

CROATIA

Key conditions and challenges

Table 1 **2023**

Population, million	3.9
GDP, current US\$ billion	82.7
GDP per capita, current US\$	21423.7
International poverty rate (\$2.15) ^a	0.3
Lower middle-income poverty rate (\$3.65) ^a	0.4
Upper middle-income poverty rate (\$6.85) ^a	1.8
Gini index ^a	28.9
School enrollment, primary (% gross) ^b	95.9
Life expectancy at birth, years ^b	77.6
Total GHG emissions (mtCO2e)	17.4

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2021), 2017 PPPs.
b/ Most recent WDI value (2022).

Croatia's economic activity continued to expand in the first half of 2024, mainly driven by strong domestic demand. The medium-term outlook is relatively favorable, as the external environment is expected to gradually improve and domestic demand to remain robust, in part supported by the inflow of European Union (EU) funds. However, rising labor costs amid subdued productivity growth pose a risk for the country's external competitiveness and export performance. Poverty in 2024 is expected to decline to 1.3 percent.

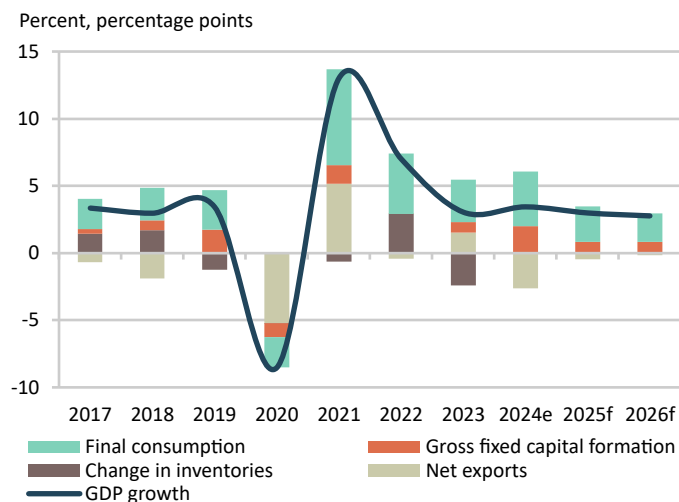
Croatia's growth remains robust, but despite the positive momentum several challenges loom. The country's economic activity has been consistently outpacing average growth in the EU over the last three years, and in 2023 Croatia's GDP per capita (in PPS) reached 76 percent of the EU average, up from 67 percent in 2019. The positive trends continued in the first half of 2024, but growth has become increasingly dependent on consumption and public investment, largely driven by rising wages, expansionary fiscal policy, and the inflow of EU funds. At the same time, productivity growth has been relatively subdued which, when taken together with strongly rising labor costs, may weigh on Croatia's external competitiveness and export performance, with manufacturing production already weak due to relatively subdued external demand. Moreover, the tourism sector, one of the key drivers of economic growth over the past three years, is showing signs of reaching peak capacity. Dependence on the tourism sector makes the economy vulnerable to shocks. The sector also exerts strong pressure on local infrastructure, which raises sustainability concerns, further highlighting the need for economic diversification. Against the backdrop of a tight labor market and rising unit labor costs, accelerating productivity growth will be essential for sustaining income convergence in the medium

to long term. Downside risks to growth coming from the external environment remain significant. Geopolitical tensions continue to be elevated, making global economic developments as well as energy price dynamics highly uncertain. At the same time, inflation in the euro area could remain elevated given increases in labor costs, which may result in tighter than expected monetary policy. However, Croatia's overall macroeconomic imbalances remain contained, given a robust banking sector, a positive current and capital account and public debt that has fallen to close to 60 percent of GDP.

Recent developments

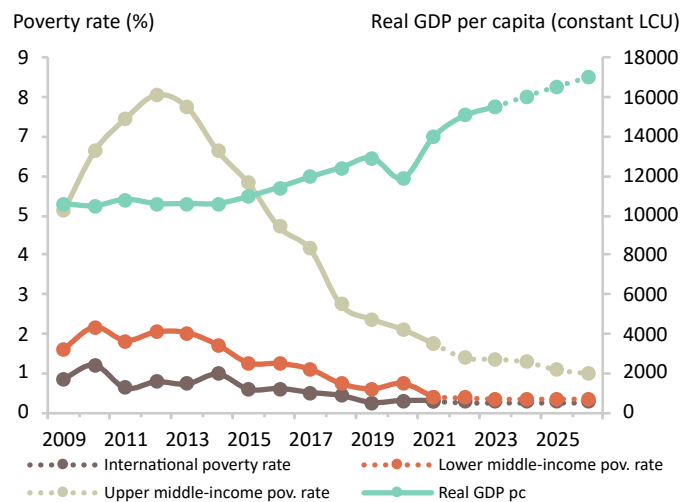
Economic activity in Croatia continued to expand in the first half of 2024, with annual real GDP growth averaging 3.6 percent, primarily driven by robust domestic demand. Personal consumption remained strong, bolstered by ongoing increases in real disposable income. Investment activity also gained momentum, with its average annual growth rate reaching double digits. This reflects the continuation of a strong rise in public investment, but after several years of sluggish developments private investments are also gaining momentum. Moreover, after a sharp decline in 2023, exports of goods began to recover, while exports of services fell, partly due to a strong rise in the same period of 2023 and relatively subdued tourism activity in Q2 2024. Employment growth was broad-based across sectors in the first half of 2024,

FIGURE 1 Croatia / Real GDP growth and contributions to real GDP growth



Sources: CROSTAT and World Bank.

FIGURE 2 Croatia / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see Table 2.

with construction, the public sector and tourism making the strongest contributions to employment growth. The tight labor market continued to exert upward pressure on private sector wages. Overall, wage growth further accelerated after a strong rise in 2023, reflecting a substantial increase in public sector wages following the reform of the public sector wage system in April 2024. This has also resulted in worsening of the general government budget balance, despite relatively strong revenue collection. At the same time, inflation is moderating and in August 2024 it stood at 3 percent, down from 5.4 percent at the end of last year. This deceleration was driven by lower inflation for industrial products and food, while there was a slight uptick in energy inflation. Meanwhile, services inflation, though easing somewhat, remained high at over 7 percent. Poverty, as measured by the share of population living below the upper-middle income poverty line at 6.85 USD in PPP terms, is estimated to have declined modestly from 1.4 percent in 2023 to 1.3 percent in 2024.

However, while Croatia's income inequality is below the EU average, pockets of poverty persist, and inequality of opportunity remains high. Marginalized communities, those with low education, the elderly living alone, and the unemployed are most at risk.

Outlook

Following relatively favorable economic developments in the first half of the year, Croatia's economic growth in 2024 is expected to strengthen compared to 2023 before moderating somewhat over the subsequent two years. Real GDP growth in 2024 is projected to reach 3.5 percent, driven primarily by robust domestic demand. This is underpinned by a tight labor market, expansionary fiscal policy—partially fueled by the inflow of EU funds—and a robust growth of public and private investment in the first half of the year. A gradual recovery in external demand is expected

to support goods exports, following their decline in 2023, while exports of services may be constrained by an adverse base effect early in the year and a moderation in tourist arrivals. Growth over the next two years is expected to average 2.9 percent. Inflation, after averaging 4.2 percent in 2024, is expected to gradually decline over the forecast horizon toward the European Central Bank's target of 2 percent. However, a tight labor market and still elevated wage growth could keep inflation slightly above that level. Strong wage growth in the public sector in 2024, coupled with an increase in the number of public sector employees, is expected to significantly widen the fiscal deficit to nearly 3 percent of GDP. Nevertheless, expenditures are projected to remain restrained over the next two years, which, along with continued economic expansion, should allow for gradual fiscal adjustment and a steady decline in public debt. Poverty is projected to decline marginally to 1.1 percent by 2025 and then to 1 percent in 2026.

TABLE 2 Croatia / Macro poverty outlook indicators

(annual percent change unless indicated otherwise)

	2021	2022	2023	2024e	2025f	2026f
Real GDP growth, at constant market prices	13.0	7.0	3.1	3.5	3.0	2.8
Private consumption	10.6	6.7	3.0	5.6	3.5	2.7
Government consumption	3.1	2.7	6.6	3.4	2.5	2.1
Gross fixed capital investment	6.6	0.1	4.2	10.8	4.0	4.2
Exports, goods and services	32.7	27.0	-2.9	0.1	2.2	2.4
Imports, goods and services	17.3	26.5	-5.3	4.8	2.9	2.5
Real GDP growth, at constant factor prices	12.2	7.9	2.3	3.5	3.0	2.8
Agriculture	9.6	-4.3	0.4	0.0	0.9	1.0
Industry	12.4	2.7	-0.5	2.0	2.2	2.3
Services	12.3	10.5	3.4	4.2	3.3	3.0
Inflation (consumer price index)	2.7	10.7	8.4	4.2	2.8	2.2
Current account balance (% of GDP)	1.0	-2.8	1.1	0.1	0.0	0.3
Net foreign direct investment inflow (% of GDP)	5.1	5.3	1.9	2.1	2.2	2.2
Fiscal balance (% of GDP)	-2.5	0.1	-0.7	-2.9	-2.4	-1.7
Revenues (% of GDP)	45.2	44.5	46.7	45.3	45.5	46.1
Debt (% of GDP)	77.5	67.8	63.0	60.0	59.1	58.1
Primary balance (% of GDP)	-1.0	1.5	1.0	-1.3	-0.7	-0.1
International poverty rate (\$2.15 in 2017 PPP)^{a,b}	0.3	0.3	0.3	0.3	0.3	0.3
Lower middle-income poverty rate (\$3.65 in 2017 PPP)^{a,b}	0.4	0.4	0.3	0.3	0.3	0.3
Upper middle-income poverty rate (\$6.85 in 2017 PPP)^{a,b}	1.8	1.4	1.4	1.3	1.1	1.0
GHG emissions growth (mtCO₂e)	4.0	-1.8	-0.1	0.9	0.2	-0.1
Energy related GHG emissions (% of total)	88.5	88.6	88.1	87.8	87.6	87.3

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.

Notes: e = estimate, f = forecast.

a/ Calculations based on ECAPOV harmonization, using 2022-EU-SILC. Actual data: 2021. Nowcast: 2022-2023. Forecasts are from 2024 to 2026.

b/ Projection using neutral distribution (2021) with pass-through = 0.87 (Med (0.87)) based on GDP per capita in constant LCU.