CROATIA: MACRO OUTLOOK

Weathering global headwinds?

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Economy Croatia - Analyses and Forecasts | Erste Group Bank AG
March 18, 2025

Spot Rates as of: March 18, 2025
Note: Information on past performance is not a reliable indicator for future performance.
Forecasts are not a reliable indicator for future performance.

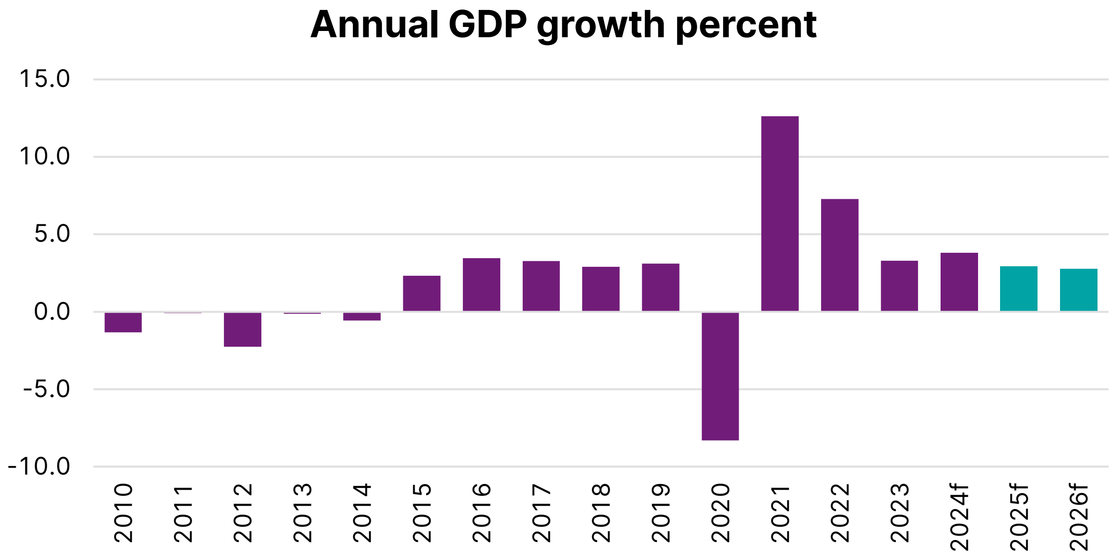
Growth expected to remain in decent shape

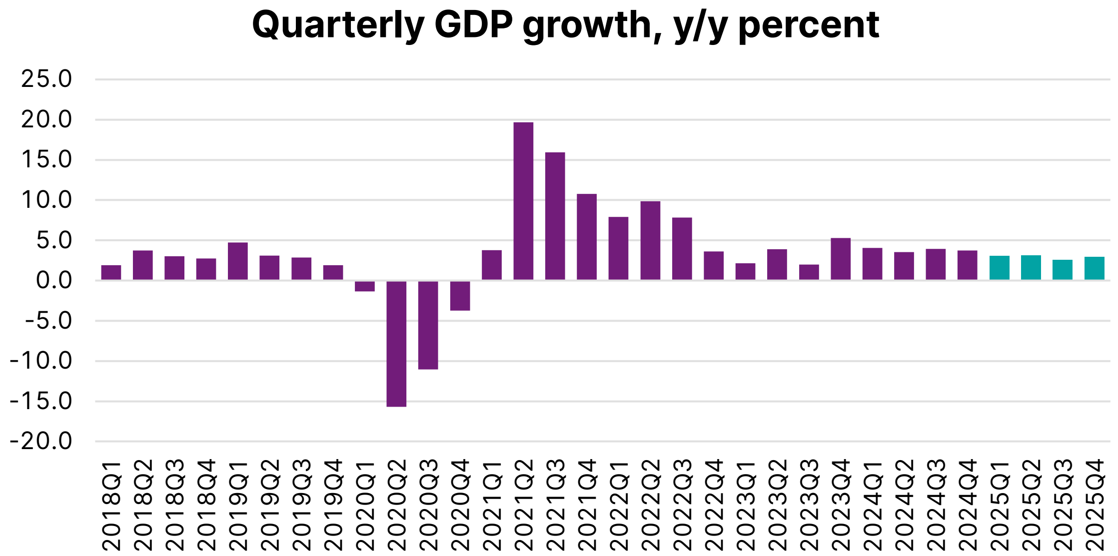
The economy delivered another strong quarter, as GDP grew 3.7% y/y in 4Q24, wrapping up FY24 GDP growth at a robust 3.8%. Strong domestic demand remained the backbone of growth as private consumption and investments saw ongoing steady expansion. As far as the 2025 outlook goes, we continue to expect GDP growth to remain in decent gear at around 3%. Domestic demand is anticipated to continue to support above-EU average growth momentum, although at a more moderate pace compared to what we saw in 2024. Risks are tilted to the downside, mostly owing to the external environment and growing uncertainty on a global level.

For inflation, we see the headline figure hovering in the 3-4% range for the majority of 2025, with the average landing slightly above 3%, hence maintaining the above-EU trend as demand-side pressures are seen as persisting. Food price indices still suggest a bumpy ride ahead, while energy prices and supply-side factors should play a more neutral role.

Fiscal news flow has been scarce since our last report, thus we are awaiting details on the 2024 fiscal results, where the government is targeting a 2.1% of GDP budget gap. The target for 2025 is set at 2.3% of GDP, where budgeting assumptions suggest more limited maneuvering space in the event of negative risks materializing, hence our call of a marginally higher budget gap (2.5% of GDP). As suggested by the maturity profile, the MoF has been working diligently in 1Q25, with issuance seen as landing in excess of 7% of GDP, thus roughly meeting 2/3 of the FY25 funding needs. Both Fitch and S&P remained on hold as expected in their recent rating updates, which, following another round of rating upgrades in 2024, remains our baseline for the remainder of 2025. Yields again kept up a volatile trajectory, mostly reflecting strong benchmark swings. Despite the 10Y yield moving closer to the 3.5% level recently, spreads showed some additional tightening towards the 50bp region, supporting our recent downward revision of spreads towards the 60-70bp region for the upcoming quarters.

Growth to remain in decent gear despite global headwinds





As far as the 2025 outlook goes, we continue to expect GDP growth to remain in decent gear at around 3%, with risks tilted to the downside, mostly owing to the external environment and growing uncertainty. Domestic demand is anticipated to continue to support above-EU average growth momentum, although at a bit more moderate pace compared to what we saw in 2024. Private consumption remains supported by the labor market, yet disposable income gains should soften as wage and employment growth moderate compared to strong 2024. Also, somewhat more elevated inflation pressures would weigh on real income, while the regulator signals focus on trimming excessive consumer credit growth. Investments should remain shaped by EU fund flows and a strong construction sector footprint. While interest trending lower should add support to investment activity, growing geopolitical uncertainty is likely to act as a headwind in the coming period. External demand remains sensitive to EU growth dynamics, i.e. uncertainty remains elevated amid chaotic trade war dynamics, and looming fiscal expansion directed towards EU defense capacities. Also, tourism is likely to continue to face growth challenges as a consequence of modest economic momentum in several key markets and deteriorating price competitiveness.

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Source: Eurostat, Refinitiv, Erste Group Research

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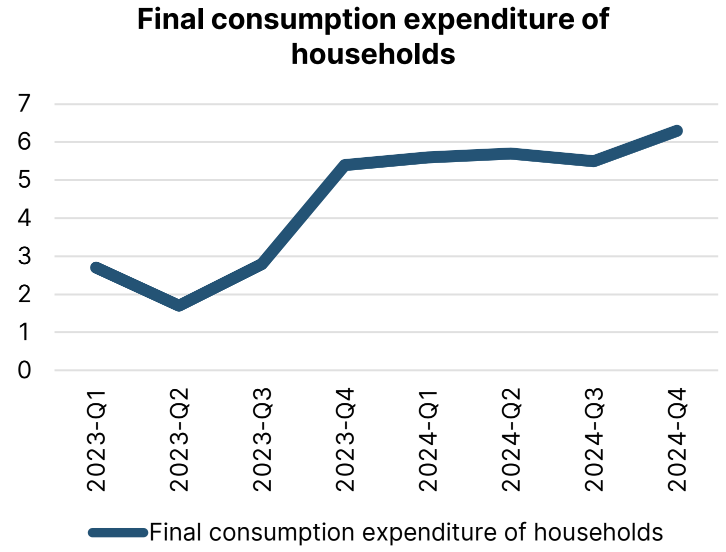
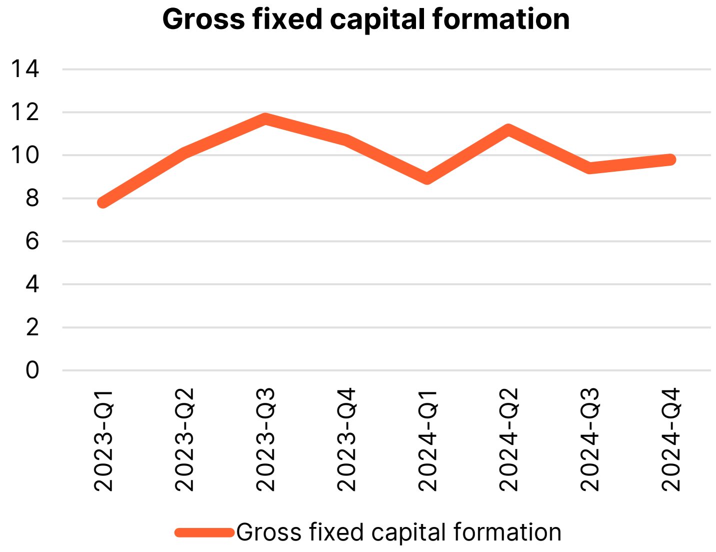
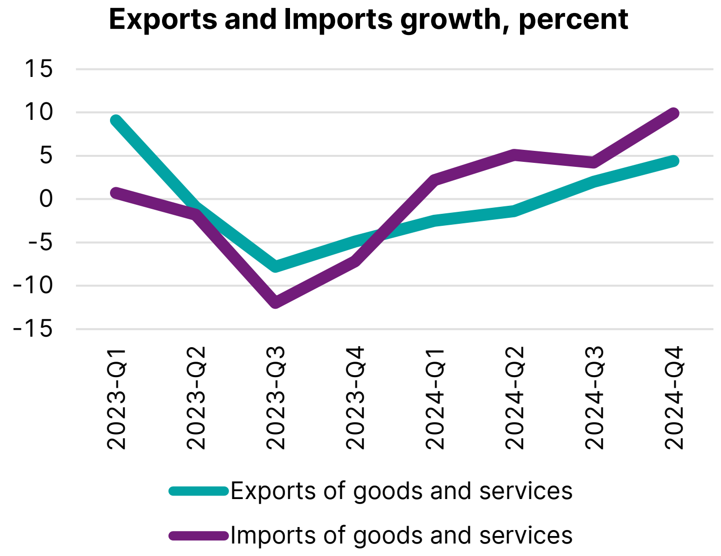
Domestic demand remained strong tailwind







The economy delivered another strong quarter, as GDP grew 3.7% y/y in 4Q24. Seasonally adjusted data indicates that the economy expanded by 1.4% q/q, translating to a 3.6% y/y increase. The detailed breakdown revealed strong domestic demand, with both private consumption and investment activity posting robust growth rates of 6.3% and 9.5% y/y, respectively. Public consumption added to the strong domestic demand narrative, increasing by 7.1% y/y. On the external trade front, exports grew by 4.7% y/y, driven by a 9.2% y/y increase in goods, while services remained largely unchanged. Imports, however, rose by 9.9% y/y, pushed both by goods and services and pushing the net exports contribution further in the red.

Overall, for 2024, GDP grew by 3.8%, putting Croatia high in the EU rankings and supporting further income convergence towards 80% of the EU27 average. On the annual level, we also saw domestic demand-driven growth, as both private consumption and investments delivered consistently strong performance. As expected, net exports turned red courtesy of import-side pressures and less support from services (tourism) on the export side.

Source: Eurostat, Refinitiv, Erste Group Research

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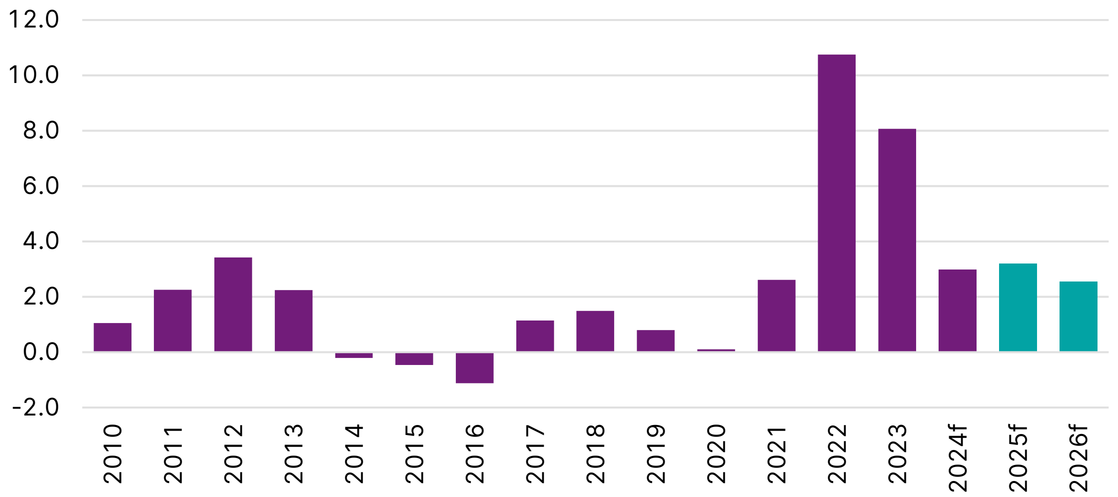
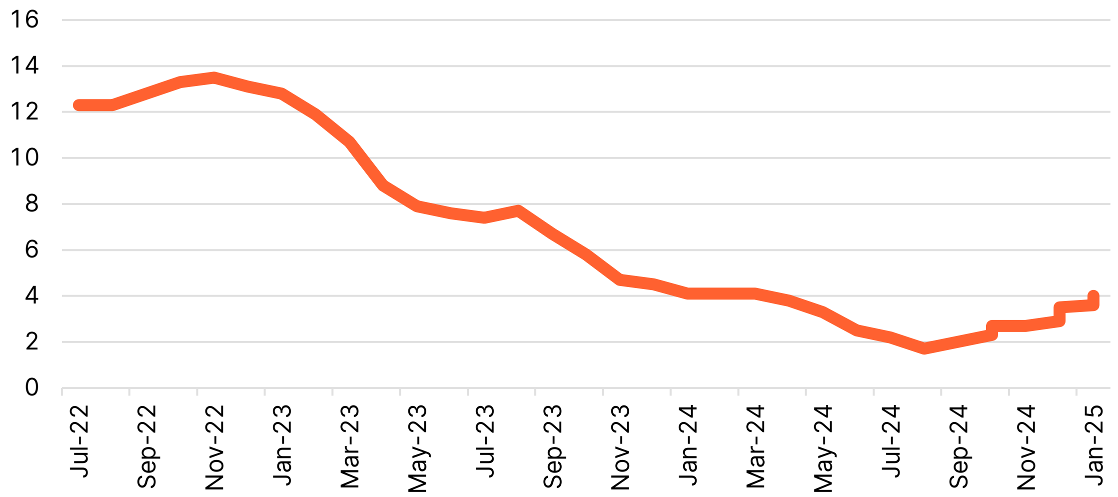
Average inflation in 2025 seen slightly above 3% level

Annual inflation, percent



Monthly inflation development, y/y percent

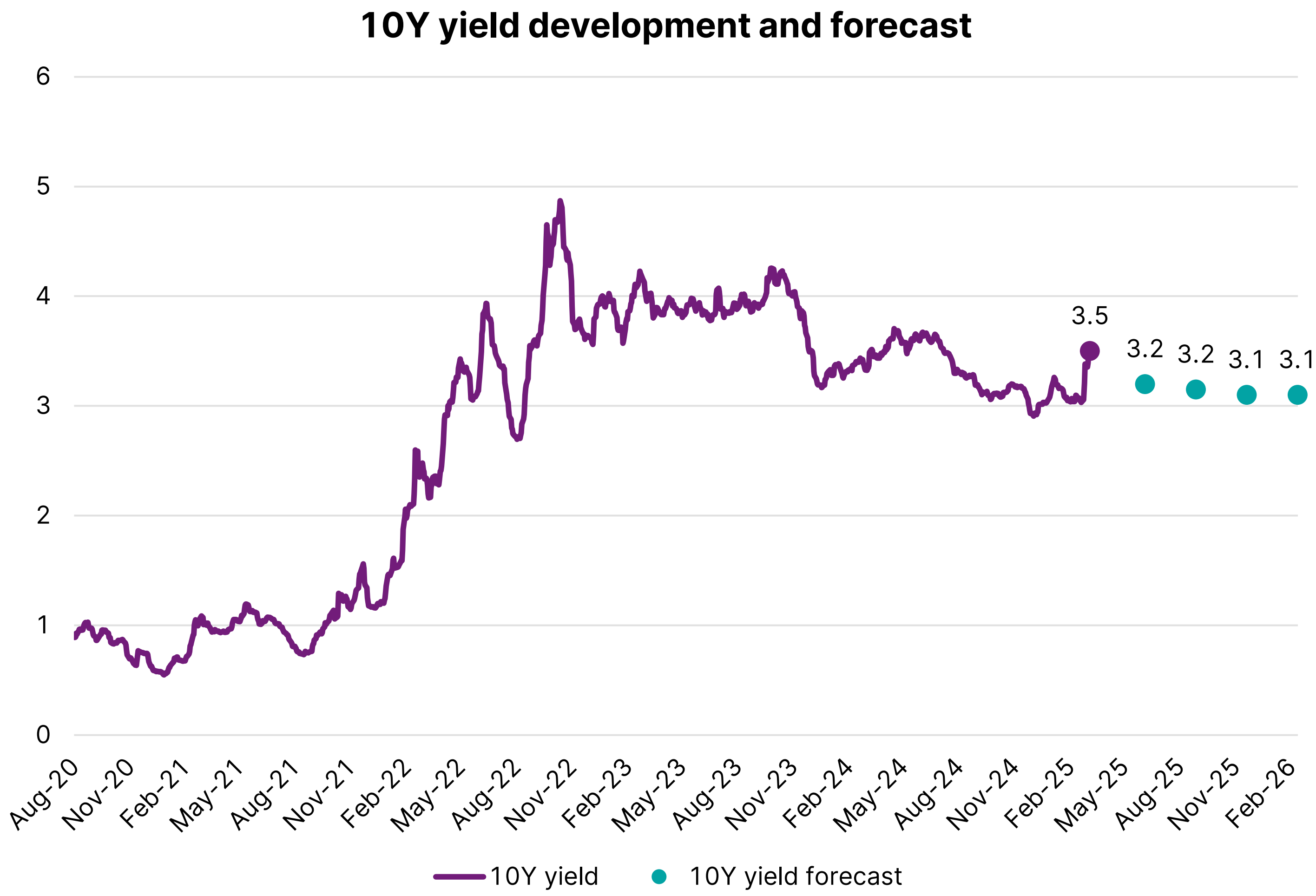


As far as the headline figure is concerned, inflation likely reached an intra-year peak in January (4.0% y/y), before subsiding somewhat in February (3.6% y/y). Structure-wise, on an annual level, services and food items remain the dominant drivers, with the former reflecting pronounced demand-side pressures, while the latter also reflected some supply-side pressures in recent periods. Energy prices in recent months added to the inflation pressures, getting back to positive region on the annual level, and reflecting also two-step increase in electricity prices. Looking ahead we see inflation hovering in the 3-4% range for the majority of 2025, hence keeping the above-EU trend as demand-side pressures are seen as persisting. Food price indices are still suggesting a bumpy ride ahead, while energy prices and supply-side factors should be playing a more neutral role. We bumped up our 2025 average CPI forecast to 3.2%, while the trade war and looming introduction of new tariffs remain an upside risk.

Spreads further narrow

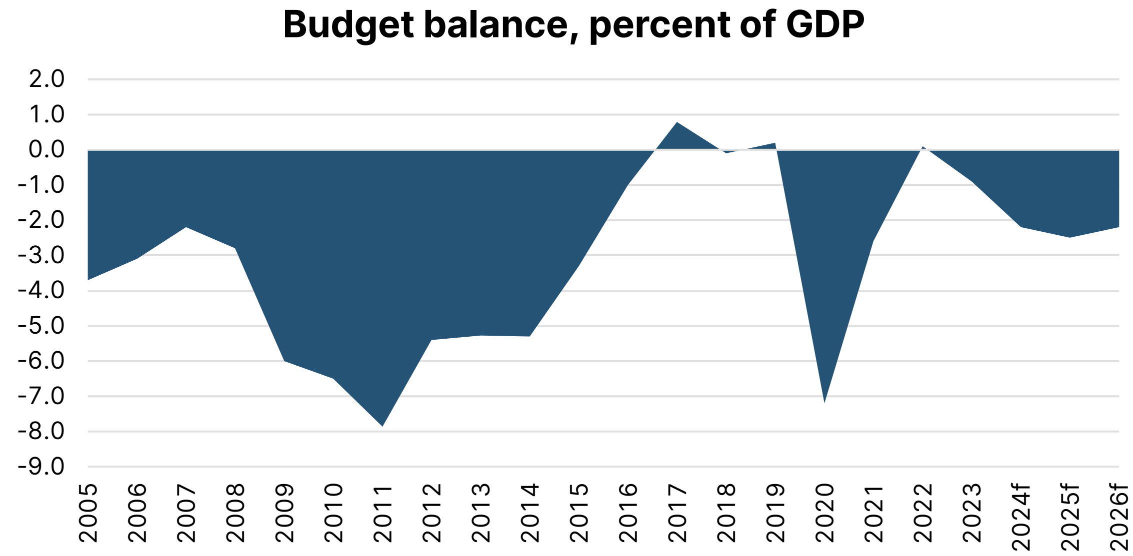
As suggested by the maturity profile, 1Q25 brought extensive financing actions, with total issuance anticipated to finish just above 7% of GDP (out of which 90% has already been carried out), thus meeting approx. 2/3 of the FY24 issuance target. Slightly less than 1/3 goes to Eurobond issuance (EUR 2037), while the remainder goes to the local market with a notable shift towards institutional investors as demand from households faded as rates moved down courtesy of ECB rate cuts.

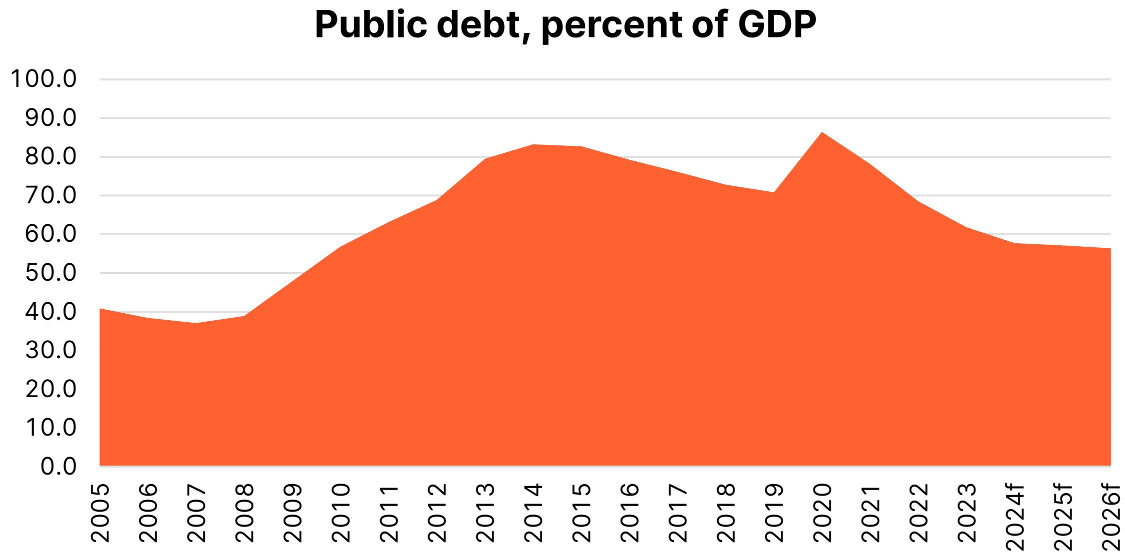
Roller-coaster seems like the most appropriate word for the bond market, with the DE benchmark driving the volatility and hence driving the long end of the curve to 3.40-3.50% region, i.e. some 30-40bp up YTD. Spreads are telling a more favorable story as they have narrowed further and are now close to the 50bp region. Time will tell if the move was of a more permanent nature once the dust settles down a bit, yet our 60-70bp spread range seems like a relatively conservative call at the moment. Unsurprisingly, benchmark developments would remain the shaping factor, thus basing our view of 10Y DE rates moving closer to 2.50%, we see 10Y HR rates gradually moving towards the 3% region down the road.



Source: Eurostat, Refinitiv, Erste Group Research

Anticiapting 2024 fiscal results





On the fiscal side, we are still awaiting details on the 2024 budget execution. The available January-November 2024 data put the cash-based central budget gap at around EUR 3bn (approx. 90% of FY24 target), yet we will soon see what conversion to ESA2010 figures will bring and where we land compared to MoF target (2.1% of GDP). Our expectation remains relatively close. As far as 2025 goes, the budget target is set at 2.3% of GDP, being reliant, among other factors, on tighter control of wage growth and a relatively optimistic VAT intake (YTD tax authorities data point to somewhat more modest nominal retail trade growth). We reiterate our call that maneuvering space is more constrained – and we are expecting the budget gap to land slightly above the official target, yet still likely to deliver a satisfying picture to rating agencies and investors. On that note, after a round of upgrades in 2024, rating agencies remained on hold in the first round of rating reviews (S&P and Fitch). In our view, the rating agency focus in 2025 would be on whether the fiscal gap will be contained close to the 2024 level, and being in no rush, we see no rating change as the most likely outlook for 2025.

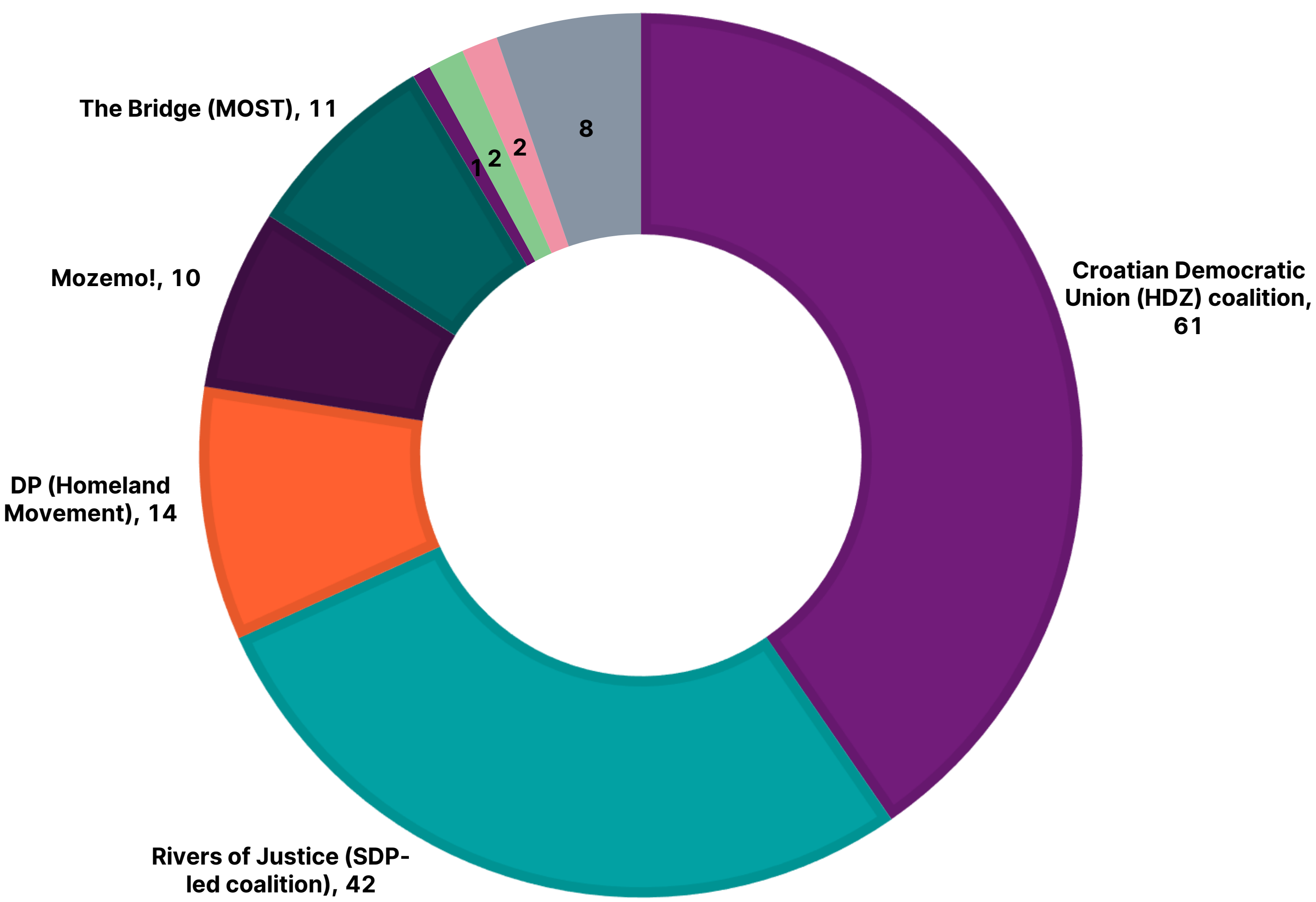
Source: Eurostat, Refinitiv, Erste Group Research

Focus turns to local elections

Incumbent President Milanovic, after being just shy of securing the post already in the 1st round (49.1% of votes) took a landslide victory in the 2nd round by securing almost ¾ of votes against the ruling HDZ candidate. The outcome was largely anticipated as, apart from traditional backing on the left and center-left, he is also faring well on the opposite side of the spectrum, which benefits him in the presidential elections race as traditional party loyalty is less obvious. Given the relatively limited scope of power (mostly foreign policy and defense), similar to his first term, President Milanovic is likely to pursue a similar policy course, namely use his position as a corrective factor to the current ruling center-right HDZ cabinet.

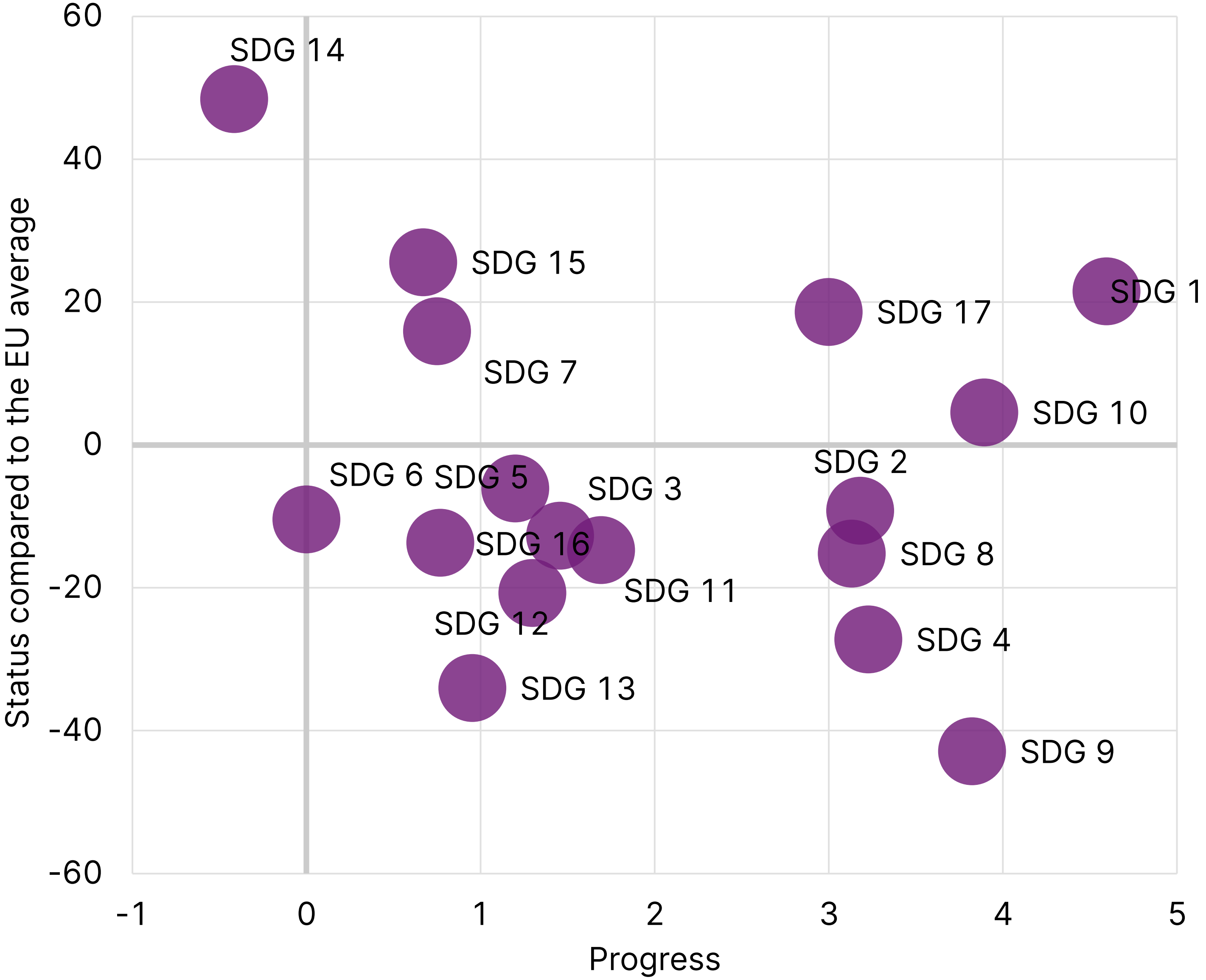
Local elections scheduled for May 18 would round out the intensive election period and serve as an intermediate test of popularity a year after the parliamentary elections. For ruling center-right HDZ, the stakes are increasing, as weak presidential election results and recent polls are suggesting they are losing primacy to center-left SDP, creating additional pressure. On the other hand, center-left SDP, now polling above 26.3%, sees the elections as a true test of recent popularity gains and potential boost to parliamentary-level ambitions.

Parliamentary seats



Source: Eurostat, Refinitiv, Erste Group Research

Social Development Goals



Regarding SDGs, Croatia is showing an improving trend for the vast majority of them. Croatia scores above average in 6 out of 17 SDGs and apart from SDG 14 (Life below water) is showing further progress. Out of 11 SDGs that are ranked below the EU average, significant progress is being made in 4 of them - Zero hunger (SDG 2), Quality education (SDG 4), Decent work and economic growth (SDG 8) and Industry, innovation and infrastructure (SDG 9). Regarding other below-average SDGs – Clean water and sanitation is showing no progress at the moment, while remaining SDG are showing gradual improvement. Looking at the gap to EU average Industry, innovation and infrastructure (SDG 9), Climate action (SDG 13) and Quality education (SDG 4) should remain in the focus.

Source: Eurostat, Refinitiv, Erste Group Research

Wrap-up of 2024 tourism season

Special topic

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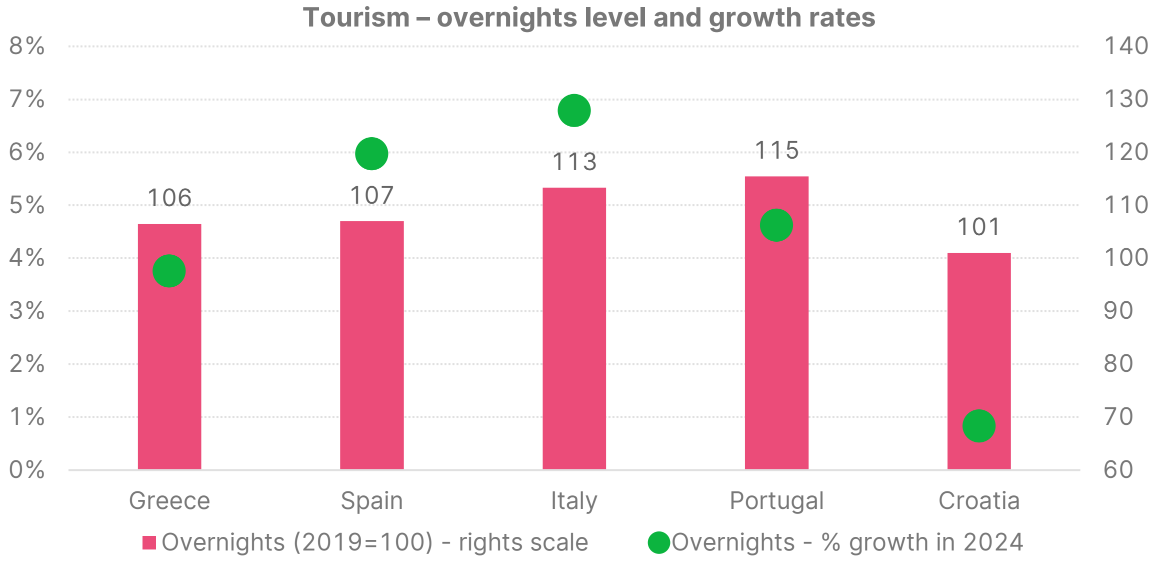
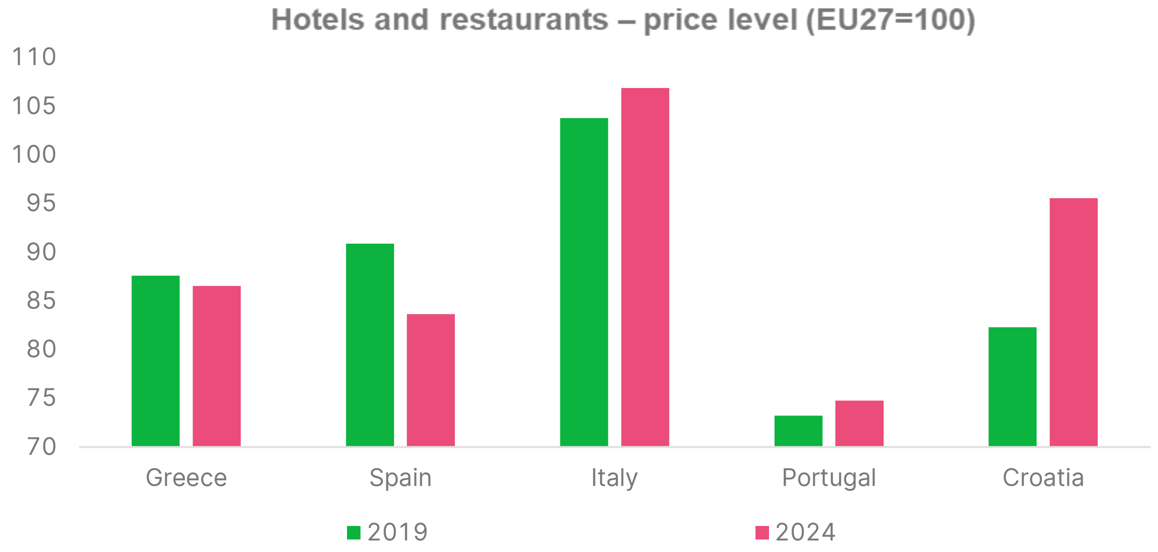
Tourism growth rates slow as price competitiveness deteriorates





While Croatia has reached pre-pandemic overnight rates relatively swiftly, growth moderation from 2023 has been confirmed also in 2024.

Looking at main competitors in Mediterranean region, Croatia is lagging both in terms of 2024 growth rate and position vs. pre-pandemic levels.

Deteriorating price competitiveness (HICP – hotels and restaurants prices) has been evident in recent period. Compared to pre-pandemic levels, Croatia showed the strongest price convergence to the EU average among the selected countries, with the price level nearing the gap to the EU27 average.

Source: Eurostat, Refinitiv, Erste Group Research

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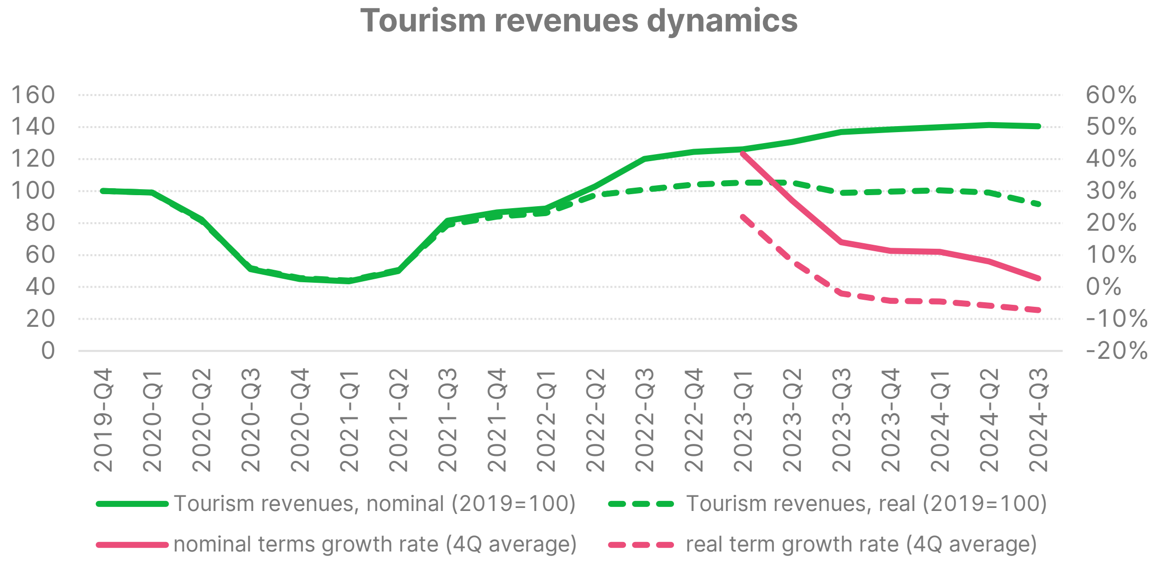
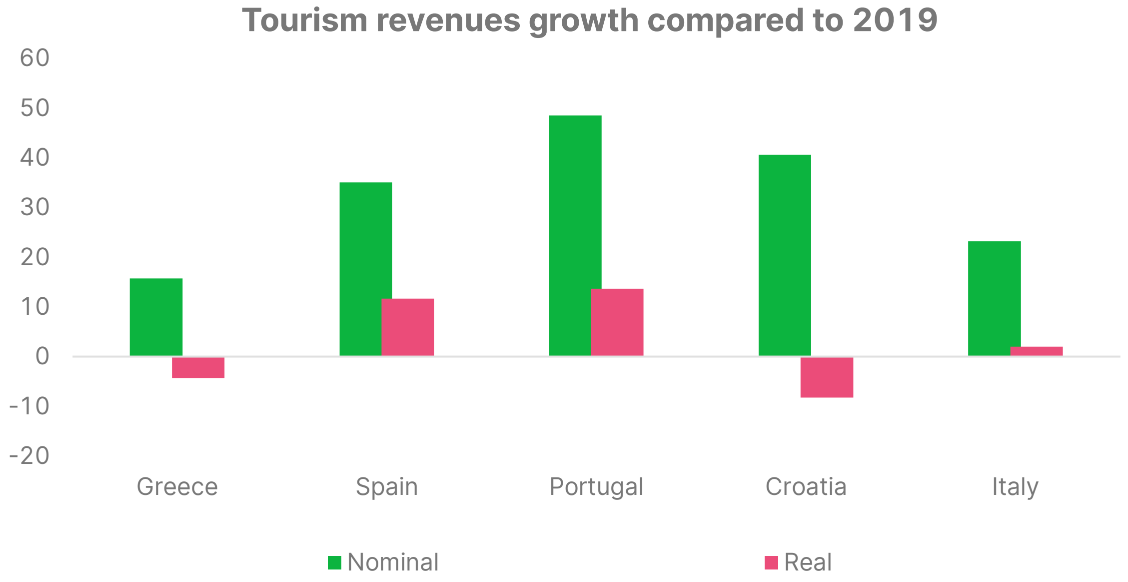
Tourism support to real GDP turned red and outlook for 2025 remains bleak





Nominal tourism revenues showed strong dynamics following the pandemic shock, now standing some 40% above the pre-pandemic level (according to Balance of Payments data).

Though similar to overnights, trend lost momentum, moving towards flattish performance.

Considering already mentioned price level developments, despite robust growth of nominal revenues, revenues in real terms turned negative.

Trend became visible already in 2023 and continued also in 2024, weighing on the headline GDP performance. Similar developments are likely to persist as travel overnight growth rates should remain modest, and price pressures are likely to persist.

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Source: Eurostat, Refinitiv, Erste Group Research

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Croatia : Forecasts

	2018	2019	2020	2021	2022	2023	2024f	2025f	2026f
Percent					**Annual average**				
Real GDP growth	2.9	3.1	-8.3	12.6	7.3	3.3	3.8	2.9	2.8
Private consumption growth	3.3	4.0	-5.2	10.9	6.9	3.2	5.8	3.7	3.0
Fixed capital formation growth	4.4	12.8	-6.3	4.8	10.4	10.1	9.9	3.4	4.0
Inflation	1.5	0.8	0.1	2.6	10.8	8.1	3.0	3.2	2.5
Unemployment rate	8.4	6.6	7.5	7.6	7.0	6.1	5.2	4.8	4.6
Percent of GDP									
Budget balance	-0.1	0.2	-7.2	-2.6	0.1	-0.9	-2.2	-2.5	-2.2
Public debt	72.8	70.9	86.5	78.2	68.5	61.8	57.7	57.1	56.4
Current account balance	1.1	2.5	-1.3	0.5	-3.5	0.4	-0.7	-1.2	-1.4
					End of year				
10Y Yield	2.04	0.62	0.66	0.56	3.77	3.17	2.96	3.10	3.10
Spreads vs. German Bunds (bps)								65	65

Croatia: Country overview

Official EU language: Croatian

Capital: Zagreb

Geographical size: 56 594km2

Population: 3 861 967

GDP per capita: EUR 22 200, below the EU average

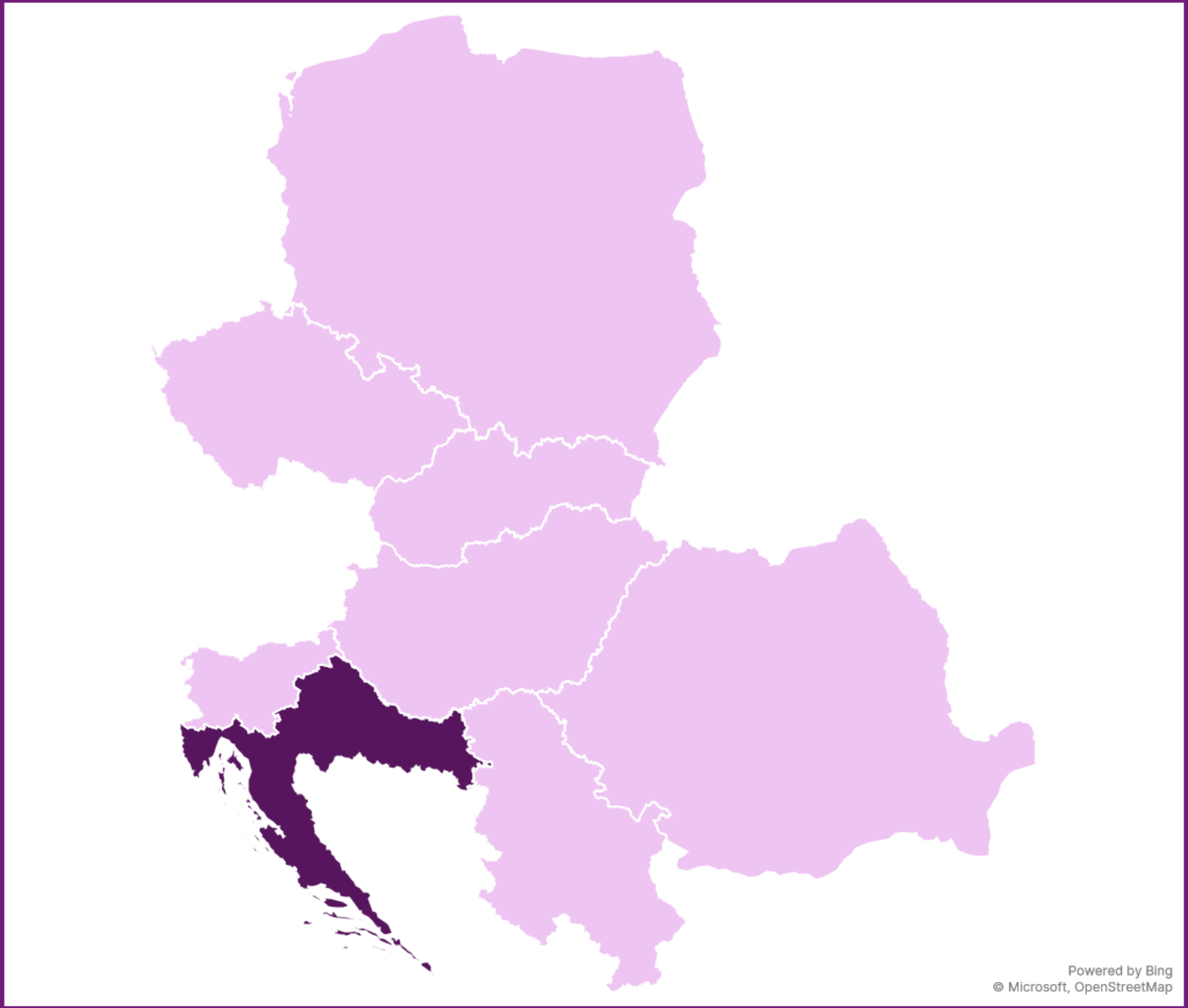
Currency: Euro EUR since January 2023

Credit Ratings:

- **Moody's: A3, outlook stable**
- **S&P: A-, outlook positive**
- **Fitch: A-, outlook stable**

EU member state: since July 1, 2013

Schengen: member since January 1, 2023



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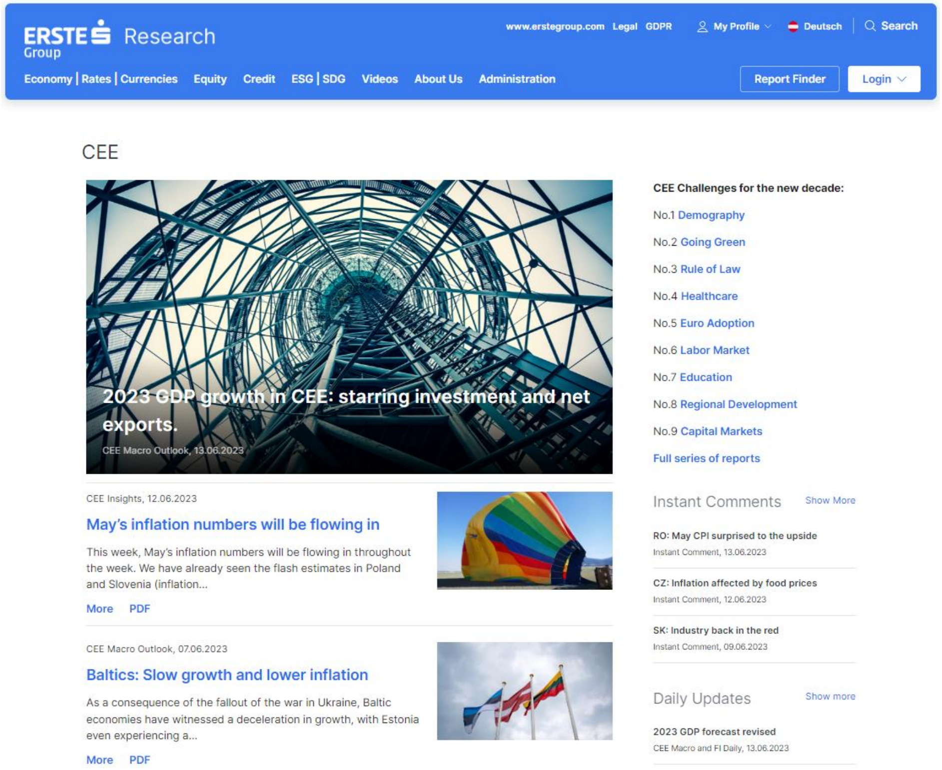

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