Table 1. Croatia: Key Macroeconomic Indicators, 1999-2003

	1999	2000	2001	Projections 2002	Program 2003
			(Percentage change)		
Output and prices					
Real GDP	-0.9	2.9	3.8	4.0	4.2
CPI inflation (average)	4.1	6.2	4.9	2.4	3.0
CPI inflation (end of period)	4.4	7.4	2.6	3.5	2.1
			(In percent of GDP)		
Savings and investment					
Gross national savings	18.6	19.4	19.8	21.5	23.0
Gross domestic investment	25.7	21.8	23.6	25.1	26.6
General government operations					
Revenue and grants	48.4	46.2	44.7	45.4	45.0
Expenditure and net lending	56.6	52.7	51.5	51.5	50.0
Overall balance	-8.2	-6.5	-6.8	-6.2	-5.0
Privatization receipts 1/	4.9	3.1	3.7	2.0	1.2
Foreign borrowing	3.3	4.2	2.0	3.8	1.5
Domestic borrowing (including arrears)	0.0	-0.8	1.1	0.4	2.2
			(End of period; change in percent)		
Money and credit					
Credit to the nongovernment sector	...	9.4	24.5	29.8	13.7
Broad money	...	28.9	45.2	11.7	14.4
Base money	...	13.6	51.9	23.1	15.6
			(End of period; in percent)		
Interest rates					
Average deposit rate	4.3	3.4	2.8	1.7 4/	...
Average credit rate	13.5	10.5	9.5	13.0 4/	...
			(In millions of U.S. dollars)		
Balance of payments					
Current account balance	-1,398	-439	-740	-800	-893
(In percent of GDP)	-7.0	-2.4	-3.8	-3.6	-3.6
Capital and financial account	2,786	1,814	2,503	3,166	1,465
Overall balance	410	611	1,344	1,109	572
			(End of period; in millions of U.S. dollars)		
Debt and reserves					
Gross official reserves	3,025	3,525	4,704	5,706	6,278
In months of following year's imports of goods and NFS			4.7	5.3	5.6
Gross usable international reserves 2/	2,249	2,629	3,653	4,547	5,038
In months of following year's imports of goods and NFS			3.7	4.3	4.5
As a percentage of short-term debt 3/	125	123	171	307	260
External debt service to exports ratio (in percent)	21.0	23.5	23.1	25.3	17.4
Public debt (in percent of GDP)	47.8	53.2	55.1	57.5	57.2
Of which: External	29.1	33.7	33.0	33.3	32.4
Total external debt (in percent of GDP)	49.6	59.7	57.5	61.7	59.0

Sources: Croatian National Bank, World Economic Outlook, and Fund staff estimates.

1/ In 2000, includes 0.5 percent of GDP in back taxes.

2/ Gross reserves adjusted downward by foreign currency redeposit requirements held at the CNB, and by the amount of outstanding foreign currency CNB bills.

3/ On a remaining maturity basis. Coverage is limited to short-term debt contracts registered with the CNB.

4/ October. A change in methodology has introduced a break in the series as of January 2002.

Statement by Jeroen Kremers, Executive Director for the Republic of Croatia
February 3, 2003

Introduction

The Croatian authorities would like to thank staff for their fair assessment of the economic performance, and for their continuous efforts in helping them to steer through the complex economic reform course. After successful completion of the previous precautionary SBA in May last year, which was beneficial for the country in many ways, the authorities decided to request another precautionary SBA, with an aim to confirm their decisiveness regarding the reform process. This time, to demonstrate even more the precautionary nature of the program, the authorities repaid all their obligations towards the Fund ahead of schedule (in late December 2002), and they requested the lowest possible access (less then 30 percent of their quota) under the new arrangement.

General Outlook

Last year's economic growth could be as high as 5 percent (according to preliminary estimates), which is well above all previous projections. Let me recall that the authorities entered into the last year with a conservative growth projection of 3.5 percent, and then accepted a 4.0 percent projection after the first quarter data became available. However, the good tourist season, and very strong industrial production seem to have accelerated real growth even further, which is especially satisfactory in light of the less favorable external environment and the ongoing (considerable) fiscal consolidation. Good growth prospects are expected for this year too (above 4 percent for GDP), and the latest figures on the industrial production (which indicated an acceleration in the last quarter of 2002) are encouraging in this respect.

Turning back to last year's strong economic growth, it is noteworthy that this growth was mainly an outcome of the impressive performance of the private sector. For the first time since transition started, the aggregate net profit/loss balance of the Croatian enterprises turned to positive values last year. Furthermore, unemployment statistics improved, despite significant lay-offs in the public sector. Unemployment still remains high in Croatia, roughly 15 percent on an ILO basis, but it fell by a full percentage point last year.

Fiscal Policy

Perhaps the main accomplishment over the past few years was in the fiscal area. The fiscal adjustment has been considerable in every aspect (well-presented in the table on page 12 of the staff report) – the fiscal deficit has been lowered by some 2–3 percentage points of GDP, and the government expenditures by some 5 percentage points of GDP. At the same time, the tax burden has been lowered too, and almost all government arrears (which amounted to some 5 percent of GDP at end-1999) have been paid. However, despite strong consolidation efforts, the public debt continued to climb (although at a much slower pace than before). Hence, the authorities' strong aim under the proposed new arrangement is to reverse the debt dynamics, and to make further progress towards the medium-term soundness of the public finances.

Against this background, the authorities are committed to reduce the consolidated general government deficit to 5 percent of GDP in 2003. Although this figure still looks high, it represents a significant adjustment effort (1.4 percentage points of GDP), which comes in the pre-election period. It is also worth noting that the figure includes highway construction (an annual cost of approximately 2 percentage points of GDP), which has the characteristics of a self-financing investment project. In any case, the latter fact at least adds to the medium-term debt sustainability. In addition, let me underscore that beside the authorities' strong intention to reduce the deficit this year, they are fully committed to further fiscal consolidation. The track record they have established over the past three years speaks the best for their determination to put the public finances on a sound footing.

Monetary and Exchange Rate Policy

Monetary policy successfully continues to be focused on low inflation, while keeping an eye on exchange rate developments. Last year's inflation was 2.3 percent, with core inflation about 1 percent. It is noteworthy that this year – 2003 – is the 10^{th} anniversary of the stabilization program (implemented in Fall 1993), during which Croatia has been experiencing very low inflation rates. On average, annual headline inflation has been roughly 3.3 percent, and core inflation has remained below 2.5 percent. With such a performance, Croatia is an excellent performer among CEE transition countries, and there is little need to stress how eager the central bank is to continue to perform well on the inflation front.

The role of exchange rate stability should not be underestimated in considering the outstanding inflation performance. This is especially true in light of Croatia's monetary history, which provides an explanation for the high level of euroization in the economy. Hence, the monetary authorities intend to continue to rely on foreign exchange interventions at their discretion, with an aim to preserve the price stability objective, but also to discourage any potential one-way bets on the foreign exchange market. To this end, such a policy is entirely consistent with the authorities' aspirations to join the EU and to introduce the euro as legal tender in a manner consistent with practices that are applicable to the economies embarking on an accession path, and consistent with the recommendations of the EU and the ECB.

Separately, with regard to strong growth of bank credit to the private sector, let me note that the monetary authorities have already adopted measures to discourage excessive commercial banks' lending. Given the fact that the recent growth in bank placements has been based on the growth in foreign liabilities rather than on domestic deposits, the adopted measures tend not only to preserve a quality of commercial banks loan portfolio, but also to reduce pressures on the balance of payments and the external debt.