

Croatia Country Report

November 2014

Poor progress, dismal prospects

- Still struggling with recession
- Lack of fiscal and private sector adjustments
- Another rating downgrade possible
- Low liquidity still a bottleneck for ZSE



**Raiffeisen
RESEARCH**

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Currencies and Countries

ALL	Albanian lek
BAM	Bosnian marka
BGN	Bulgarian lev
BYR	Belarusian rouble
CNY	Chinese yuan
CZK	Czech koruna
EKK	Estonian kroon
HUF	Hungarian forint
HRK	Croatian kuna
LTŁ	Lithuanian litas
PLN	Polish zloty
RON	Romanian leu
RSD	Serbian dinar
RUB	Russian rouble
TRY	Turkish lira
UAH	Ukrainian hryvnia

Economic abbreviations

%-chg	Percentage change (not in percentage points)
avg	average
bp	basis points
BoP	Balance of Payments
C/A	Current Account
CPI	Consumer Price Index
FDI	Foreign Direct Investments
FX	Foreign Exchange
GDP	Gross Domestic Product
LCY	Local Currency
mmav	month moving average
mom	month on month
pp	percentage points
PPI	Producer Price Index
qoq	quarter on quarter
T/B	Trade Balance
ULC	Unit Labour Costs
yoy	year on year

Stock Exchange Indices

BELEX15	Serbian stock index
BET	Romanian stock index
BUX	Hungarian stock index
CROBEX10	Croatian stock index
PX	Czech stock index
MICEX	Russian stock index
SASX-10	Bosnian stock index
WIG 20	Polish stock index

Equity related

DY	Dividend yield
EG	Earnings growth
LTG	Long term (earnings) growth
P/E	Price earnings ratio
RS	Recommendation suspended
UR	Under Revision

Still no source for growth in Croatia

Croatia has been struggling with recession and poor prospects of recovery for the sixth year in a row. Structural adjustment measures are still lacking, while positive developments in net exports and growth in manufacturing (spurred primarily by foreign demand) are slowly fading. The necessary preconditions for a recovery are still not in place, and on the contrary most of the well-known structural problems (low competitiveness, weak labour market, administrative barriers, etc.) remain. Domestic demand is still hampered by the weaknesses in the labour market, continued corporate deleveraging and widespread consumer pessimism. Additionally, the relatively unfavourable business and investment environment, the significant burdens from frequent changes in taxation regulations and administrative hurdles, and demand hampered by pessimism are all undermining an investment recovery. This is confirmed by construction sector data, which is deep in recession with no signs of recovery on the horizon in 2015. There are also no signs of investment in the public sector. On the one hand, this is a consequence of unprepared projects and on the other hand due to continued one-off savings in the capital expenditure items of the state budget.

Given the objectives of the EU Excessive Deficit Procedure (EDP), there is a need for stronger structural adjustments so we do not expect government spending and investments to contribute to GDP growth in the medium term. However, the role of fiscal policy-makers should also be reflected in creating the preconditions for sustainable growth, and the lack of growth and fiscal policy weaknesses are exactly the key arguments for the country's current non-investment credit rating. The lack of fiscal adjustment still does not prevent the government from tapping the global capital markets. Moreover, ample liquidity and low interest rates might continue to create an illusion of successful borrowing in 2015. Still, the level of risk premium relative to comparable countries clearly reflects the fundamental weaknesses in the Croatian economy. The issue of public finances sustainability becomes prominent with the implementation of Eurostat's new methodology (ESA2010) since in a mid-term perspective public debt might reach 90% of GDP.

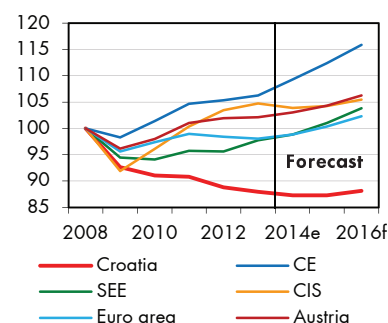
Financial analyst: Zrinka Zivkovic Matijevic

Key economic figures and forecasts

	2011	2012	2013	2014e	2015f	2016f
Nominal GDP (EUR bn)	44.7	44.0	43.6	42.9	43.4	44.6
Real GDP (% yoy)	-0.3	-2.2	-0.9	-0.8	0.0	1.0
Household consumption (real, % yoy)	0.3	-3.0	-1.3	-0.3	0.1	0.7
Gross fixed capital formation (real, % yoy)	-2.7	-3.3	-1.0	-2.9	0.3	3.8
Industrial output (% yoy)	-1.2	-5.5	-2.0	0.5	1.5	2.5
Producer prices (avg, % yoy)	6.4	7.0	0.5	-2.4	2.0	2.5
Consumer prices (avg, % yoy)	2.3	3.4	2.2	0.0	1.5	1.9
Average gross industrial wages (LCY, % yoy)	1.3	1.9	-1.0	0.0	2.0	2.1
Unemployment rate (avg, %)	13.5	15.8	17.2	17.4	17.2	17.0
General budget balance (% of GDP)*	-7.7	-5.6	-5.2	-6.0	-5.1	-4.4
Public debt (% of GDP)*	59.9	64.4	75.7	82.0	86.5	89.0
Export of goods (EUR bn)	9.8	9.8	9.8	10.3	10.6	11.2
Import of goods (EUR bn)	15.9	15.9	16.1	16.5	16.7	16.9
Current account balance (% of GDP)	-0.9	-0.1	0.9	0.9	1.2	0.9
Official FX reserves (EUR bn)	11.2	11.2	12.9	12.5	12.6	12.7
Gross foreign debt (% of GDP)	102.6	102.1	104.8	106.7	106.4	104.2
EUR/HRK (avg)	7.43	7.52	7.58	7.63	7.65	7.66
USD/HRK (avg)	5.34	5.85	5.71	5.69	6.38	6.38
EUR/USD (avg)	1.39	1.29	1.33	1.34	1.20	1.20
3-month money market rate (% avg)	3.2	3.4	1.5	1.1	1.1	1.5
7-year T-bond yield (% avg)	6.6	5.8	4.8	4.5	4.3	4.5

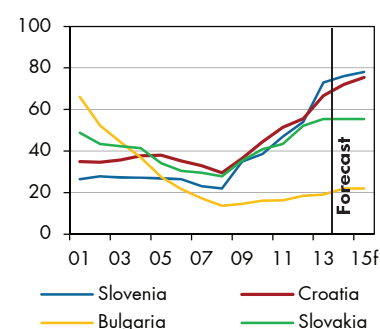
* according to ESA2010 methodology; Source: Thomson Reuters, CNB, CBS, RBI/Raiffeisen RESEARCH

Real GDP index (2008=100)



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Public debt (% of GDP)*



* ESA95 data

Source: national sources, RBI/Raiffeisen RESEARCH

Ratings

	S&P	Moody's	Fitch
LCY, long-term debt	BB	Ba1	BB+
FCY, long-term debt	BB	Ba1	BB
Outlook	stable	negative	stable

Source: rating agencies, RBI/Raiffeisen RESEARCH

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