CROATIA | MACRO OUTLOOK

Croatia joining 'A' rating club

Domestic demand driving GDP growth
ECB: next interest rate cut in October
S&P delivering anticipated rating upgrade
Weaker dollar expected

Economy (%)	2024e	2025e	2026e
GDP (real, y/y)	3.4	2.8	2.7
Unempl. Rate	5.6	5.5	5.4
CPI (y/y)	3.1	2.6	2.4
Retail Sales (y/y)	7.5	4.0	4.0
Ind. Prod. (y/y)	-1.5	1.5	2.0
Public Debt/GDP	61.0	59.8	58.4

Source: Erste Group Research

Market	Spot	24Q4	25Q1	25Q2
ECB (deposit)	3.50	3.00	2.75	2.50
3M Euribor	3.47	3.09	2.86	2.64
EUR/USD	1.11	1.13	1.14	1.14
5Y Bond (%)*	2.75	2.90	2.90	2.90
10Y Bond (%)*	3.12	3.20	3.20	3.20

Source: FactSet, Erste Group Research

Rating	Current	Outlook
Moodys	Baa2	pos
S&P	BBB+	pos
Fitch	BBB+	pos

Source: Erste Group Research

General	2024
Population mn	3.9
GDP/Capita EUR	21,078

Source: Erste Group Research

Spot Rates as of:
13th Sep. 2024

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Note:
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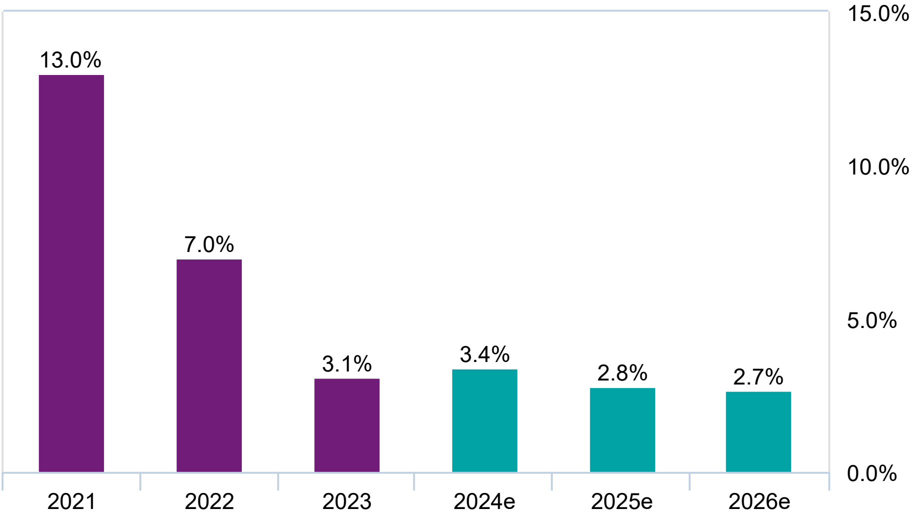
GDP remained in solid gear in 2Q24, adding 3.3% y/y and 0.8% q/q s.a. Domestic demand continued to push strongly, with private consumption adding 6.1% y/y and investments maintaining double-digit growth (12.9% y/y), while net exports remained a drag. Going forward, domestic demand is anticipated to maintain supportive momentum, reflecting strong labor market fundamentals on the consumption side and EU fund backing on the investment side. Exports should deliver a steady tourism footprint, but weak EU growth keeps weighing on a stronger goods export recovery. We maintain our FY24 call at 3.4%, with risks tilted modestly to the downside.

Inflation kept a moderating trend amid supportive supply-side factors. Demand-side pressure continues, fueling above-EU average inflation, with the average CPI in 2024 landing close to 3%. The budget gap is expected to slip to 2.5% of GDP in 2024, reflecting pre-election generosity. In anticipation of the 2025 budget, a stronger consolidation effort seems unlikely at present. S&P delivered a strong message with a rating upgrade to 'A-' and even more so with the outlook remaining unchanged at positive. The latter signals an increasing likelihood of another upgrade in the 1-2 year horizon. Fitch and Moody's are likely to act in a similar fashion.

GDP (real,y/y)



Source: Erste Group Research

GDP

Domestic demand driving GDP growth

As anticipated, GDP maintained a solid growth pace in 2Q24, with the headline figure up 3.3% y/y and the economy adding 0.8% q/q seasonally-adjusted. The detailed structure revealed strong domestic demand, as private consumption growth remained vivid with a 6.1% y/y increase, while investment activity continued to surprise to the upside, accelerating further (12.9% y/y). Public consumption also moved to a higher gear with 4% y/y growth. On the other hand, developments in external trade weighed on the headline figure. Exports showed another decline (-1.3% y/y), again driven by the negative services performance. Goods delivered a positive footprint (3.1% y/y), supporting the anticipated gradual normalization in 2024. Imports brought a 5.2% y/y increase, reflecting a strong increase in both goods and services, shaped by strong domestic demand.

Private consumption should still deliver a supportive profile, due to the strong labor market, resilient consumer sentiment and vivid consumer credit. Investments surprised positively during 1H24, despite the focus shifting from the outgoing MFF 2014-20 to MFF 2021-27, and with construction still strong. In that sense, 2H24 should keep a decent shape, owing to the economic outlook, supportive sector sentiment and interest rate outlook. As for external demand, tourism developments are largely matching expectations of modest sector growth, driven by both pre-season and post-season (real growth rates might be tamed by the still high sector deflator). On the goods side, we expect gradual normalization, such as that seen in 1H24, but external demand remains in weak shape. Wrapping it up, our call for FY24 remains at 3.4%, with risks tilted modestly to the downside.

Annual	2022	2023	2024e	2025e	2026e
GDP real	7.0%	3.1%	3.4%	2.8%	2.7%
CPI (y/y)	10.8%	8.1%	3.1%	2.6%	2.4%
Private Consumption	6.7%	3.1%	5.2%	3.2%	3.0%

Source: Erste Group Research

Inflation

Inflation moved below 2% mark

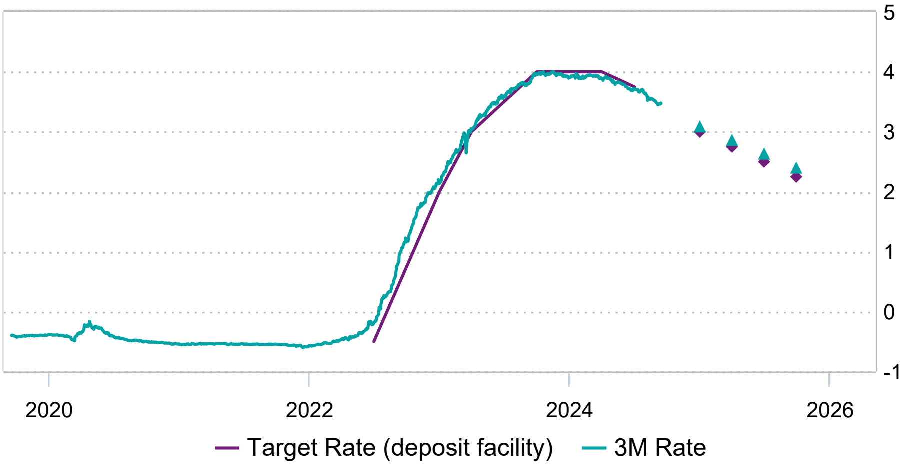
Recent months confirmed easing inflation pressures, with the most recent August print landing at 1.8% y/y, the lowest level since Mar-21, and the 1Y rolling average at 3.9%. Supply-side factors remained benevolent, while demand-side pressures kept services inflation in higher gear. A similar footprint is seen persisting, as strong real wage growth and the tight labor market remain demand-supportive, while supply-side factors are seen remaining largely in check (energy prices turning more inflationary courtesy of electricity and gas price hikes). The fading base effect points to some y/y CPI acceleration, but average CPI is seen moderating close to 3%.

ECB Monetary Policy

ECB: next interest rate cut in October

As expected, the ECB Governing Council decided to cut the deposit rate by 25 basis points to 3.50% at its meeting in September. The forecast for core inflation was raised slightly, while ECB economists continue to expect the core rate to fall rapidly from 2025. Leading data (including wage growth) give the ECB confidence that services inflation will lose momentum in 2025. We expect economic data to confirm disinflation and thus allow the ECB to make the next rate cut in October, which should be followed by a further rate cut of 25 basis points in December.

Eurozone Short Term Yields



Source: FactSet, Erste Group Research

Market (%)	Spot	24Q4	25Q1	25Q2	25Q3
ECB (deposit)	3.50	3.00	2.75	2.50	2.25
3M Rate	3.47	3.09	2.86	2.64	2.40

Source: FactSet, Erste Group Research

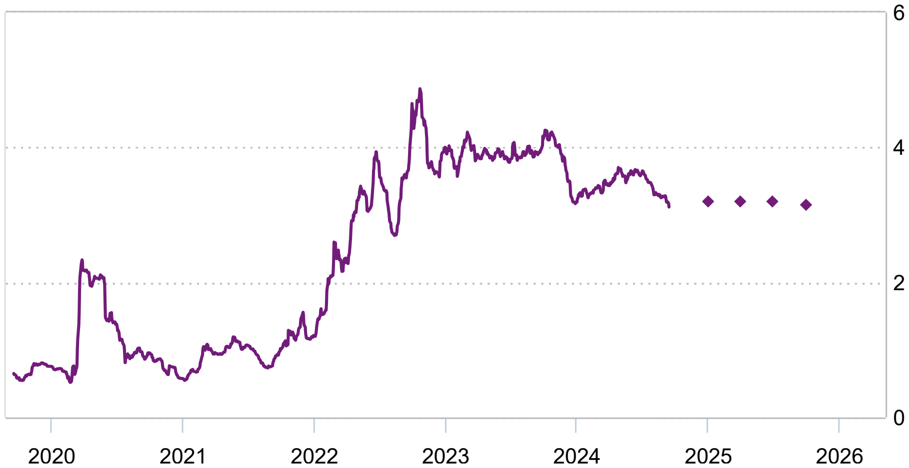
Bond Yields

S&P delivering anticipated rating upgrade

On the fiscal front, we are still awaiting the 2024 budget update and mid-term fiscal framework, which leaves us somewhat in the dark regarding the fiscal targets. The looser fiscal stance in 2024 is old news, with the government targeting a 1.9% of GDP gap, with risks tilted to the upside due to pre-election generosity, despite a still favorable GDP/inflation combination. With the 2024 budget gap anticipated around 2.5% of GDP, the focus shifts to 2025, with market participants seeking more clarity on the fiscal trajectory and commitment to a sound fiscal stance going forward. In the meantime, S&P has kick-started the autumn rating round with an expected upgrade to 'A-', while sticking with a positive outlook, which came as a positive surprise (at least to us). We expect a similar call from Fitch and see a decent chance that Moody's would also add a notch in November.

Ahead of summer, the MinFin hit the throttle, as issuance exceeded EUR 3bn, with EUR 1.025bn mostly going to retail investors (EUR 0.83bn), while institutional investors showed a healthy appetite for longer-dated tenors, namely 3Y and 10Y, sized at EUR 0.75bn and EUR 1.25bn, respectively. The focus until year-end should be more on the roll-over of maturities and potentially further testing the retail segment's appetite for additional debt. As for yields, benchmark developments remained the dominant shaping factor, allowing for a close to 50bp q/q yield drop across the yield curve, with the 10Y rate now moving close to 3.2%. As for spreads, the 100bp region remained the anchoring point. Looking at other EA CEE peers, we expect similar developments, with DE yields remaining the key shaping factor as far as yield levels are concerned.

10Y Generic Govt. Bond Yield (%)



Source: Refinitiv, Erste Group Research

Market	Spot	24Q4	25Q1	25Q2	25Q3
5Y Bond*	2.75	2.90	2.90	2.90	2.80
10Y Bond*	3.12	3.20	3.20	3.20	3.15

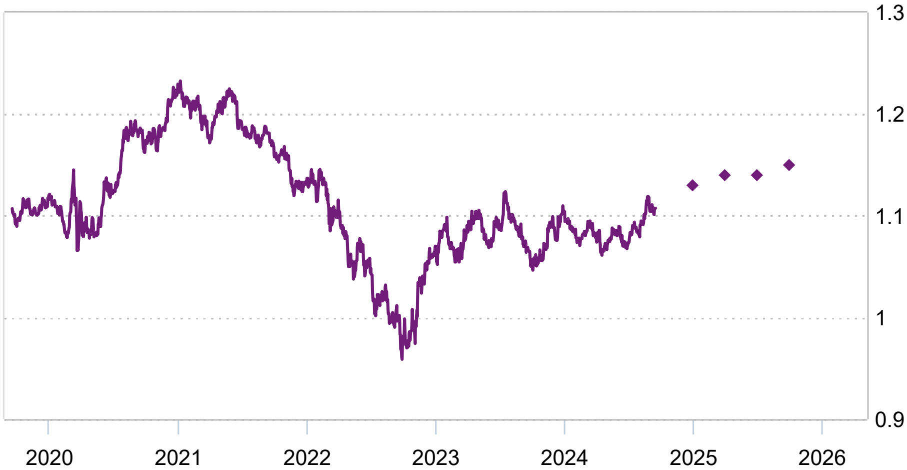
Source: Refinitiv, Erste Group Research

Euro

Weaker dollar expected

Weak US labor market data for July raised expectations of interest rate cuts in the US and triggered a weakening of the dollar. In addition, recent statements by the Fed Chairman contained clear indications of an interest rate cut in the US in September. From the market's perspective, this heralds the start of a series of US interest rate cuts. The speed will depend on the incoming data. The labor market offers risks for a faster approach by the central bank than the three interest rate cuts of 75 basis points in total that we currently expect by the end of the year. The ECB will also cut interest rates further. However, the momentum in the USA will be the main focus for the markets. We expect a further slow weakening of the dollar.

EUR/USD



Source: FactSet, Erste Group Research

	Spot	24Q4	25Q1	25Q2	25Q3
EUR/USD	1.11	1.13	1.14	1.14	1.15
vs. Spot		*1.8%*	*2.7%*	*2.7%*	*3.6%*

Source: FactSet, Erste Group Research

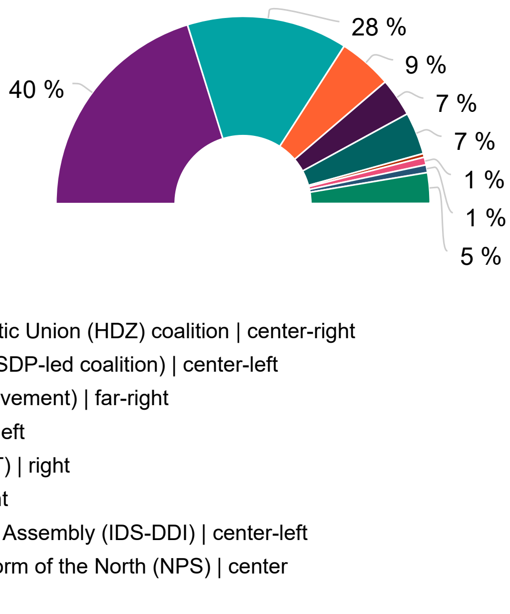
Politics

Presidential elections wrapping up super-electoral 2024

With the dust settling gradually after parliamentary and EU elections, the super-electoral year will finish with presidential elections, with the first round likely scheduled for December. Current polls suggest that President Milanovic is the strong front-runner to secure a second term, as challengers from both sides of the spectrum are polling in the 10-15% range. Thus, if the situation remains unaltered, the baseline scenario is another political cycle with PM Plenkovic and President Milanovic as juggernauts on the domestic political scene.

Post-election polls show a volatile pattern, with the two largest parties getting a transitory bump after the April election. Center-right HDZ remains in front with support in the 27-28% region, while center-left SDP enjoys 21-22%. Volatility is visible with the remainder of the top 5, with leftist Mozemo holding the third spot, moving in the 8-10% band. Homeland movement, the junior coalition partner, following the recent turmoil paid the price, with support slipping below 5%, while right-center Most is holding steady at 6-7% support.

Parliament Seats



Source: Erste Group Research

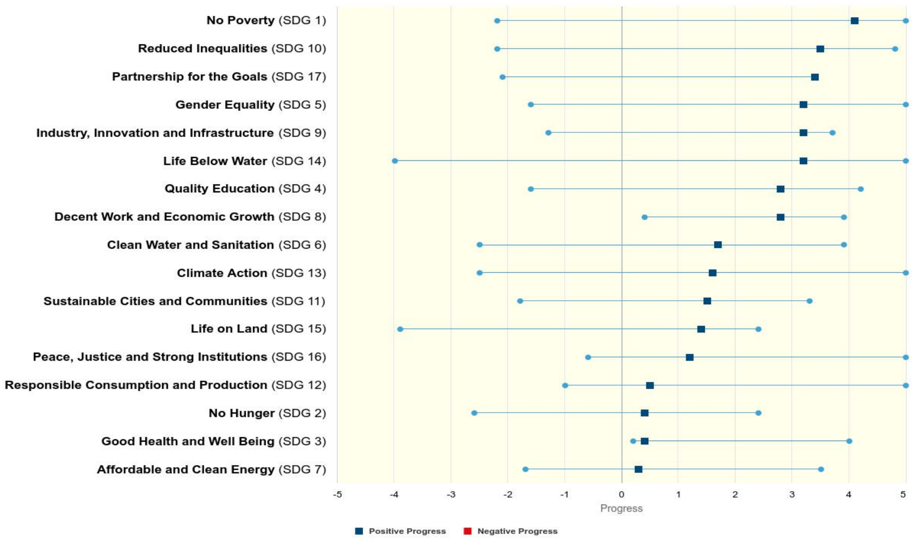
Last Election:
2024, April

Next Election:
2028

Sustainable Development Goals

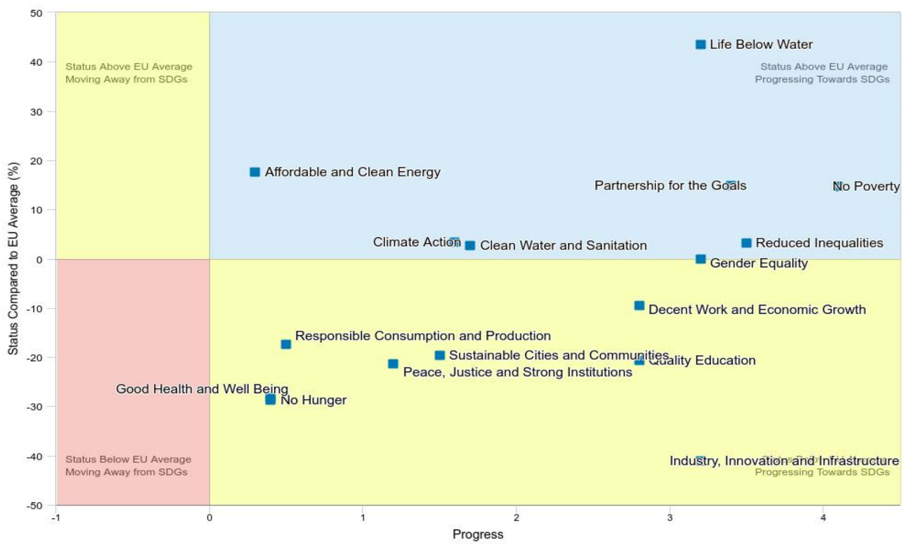
Regarding SDGs, Croatia is showing an improving trend for the vast majority of them. Most notably in No Poverty (SDG 1), No Hunger (SDG 2), Clean Water (SDG 6), Industry, Innovation and Infrastructure (SDG 9), and Life on Land (SDG 15), apart from showing significant progress, Croatia tops the EU ranking. The SDGs still failing to deliver progress and needing more attention are Peace, Justice and Strong Institutions (SDG 16), Affordable and Clean Energy (SDG 7) and Gender Equality (SDG 5). The same holds true for Climate Action (SDG 13), where, amid some progress achieved, Croatia remains close to the bottom of the EU ranking

Progress Overview



Source: Erste Group Research

Progress Overview



Source: Erste Group Research

Forecasts

Annual	2018	2019	2020	2021	2022	2023	2024e	2025e	2026e
Real GDP growth	3.0	3.4	-8.5	13.0	7.0	3.1	3.4	2.8	2.7
Inflation (CPI, avg)	1.5	0.8	0.1	2.6	10.8	8.1	3.1	2.6	2.4
Unemployment rate (avg)	8.4	6.6	7.5	7.6	7.0	6.1	5.6	5.5	5.4
Retail sales growth	3.8	3.6	-5.8	12.1	2.1	3.7	7.5	4.0	4.0
Industrial output growth	-1.0	0.5	-3.4	6.7	1.6	-0.1	-1.5	1.5	2.0
Private consumption growth	3.3	4.0	-5.2	10.7	6.7	3.1	5.2	3.2	3.0
Fixed capital formation growth	3.9	9.0	-5.0	6.6	0.1	4.2	9.0	3.2	4.0
Percent of GDP									
Trade balance	-18.5	-19.0	-17.4	-19.4	-26.5	-22.6	-22.2	-22.5	-22.3
Current account balance	1.6	2.5	-1.0	1.0	-2.8	1.1	0.4	-0.4	-0.3
Foreign direct investment	2.1	6.3	2.2	6.7	5.0	3.5	3.2	2.4	2.5
Budget balance	-0.1	0.2	-7.3	-2.5	0.1	-0.7	-2.4	-2.0	-1.5
Public debt	72.6	70.4	86.1	77.5	67.8	63.0	61.0	59.8	58.4
External debt, gross	81.7	73.4	81.0	80.3	72.9	83.7	82.4	80.4	79.2
(percent)									
10Y Yield (average)*	2.18	1.31	0.82	0.50	3.44	3.85	3.35	3.15	3.10

Source: Erste Group Research

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Published by:

Erste Group Bank AG
Group Research
1100 Vienna, Austria, Am Belvedere 1
Head Office: Wien
Commercial Register No: FN 33209m
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