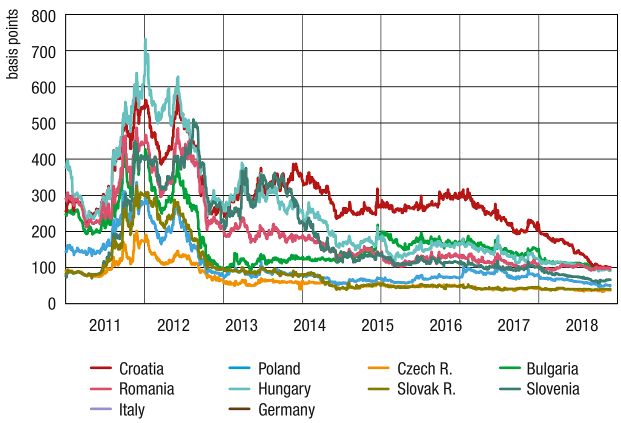
Sources: ECB and CNB.

Figure 13.14 Interest rates on housing loans



Sources: ECB and NCBs.

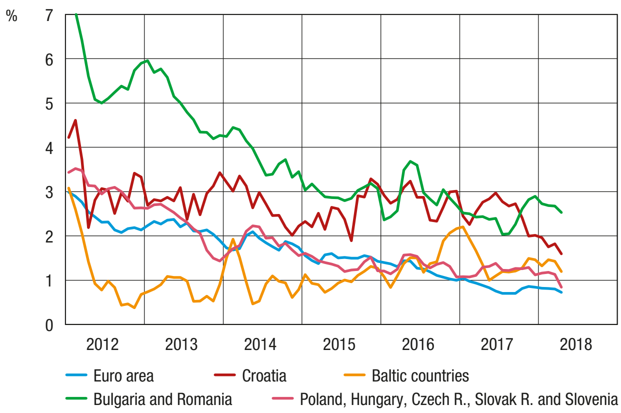
Figure 13.12 CDS spreads for 5-year government bonds of selected countries



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

Figure 13.15 Expected real interest rate on corporate loans

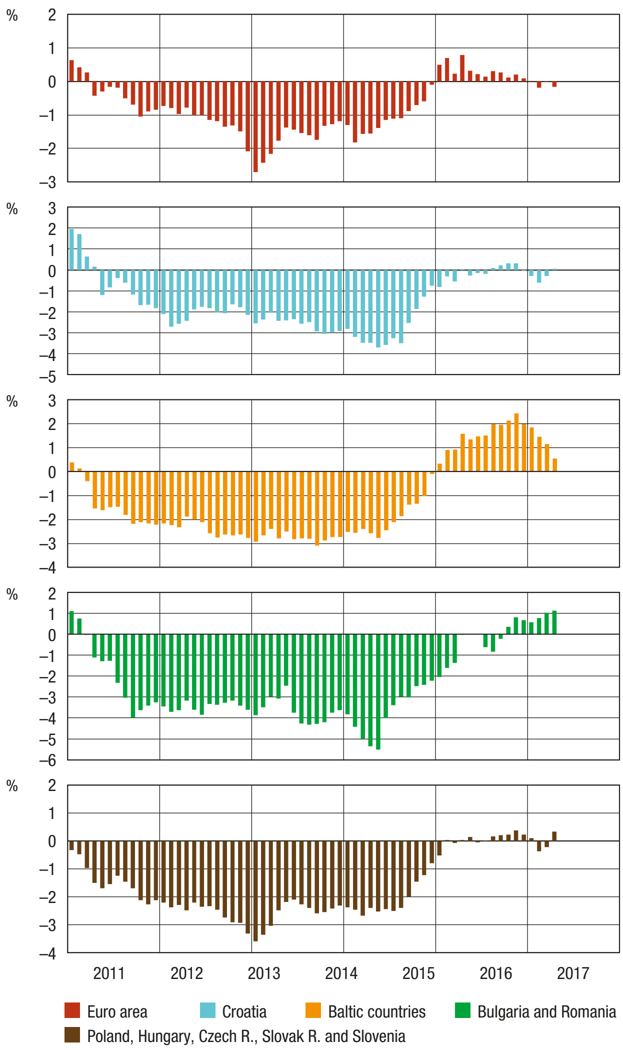
up to EUR 1m and with maturity up to 1 year



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

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

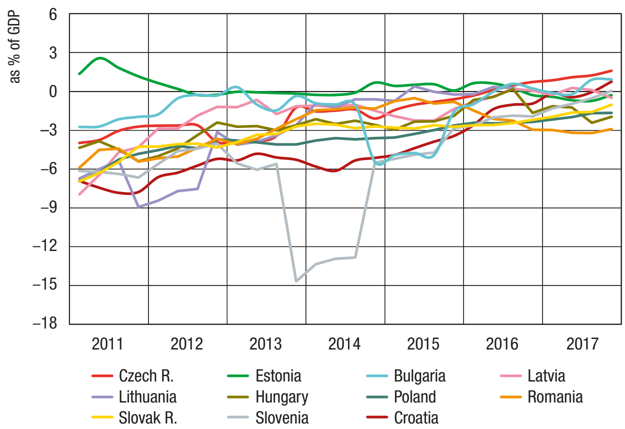
up to EUR 1 and with maturity up to 1 year



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

Figure 13.17 Consolidated general government balance

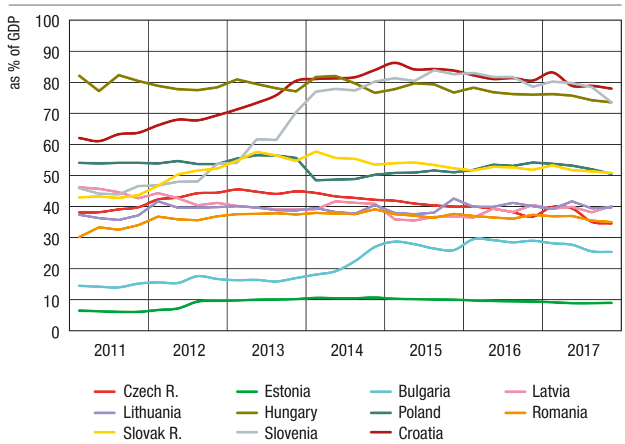
four-quarter moving sums



Sources: Eurostat and CNB.

Figure 13.18 General government debt

end-quarter stock



Sources: Eurostat and CNB.

Abbreviations and symbols

Abbreviations

ARZ – Rijeka-Zagreb Motorway
BIS – Bank for International Settlements
bn – billion
b.p. – basis points
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
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

Two-letter country codes

BG – Bulgaria
CZ – Czech R.
EE – Estonia
HR – Croatia
HU – Hungary
LV – Latvia
LT – Lithuania
PL – Poland
RO – Romania
SK – Slovak R.
SI – Slovenia

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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