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# IMF Executive Board Concludes 2017 Article IV Consultation with the Republic of Croatia

On January 10, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Republic of Croatia.

In 2017, Croatia continued its third year of positive economic growth supported by strong tourism and private consumption, trade partner growth, and improved confidence. Growth is expected to stay at similar levels in the near future but to decelerate over the medium term. Consumer prices increased at a moderate pace and wage growth was also moderate as unemployment remained high. The external current account is expected to record another strong surplus, underpinned by robust performance of exports and tourism and lower repatriation of profits as banks absorbed losses from Agrokor. The balance of risks has improved but vulnerabilities remain sizable as public and external debt levels are still high and the full impact of the Agrokor restructuring is yet unknown.

Fiscal consolidation progressed at a faster pace than planned and Croatia exited the European Union’s Excessive Deficit Procedure in June. Preliminary information indicates that the fiscal position will be in a small surplus in 2017.

Domestic monetary conditions remained accommodative and banks’ financial positions strengthened. Money market rates have been modest and liquidity ample. Although continued deleveraging resulted in a negative overall credit growth on a stock basis, transaction data suggest that bank lending has resumed. There has been moderate upward pressure on the exchange rate and the Croatian National Bank accumulated international reserves. On average, the banking system, remained well capitalized and liquid. The still high NPL ratio to total loans has been declining despite the Agrokor crisis.

The pace of structural reforms slowed down after the EU accession in 2013. Croatia’s GDP per capita stands at about 60 percent of the EU average and the business environment remains less favorable than peers.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

**Executive Board Assessment**[2]

Executive Directors welcomed Croatia's continued economic recovery and favorable fiscal performance. Nonetheless, output has not yet fully recovered to its pre-recession level and per capita income remains well below the EU's average. In addition, public debt, elevated unemployment, and structural impediments continue to weigh on medium term growth prospects. With this background, Directors underscored the need to implement policy measures and expedite structural reforms to boost growth and reduce vulnerabilities.

Directors were encouraged by the commitment to fiscal discipline, and noted the overperformance of recent years. The favorable cyclical position provides an opportunity for growth friendly consolidation and a faster reduction in public debt. In this context, Directors emphasized the need to improve the structure of revenue and expenditure. They supported a streamlining of VAT rates and an introduction of a modern real estate tax. Directors encouraged the authorities to resist pressures to increase the wage bill and untargeted benefits. They stressed the need for reforms to enhance the efficiency of public services. Directors also underscored the importance of an ambitious reform of the pension and health care systems.

Directors noted that monetary policy has been appropriately accommodative within the limits of the exchange rate anchor. They encouraged the Croatian National Bank (CNB) to maintain such a stance as long as risks to inflation and financial stability remain low. Directors stressed that the ambition to adopt the euro raises the importance of pressing ahead with reforms to maximize the benefits from joining the currency union while enhancing the ability of the economy to respond to adverse shocks.

Directors commended the CNB for its conservative prudential policies which have thus far helped banks withstand the Agrokor crisis. They stressed that it is vital to maintain these policies and vigilant supervision. Directors encouraged the authorities to build on recent improvements in bankruptcy legislation to address remaining gaps in corporate governance.

Directors urged the authorities to advance structural reforms to remove impediments to sustained growth. They highlighted the need to improve the business environment by streamlining public administration, and enhancing the legal process and property rights. In addition, they encouraged the authorities to ease regulations on temporary employment, and the hiring and retrenchment of labor. Directors stressed the need to improve productivity and resource allocation by raising the efficiency of SOEs and divesting underutilized state assets.

It is expected that the next Article IV consultation with the Republic of Croatia will be held on the standard 12-month cycle.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

## Croatia: Selected Economic Indicators, 2012–18

| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|---|
| | | | | | | Proj. | |
| **Output, unemployment, and prices** | (Percent change, annual average, unless otherwise indicated) | | | | | | |
| Real GDP growth | -2.2 | -1.1 | -0.5 | 2.2 | 3.0 | 3.1 | 2.8 |
| Contributions: | | | | | | | |
| Domestic demand | -3.3 | -1.0 | -1.8 | 1.9 | 3.0 | 3.4 | 3.1 |
| Net exports | 1.1 | 0.0 | 1.2 | 0.3 | 0.1 | -0.3 | -0.3 |
| Unemployment | 18.9 | 20.2 | 19.6 | 17.0 | 14.8 | ... | ... |
| CPI inflation (avg.) | 3.4 | 2.2 | -0.2 | -0.5 | -1.1 | 1.1 | 1.5 |
| **Saving and investment** | (Percent of GDP) | | | | | | |
| Domestic investment | 19.3 | 19.1 | 18.6 | 19.8 | 19.8 | 19.7 | 20.2 |
| *Of which*: fixed capital formation | 19.6 | 19.8 | 19.4 | 19.8 | 20.1 | 20.6 | 21.3 |
| Domestic saving | 19.2 | 20.1 | 20.6 | 24.4 | 22.4 | 23.4 | 23.1 |
| Government | -1.4 | -0.7 | -0.7 | 0.3 | 2.4 | 2.9 | 2.9 |
| Nongovernment 1/ | 20.5 | 20.8 | 21.3 | 24.1 | 20.0 | 20.5 | 20.1 |
| **Government sector (ESA 2010 definition)** | | | | | | | |
| General government revenue | 41.8 | 43.0 | 43.1 | 45.0 | 46.8 | 46.6 | 46.8 |
| General government expenditure | 47.1 | 48.3 | 48.5 | 48.4 | 47.6 | 47.2 | 47.3 |
| General government balance | -5.3 | -5.3 | -5.4 | -3.4 | -0.9 | -0.6 | -0.5 |
| Structural balance 2/ | -3.4 | -3.0 | -2.8 | -2.1 | -0.4 | -0.6 | -0.6 |
| General government debt | 70.7 | 82.2 | 86.6 | 86.3 | 83.7 | 80.4 | 77.5 |
| **Money and credit** | (End of period, change in percent) | | | | | | |
| Broad money (M4) | 3.6 | 4.0 | 3.2 | 5.1 | 4.7 | ... | ... |
| Claims on other domestic sectors 3/ | -6.2 | -1.3 | -2.2 | -3.0 | -3.4 | ... | ... |
| **Interest rates** | | | | | | | |
| Average 3-month T-bill interest rate (in kuna) 4/ | 1.3 | 0.8 | 0.3 | 0.4 | 0.4 | ... | ... |
| Kuna credit rate (unindexed, outstanding amount) | 8.2 | 7.8 | 7.5 | 7.1 | 6.6 | ... | ... |
| **Balance of payments** | (Billions of euros, unless otherwise indicated) | | | | | | |
| Current account balance | -0.1 | 0.4 | 0.9 | 2.0 | 1.2 | 1.8 | 1.4 |
| Percent of GDP | -0.1 | 1.0 | 2.0 | 4.6 | 2.5 | 3.7 | 2.8 |
| Capital and financial account | 0.5 | 2.3 | -0.8 | -0.8 | -0.8 | 0.9 | -0.6 |
| FDI, net (percent of GDP) | 2.8 | 1.9 | 1.6 | 0.6 | 4.2 | 1.6 | 2.0 |
| Overall balance | 0.0 | 1.8 | -0.5 | 0.7 | -0.3 | 2.0 | 0.8 |
| **Debt and reserves** | (End of period, billions of euros, unless otherwise indicated) | | | | | | |
| Gross official reserves | 11.2 | 12.9 | 12.7 | 13.7 | 13.5 | 15.5 | 16.2 |
| Percent of short-term debt (by residual maturity) | 98.9 | 100.1 | 108.3 | 115.5 | 140.4 | 155.2 | 155.0 |
| Gross official reserves in months of imports in goods and services (based on next year level) | 7.4 | 8.3 | 8.1 | 8.0 | 7.6 | 7.9 | 7.6 |
| Total external debt (percent of GDP) | 103.1 | 105.3 | 108.0 | 103.0 | 90.9 | 84.3 | 78.7 |
| Net external debt (percent of GDP) | 65.7 | 64.5 | 65.1 | 57.6 | 48.7 | 39.2 | 33.4 |
| **Exchange rate** | | | | | | | |
| Kuna per euro, end of period | 7.5 | 7.6 | 7.7 | 7.6 | 7.6 | ... | ... |
| Real effective exchange rate (CPI-based, y-o-y change) (negative sign = appreciation) | -1.9 | 1.4 | -1.1 | -3.0 | -1.5 | ... | ... |
| Memorandum items: | | | | | | | |
| Nominal GDP (billions of euros) | 43.9 | 43.5 | 43.0 | 44.1 | 45.8 | 47.8 | 49.8 |

Sources: Croatian authorities; and IMF staff estimates.

1/ Includes state-owned enterprises.
2/ In percent of potential GDP, excluding capital transfers to public enterprises and one-off investment retrenchment in 2015.
3/ Comprises claims on households and non-financial corporations.
4/ Weighted monthly average of daily interest rates for auctions of Treasury bills issued by the Ministry of Finance.