

**COUNTRY PROFILE:****REPUBLIC OF CROATIA****DATED:****MAY 2008****CREDIT GUARANTEE:**

IES/02: ATTACHMENT A

	<i>Country Rating</i>	<i>U/W Method</i>
<i>Short-term</i>	3C	Case-by-case

*Recent Political Highlights*

- ❑ President Stjepan Mesic won a second five-year term in January 2005 and the next elections are scheduled for January 2010. The presidency is a largely ceremonial role. The president can dissolve parliament and call elections. The leader of the majority coalition is usually appointed prime minister by the president and then approved by the assembly.
- ❑ Ivo Sanader, who has been prime minister since 2003, was given a new mandate by the president to form a government after his conservative HDZ party won the most seats in parliamentary elections in November 2007. Mr Sanader has pledged commitment to democracy and the rule of law as well as to upholding human rights and promoting a free market economy. He has said that EU and NATO membership are the top priority in foreign policy. On the economic front, he aims to address the budget deficit and to reduce the foreign debt. The government fulfilled one of its political objectives at the NATO summit in April this year, when Croatia, along with Albania, received an invitation to join the alliance. The protocol for Croatia's accession is expected to be signed by early July, after which it is to be ratified by member countries.
- ❑ The EIU expects the government to adhere to an agenda of EU-mandated reforms, although the pace of these will be slow in sectors of the economy that are politically sensitive such as agriculture, fishing, shipbuilding and steel. The country hopes to become a member of the EU by 2010 but the EIU says it's unlikely to occur before 2011 and there is some risk even to this entry date.

*Recent Economic Highlights*

- ❑ Croatia's population is estimated at 4.5 million and is declining by 0.043% annually.
- ❑ Since 2000, Croatia's economic fortunes have begun to improve slowly, with moderate but steady GDP growth between 4 and 6% led by a rebound in tourism and credit driven consumer spending. Nevertheless, difficult problems still remain including a stubbornly high unemployment rate, a growing trade deficit and uneven regional development.
- ❑ The state still controls a significant part of the economy, with government spending accounting for as much as 40% of GDP. Privatisation begun in the 1990's but has been slow as privatisation efforts often meet stiff public and political resistance mainly as a result of public mistrust engendered when many state-owned companies were sold to the politically well-connected at below market prices. The government sold three large metal plants in 2007. Some-large state-owned industries, such as the country's shipyards continue to rely on government subsidies, crowding out investment in education and technology needed to ensure the economy's long-term competitiveness. The government has announced that individual privatisation plans for all Croatian shipyards have been completed.
- ❑ The Chief State Prosecutor said that state institutions were not effective in discovering corruption and that has been criticised by the European Commission. A recent survey has shown that businessmen perceive corruption as one of the biggest problems in business. The operation comes as Croatia tries to step up its clamp down on corruption, a key provision in its EU membership bid.
- ❑ The World Bank (WB) postponed the payment of €100 million loan to Croatia, as the country had failed to adopt the law on the introduction of a tax number. The adoption of the law on tax number was planned for the start of April. Tax number introduction is pivotal for the fight against corruption and will help improve the efficiency of the tax system.
- ❑ The economy grew 5.6% in 2007 supported by a general election, strong European growth, and a good tourism season. The EIU forecasts growth at 5.5% in 2008 and 4.9% in 2009 as consumer spending growth is forecast to remain strong in 2008-09 and improving productivity in Croatia's export sector should help to drive a steady upturn in foreign sales. The IMF has forecast growth at 4-4.5% in 2008 and said that although Croatia had made certain progress over the past year, it would be hard to reach the planned economic growth rate of 6% in the coming years. Furthermore, Croatia is directly exposed to a slowdown in richer European countries (UK, France and Germany) through tourism revenues.
- ❑ According to the EIU, the HRK is expected to appreciate from an average of 5.35 per US dollar in 2007 to 4.75 per US dollar in 2008 but remain relatively unchanged at 7.31 per euro in 2008. The Croatian National Bank (CNB) targets exchange rate stability of the kuna to the euro, in view of the high proportion of euro denominated consumer loans. The CNB's careful management of the currency is likely to continue to insulate the economy from inflationary pressure stemming from high commodity prices.
- ❑ Croatia has come 49th out of 55 countries on the world competitiveness list with all EU members fairing better, but with Croatia doing better by four places than the previous year. Croatia is expected to introduce a string of reforms in several areas like the efficiency of its economy, which may result in its competitiveness improving.

*Latest Trade Developments*

- ❑ Main exports and imports: machinery, transport and electrical equipment, mineral fuels and lubricants, food, live animals, beverages and tobacco, and chemicals.
- ❑ Major trade partners: Italy, Bosnia and Herzegovina, Germany, Slovenia, Austria, Russia and China.
- ❑ South African exports to Croatia totalled R42.8m in 2006 and R48.9m in 2007.

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