

Croatia Business Forecast Report Q2 2014

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Abstracts

Core Views

We hold a below consensus view on Croatia's economic growth prospects in 2014, with a sluggish economic recovery set to be undermined by ongoing deleveraging in the consumer and government sectors. We forecast real GDP to expand by 0.4% in 2014, and caution that lack of progress rebalancing the economy means that risks to our outlook are weighted firmly to the downside.

Croatia's sizeable fiscal deficit will pose one of the most significant risks to the country's economic recovery in 2014, with the government set to struggle to rein in spending and significantly boost revenue growth.

Although we estimate that Croatia's current account reached a record surplus in 2013, driven by robust tourism receipts and lower profit repatriation in the income account, we see the surplus shrinking to just 0.3% of GDP in 2014, due to a widening trade deficit and higher repayments to the EU in the current transfers account.

Easing food prices and low demand-pull inflationary dynamics will ensure that headline inflation remains subdued over the coming months. We forecast inflation to average 1.8% over the course of 2014, although we note that increased consumption during the tourist season should lead to a modest uptick in prices during the summer months.

Banking sector profits will remain weak in 2014, as loan growth is restricted by parent bank deleveraging and deteriorating asset quality. Although the banking sector will shrink further over the coming quarters, sufficient capital buffers imply that the sector is capable of withstanding considerable macroeconomic shocks.

We believe the Croatian kuna will continue heading along a modest depreciatory

trajectory over the next few years, although strong seasonal tourist receipts will ensure that the currency rebounds temporarily over the summer months. We hold to our forecast for the kuna to average HRK7.6400/EUR over the course of 2014.

We believe a referendum result preventing same-sex marriages will modestly damage Croatia's liberal EU credentials, as well as weakening the position of the ruling Kukuriku Coalition. Furthermore, the vote is likely to increase the chances of other referenda being pursued by interest groups, which could further damage Croatia's already strained relationship with the EU.

Major Forecast Changes

We have revised our forecast for real GDP growth to come in at 0.4% in 2014, from 0.6% previously, due to a weaker outlook for private consumption and government spending over the coming quarters.

Key Risks To Outlook

The main risk to our already bearish outlook for Croatia in 2014 is for a slower-than-anticipated recovery in Croatia's main trading partners in Europe. In such a scenario, already weak export demand would be hit further over the coming quarters, widening the trade deficit and putting pressure on the current account surplus. Real GDP growth would likely underperform in this scenario, and a further year of negative economic growth would look like an increasingly likely possibility.

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Croatia's sizeable fiscal deficit will pose one of the most significant risks to the country's economic recovery in 2014, with the government set to struggle to rein in spending and significantly boost revenue growth. We forecast the fiscal deficit to come in at 4.6% of GDP in 2014, ensuring that the country will fall short of meeting ambitious deficit reduction targets recently called for by the EU Commission

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Easing food prices and low demand-pull inflationary dynamics will ensure that headline inflation remains subdued over the coming months, with negative inflation a possibility over the short term. We forecast inflation to average 1.8% over the course of 2014, although we note that increased consumption during the tourist season should lead to a modest uptick in prices during the summer months.

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Banking sector profits will remain weak in Croatia in 2014, as loan growth is restricted by parent bank deleveraging and deteriorating asset quality.

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