REPUBLIC OF CROATIA

CONVERGENCE PROGRAMME OF THE REPUBLIC OF CROATIA FOR THE PERIOD 2023 - 2025

APRIL 2022

Foreword

At its session on April 27, 2022, the Government of the Republic of Croatia (hereinafter referred to as: the Government) adopted the Convergence Programme of the Republic of Croatia for the period 2023-2025. This is the ninth Convergence Programme drafted by the Republic of Croatia as a Member State of the European Union (hereinafter referred to as: the EU). This document is the result of the process within which all EU Member States are obliged to report and harmonize their economic policies with the jointly defined objectives and legal provisions of the EU. This harmonization and reporting are conducted as a part of annual cycles of the European Semester, within which each Member State submits its strategic documents to the European Commission (hereinafter referred to as: the EC) by the end of April every year. This is followed by an economic dialogue, drafting and adoption of country-specific recommendations and the practical implementation thereof. This document was drafted by the Ministry of Finance.

Table of Contents

List of Tables

List of Charts

1. FRAMEWORK AND OBJECTIVES OF THE ECONOMIC POLICY

Many years of responsible management of macroeconomic and fiscal policy in the pre-crisis period have created space for prompt action in managing the challenges caused by the coronavirus pandemic and maintaining employment and overall economic activity. Thus, already in 2021, the Croatian economy grew by 10.2%, which is an exceptional result and it indicates the acquired resilience of the Croatian economy and its private sector, despite pressures from new variants of the COVID-19 virus and overall price trends caused by global supply disruptions in supply chains and rising energy prices.

This economic policy of the Republic of Croatia has been recognized and welcomed by international financial institutions as well as credit agencies that have maintained confidence in the Croatian economy, confirming, i.e. raising the rating of the Republic of Croatia. For example, at the end of 2021, according to the Fitch agency, the Republic of Croatia achieved the BBB rating with a positive outlook, which is also historically the best result of the Republic of Croatia. Positive ratings and outlook for the Republic of Croatia are also based on the strategic national goals of achieving membership in the euro area and the Schengen area, which are expected in the coming period. In March 2022, all preconditions and measures agreed with the institutions and member states of the euro area upon Croatia's accession to the ERM II mechanism were met. In this sense, the process of introducing the euro will result in the full membership of the Republic of Croatia in the euro area when all remaining conditions contained in the Convergence Report are met and the accession acts are adopted by European institutions and member states.

Incentive factors related to our economy are also supported by the fact that the Republic of Croatia is one of the largest users of stimulus packages of EU funds, which lays the foundation for a strong investment momentum. In this regard, it is important to highlight the successful start of the full implementation of the National Recovery and Resilience Plan (hereinafter referred to as: NRRP), with the approval of which, by the EC and the EU Council, the Republic of Croatia received EUR 6.3 billion in grants under the Next Generation EU instrument. This instrument encourages structural reforms, especially green and digital transition, as well as reforms in science, education, innovation and the labour market, that strengthen potential growth, and thus the resilience and competitiveness of the Croatian economy as a whole.

During 2022, the Government of the Republic of Croatia planned to continue rehabilitating the health and socio-economic consequences of the coronavirus pandemic, and to intensify the reconstruction of the earthquake-affected areas of Zagreb, Petrinja and its surroundings. However, new challenges have emerged, such as geopolitical realignments, continued supply chain disruptions, financial market instability, all in the context of growing inflationary pressures, resulting in strong challenges in economic and fiscal policy-making.

In this macroeconomic framework, after the GDP growth of 3.0% in 2022, the growth is expected to accelerate again to 4.4% in 2023. Over the medium term, the growth of the economic activity is expected to continue at a slowing-down dynamics of 2.7% in 2024 and 2.5% in 2025.

In March, monitoring the dynamics of price growth, the Government adopted a package of measures to mitigate the price growth due to rising energy prices. Although these measures will not be able to fully neutralize the inflationary pressures, it is expected that they will mitigate the impact of the price growth on the living standards of citizens, especially the most vulnerable groups in society and businesses. In 2022, consumer price inflation is expected to accelerate to 7.8%, which will then slow down to 3.7% in 2023.

In the context of fiscal policy, the Government of the Republic of Croatia plans a gradual transition from a stimulating direction of the overall fiscal policy to a neutral one, i.e. a change in the so-called fiscal impulse from the expansive to the neutral one. In doing so, it will closely monitor volatile external and domestic circumstances in order to respond to potential risks. Furthermore, the efforts will be made to gradually reduce public debt in order to support the existing recovery and contribute to potential growth.

The fiscal adjustment will be supported by investment and reforms that boost potential growth, ensuring a sustainable trajectory for reducing the public debt-to-GDP ratio. These investments and reforms will be implemented in particular through EU-funded projects via the Recovery and Resilience Facility, as well as the Structural Funds and the Solidarity Fund. Furthermore, fiscal consolidation will be implemented primarily through improving the structure of expenditures while preserving investments, especially those aimed at green and digital transition.

Following all the above, fiscal trends on both the revenue and the expenditure side of the budget in the next medium term will result in a gradual reduction of the budget deficit from 2.9% of GDP in 2021 to 2.8% of GDP in 2022. In 2023 and 2024, the general government budget deficit is projected at 1.6% of GDP, and in 2025 at 1.2% of GDP. At the same time, the public debt-to- gross domestic product nominal value ratio will decrease annually at an average rate of 3.1 percentage points, i.e. from 76.2% of GDP in 2022 to 71.7% of GDP in 2023, 68.9% of GDP in 2024 and 66.9% of GDP in 2025.

All of the above points to the Government's determined efforts in creating and implementing responsible economic policy with an emphasis on fiscal sustainability, supporting the current recovery and strengthening the overall resilience and competitiveness of the Croatian economy in changing geopolitical and economic circumstances, and in the following medium term.

2. MACROECONOMIC TRENDS

The macroeconomic framework described in the following chapters was drafted in April of this year.[1] The external assumptions for the preparation of macroeconomic projections are taken from the latest projections of the International Monetary Fund[2] (hereinafter referred to as: IMF), the EC[3] and *Consensus Economics*[4].

The IMF has significantly revised the global economic growth projections to lower and the inflation projections to higher compared to previous January projections. The revision of the same sign is also present in recent *Consensus Economics* projections and other relevant sources. The downward correction reflects the adverse direct and indirect economic effects of the Russian invasion of Ukraine and sanctions on Russia, additional pressures on global price increases and increased levels of uncertainty.

After growing global economic activity by 6.1% in 2021, according to the IMF's April projections, the global economic recovery is expected to slow down to 3.6% in 2022 and 2023 (0.8 and 0.2 percentage points lower, respectively, compared to the January projection), and then in the rest of the projection period a further slowdown in real growth to an average growth of 3.4%. After the recovery of world trade from the consequences of the pandemic at a rate of 10.1% in 2021, in the coming period the growth of global trade in goods and services is expected to slow down to 5.0% in 2022 and 4.4% in 2023. The projections derive from assuming that the war will not spread beyond Ukraine's borders, that the energy sector will be exempted from further sanctions, and that the negative effects of the COVID pandemic on health and the economy will be reduced in 2022. There is high uncertainty about the realization of these projections, and negative risks prevail, which include the worsening of the war, tougher sanctions on Russia, a stronger slowdown in growth in China and the continuation of the pandemic.

Inflationary pressures stemming from strong increases in world commodity prices and problems in global supply chains caused by strong global demand following the closure of economies due to the COVID pandemic were further intensified in February by the start of the war in Ukraine. The Russia's invasion of Ukraine has caused the increase in prices of certain raw materials, while the sanctions against Russia increase the possibility of shortages of raw materials and the global shock of increasing energy prices. Brent oil prices are expected to grow strongly by 57.3% in 2022, from USD 70.4 per barrel in 2021 to USD 110.8 per barrel in 2022, while in 2023 they are expected to decrease to USD 96.1 per barrel, and further decrease at declining dynamics. The prices of raw materials excluding oil are expected to grow by 11.4% in 2022, followed by a slight decline of an average of 2.0% in 2023 and 2024, after which the stabilization of prices of primary raw materials is expected at significantly higher levels compared to 2020.

---

[1] Based on the data available by April 22, 2021

[2] World Economic Outlook April 2022

[3] Spring 2022 forecast assumptions

[4] Consensus Forecasts – publications of Eastern Europe and G-7 & Western Europe

According to IMF's April projections, a longer period of increased inflation is expected than projected in January. In 2022, the inflation is expected to be 5.7% in developed countries and 8.7% in developing countries, while in 2023 the inflation is expected to slow down to 2.5% and 6.5%, respectively. Under the conditions of the increasing inflation, countries face the challenge of creating policies to stop price pressures while supporting economic recovery. As the inflation rose significantly even before the war in Ukraine, many central banks in the world have already begun to change the direction of monetary policy, which has led to an increase in reference interest rates. In the event of an increase in expected inflation in the medium term, central banks will be forced to tighten monetary policy faster than expected. It is anticipated that the average exchange rate of the euro against the US dollar will be 1.10 USD/EUR during the projection period.

2.1. Gross Domestic Product

After a rapid and strong recovery in 2021 from the recession caused by the coronavirus pandemic, further growth of the Croatian economy will be limited by global supply-side disruptions, intensified effects of the Russian invasion of Ukraine, under the still-present pandemic risks circumstances. Deficits in world markets, both the labour one and many other inputs, in an environment of a strong recovery in aggregate demand, have created accelerating inflation in just les than a year. Currently, a significant level of uncertainty is associated with the impending wider spill-over of rising energy and food prices to the core inflation. However, despite the pronounced negative risks to short-term economic activity, in this macroeconomic framework it is expected that after the GDP growth of 3.0% in 2022, the growth will accelerate again to 4.4% in 2023. In the rest of the medium term, in the conditions of a slightly positive GDP gap, the economic activity is expected to continue at a slowing-down dynamics of 2.7% in 2024 and 2.5% in 2025. This dynamics of GDP includes the positive effects of the NRRP. A key positive contribution to economic growth is expected from domestic demand throughout the observed period. After two years of reducing the category of changes in inventories, in 2023 and 2024 a positive contribution to economic growth is expected due to the expected process of replenishment of inventories in the corporate sector. After a slight positive contribution to growth in 2022, net foreign demand will make a negative contribution to economic growth in 2023, in the conditions of the stronger GDP growth, which will then disappear by the end of the observed period.

Table 2.1: Projection of Gross Domestic Product

	2021	2022 projection	2023 projection	2024 projection	2025 projection
GDP - real growth (%)	**10.2**	**3.0**	**4.4**	**2.7**	**2.5**
Personal consumption	10.0	1.4	3.2	2.4	2.3
Government consumption	3.1	3.3	1.9	2.0	2.1
Gross fixed capital formation	7.6	5.8	6.1	3.9	3.6
Exports of goods and services	33.3	6.9	6.0	4.2	3.8
Exports of goods	20.0	4.8	5.4	4.6	4.1
Exports of services	51.5	9.2	6.7	3.7	3.4
Imports of goods and services	14.7	6.1	6.9	4.2	3.6
Imports of goods	14.8	5.6	6.5	4.0	3.5
Imports of services	13.9	9.1	9.5	5.1	4.2
Contribution to real GDP growth (percentage points)					
Final domestic demand	8.3	2.8	3.6	2.7	2.6
Changes in inventories	-4.9	-0.2	1.5	0.2	0.0
External balance of goods and services	6.8	0.3	-0.7	-0.1	0.0
Contribution to real GDP growth (percentage points)					
Personal consumption	5.9	0.8	1.8	1.4	1.3
Government consumption	0.7	0.7	0.4	0.4	0.5
Gross fixed capital formation	1.7	1.2	1.3	0.9	0.8
Exports of goods and services	14.0	3.5	3.3	2.3	2.1
Imports of goods and services	-7.2	-3.2	-3.9	-2.4	-2.1

Note: Data for 2021 are preliminary.

Source: Croatian Bureau of Statistics, Ministry of Finance

Compared to the macroeconomic projections from the Explanation of the Budget of the Government of the Republic of Croatia (from October 2021), a slightly stronger real GDP growth was achieved in 2021. As the negative risks on the global supply side materialized compared to the projections at the time, with an unexpectedly strong acceleration in inflation, the real GDP growth rate in 2022 was adjusted moderately downwards. Personal consumption was corrected slightly downwards as a result of the expected strong slowdown in real growth in household disposable income due to higher inflation. In addition, as the most cyclically volatile component of GDP, private investment was adjusted significantly downwards, due to a sharp decline in confidence indicators. The reason for this is the high level of uncertainty regarding the expectations about the economic activity and the inflation, as well as the scale of monetary policy tightening. Furthermore, these investment corrections are the result of an unfavourable base effect due to poor results at the end of 2021, but also unfavourable structural trends in the business environment in the medium term. Exports of goods are lower as a result of the correction of foreign demand, as well as of the expected dynamics of international trade conditions. In addition, the weaker dynamics of exports of services in 2023 is primarily due to the surprisingly favourable performance of exports of services in the previous year. The elasticity of imports in relation to final demand has also been adjusted downwards mainly as a result of the performance in the last two years. The only component that recorded a positive correction compared to the previous projections is the category of changes in inventories, which, in 2023, will record a positive contribution to GDP growth.

Due to the present imbalance between the supply and the demand for labour and favourable trends in the migration balance in the expansionary phase of the economic cycle, the labour market is characterized by favourable expectations. However, as a result of the record inflation and the consequent stagnation of disposable income of the household sector in 2022, personal consumption will record a temporary slowdown this year. The prevailing inflation effectively transfers the wealth from savers to debtors and from lower-income subjects to higher-income ones, thus generating a negative wealth effect. In addition, the inflation, as well as the announcement of possible more pronounced tightening of monetary policies in the world, has an extremely unfavourable effect on consumer mood. Despite all this, the dynamics of personal consumption in all years of the observed period reflects the more intense re-use of the financial leverage of the household sector, which has undergone a significant deleveraging process in the past period. Thus, the savings rate of the household sector will be characterized by a continuous decline towards a rate of around 9.5% at the end of the medium term. The dynamics of disposable household income will depend primarily on the trends in compensation of employees, taking into account the expected slowdown in employment growth according to the national concept, which will be more pronounced than the one according to the domestic concept, as well as the expected recovery of non-taxable household income. In accordance with the projections of fiscal categories at the general government level, in 2022 the period of increased costs will continue in order to finance the measures to mitigate inflationary pressures, but also of the costs as a result of the coronavirus pandemic. In the remaining years, no significant contribution of government spending to economic growth is expected. The largest contribution to the real growth of government spending throughout the projection period will come from the growth of intermediate consumption. The contribution by compensation of employees during the observed period will be mild and slowing down, reflecting the expected dynamics of employment growth at the general government level, which will be slightly weaker than the trends in the number of employees in the private sector at the beginning of the period. A smaller positive contribution to the growth of government spending is also expected from the category of social transfers in kind, while a negative contribution, especially expressed in 2022, is expected from the market output of general government.

Apart from the worsening dynamics of private sector investment at the end of 2021, the previously described high level of uncertainty about economic growth, inflation and interest rates will contribute to the dampened dynamics of private investment in 2022, but partly also in 2023, along with the consequently disrupted economic expectations of the business sector. Apart from the fact that business entities in the prevailing circumstances are wary primarily of higher value projects, many relatively regular investments have been delayed due to material shortages. Thus, in the first two years of the projection period, strong investment activity will be based on capital inflows from EU funds, primarily from the Recovery and Resilience Facility, while at the end of the period the contribution from public investment will take a negative direction, although the absolute value of investments will remain at historically high levels. In the last two years of the projection period, the growth of aggregate investment will be based solely on the contribution of private investment. Regarding the structure of investments by type, the favourable dynamics in the construction sector is expected to continue in the short term, supported by the need to renew the housing stock after the earthquakes recorded in 2020. In 2023, the recovery in the remaining types of investments could be intensified, which will also be supported by EU funds by the end of the projection period. Over the medium term, a further improvement in the investment climate is expected in the context of a recovery in the profitability of the corporate sector, positive trends in confidence indicators and the maintenance of relatively favourable foreign financing conditions, and the country's credit rating. We should also mention how inflation can have a positive effect on the profitability of companies and how it will effectively strengthen balance sheets and improve indebtedness and sustainability indicators, and thus can ultimately help many companies that are successfully going through this sensitive period.

The past two pandemic years have shown that improved export structure and better involvement in European value chains in the pre-pandemic period have been important in increasing the resilience of Croatian exports. Croatian merchandise exports significantly exceeded the pre-crisis level and reached historically the highest levels. After a marked increase in 2020, the growth of domestic share in foreign commodity markets continued with similar intensity in 2021. However, in 2022, only a slight positive growth in share in foreign markets is expected. By the end of the projection period, due to the slowdown in the growth of major foreign trade partners and a slight weakening of the dynamics of representation in export markets, as well as rising raw material prices, the growth in exports of goods and services is expected at moderate and slowing rates. Short-term expectations about export trends in 2022 are dominated by the development of the current Russian invasion of Ukraine and strong growth in raw material prices, which has been present since mid-2020, which will affect the slowdown in export demand of major foreign trade partners. In addition, the normalization of social contacts due to the coexistence with COVID-19 will lead to a gradual substitution of consumption of goods with services, which will put less pressure on the demand for goods in the short term. Furthermore, disruptions in global supply chains remain due to strong growth in demand in the context of economic recovery, relatively higher demand for goods compared to services, and preventive creation of stocks. Despite the predominant negative risks, exports of goods are expected to continue to be one of the cornerstones of economic growth over the projection period.

As for the export of services, it is expected that overnight stays of foreign tourists will recover quickly from the initial shock of the war in Ukraine and will record strong growth in 2022. The results of the last year's tourist season exceeded the expectations of even the most optimistic tourist forecasts. During the third quarter of 2021, in the peak of the tourist season, record revenues from tourism from the third quarter of 2019 were exceeded, while overnight stays of foreign tourists were at the level of about 90% of 2019. Such results were, besides the favourable epidemiological situation in Croatia, the consequence of the factors that are usually considered unfavourable structural features of the Croatian tourism. First of all, it is its pronounced seasonality, which in the current pandemic conditions, which significantly improve during the summer months, has allowed the mitigation of measures and the arrival of foreign tourists. In addition, the previous season was again favourably affected by the fact that foreign tourists mostly use cars as the main means of transport to the Republic of Croatia, since last year tourists again used air and sea transport to a lesser extent due to the possibility of infection. Indicators for the first quarter of 2022 confirm the continuation of positive trends from 2022, and are a good announcement of the upcoming tourist season.

However, the dynamics of growth of overnight stays in the rest of the period will be very mild and slowing down, taking into account the structural global challenges of tourism, as well as the limitations of domestic infrastructure and capacity. As early as in 2023, overnight stays of foreign tourists will reach the result from the pre-crisis 2019. However, in 2022, two-year extremely favourable base effects related to the estimated real consumption per tourist are expected to decrease sharply. In 2023, real consumption per tourist will still decrease slightly, only to accelerate slightly in the last two years. After many years of record results and significantly better performance compared to the competition, during the past two "epidemic" tourist seasons, the domestic tourism sector will in the medium term face internal constraints on the supply side as well as weaker demand dynamics, emphasizing the importance of strategic shifts in the direction of reducing the mass and seasonality of domestic tourism. The global recovery of the services sector will affect the gradual recovery of exports of services that exclude tourism.

Although it should be emphasized that previously the elasticity of imports of goods and services was expected to be higher than the final demand in 2021, in the conditions of strong growth in demand and reduced capacity, the domestic economic structure leads to strong growth in imports of goods and services and continued growth in its share in GDP. At the same time, compared to imports of goods the share of which in GDP will record the continuous and strong growth, imports of services are expected to have a subdued recovery shifted towards the end of the projection period. However, the effects of NRRP on imports of goods and services are largely concentrated in the first years of the observed period, thus leading to a relatively low level of elasticity of imports in relation to final demand in the last projection year. In addition, the increased level of elasticity of imports in 2022, besides the strong dynamics of final demand, also refers to its structure since the strengthened economic growth is based primarily on the sharp increase in investment spending and strong recovery of exports, characterized by strong import dependence. In line with the projected trends in final demand, imports will be at the slowing-down dynamics towards the end of the projection period.

2.2. Prices

Since mid-2020, there has been a sharp increase in the prices of oil and other energy products on the world market, as well as in most other categories of primary raw materials, such as prices of metals and agricultural products. Furthermore, the opening of economies after the COVID pandemic and the recovery of global demand for goods have led to marked pressures on global supply chains and affected shortages of certain product categories, extended delivery times and rising transport costs. The strong growth in raw material prices and disruptions in supply chains in the conditions of strong demand have accelerated the growth of producer prices of industrial products in the EU and the Republic of Croatia, and are increasingly spilling over into consumer prices. The previously described inflationary pressures are further intensified by the war in Ukraine and the accompanying sanctions, which affected the further increase in the prices of oil and gas and other raw materials on the world market, such as cereals and certain metals.

In line with the described trends, consumer price inflation has been continuously increasing since the beginning of 2021 from -0.3% in January to 5.5% in December last year. Observed cumulatively, in 2021 the average year-on-year growth of consumer prices of 2.6% was recorded, which was most strongly contributed by the growth of energy prices. The data available for 2022 point to a continued acceleration in the consumer price inflation in the first quarter of this year, which reached 7.3% in March, its highest level since mid-2008. Along with the still high growth of energy prices, in the first quarter of 2022 a further acceleration of the growth of food prices, but also of the prices of industrial products and services, is visible. In February this year, the Government of the Republic of Croatia presented a comprehensive package of measures to mitigate rising energy prices, which includes social benefits for citizens at risk of energy poverty, one-off allowances for retirees, limiting the increase in electricity fees, subsidies for gas to households and businesses, and the reduction in VAT rate on various product categories, including food and gas.

Table 2.1. Price Developments

	2021	2022 projection	2023 projection	2024 projection	2025 projection
GDP deflator, change (%)	**3.2**	**6.2**	**4.1**	**2.7**	**2.4**
Personal consumption	2.7	7.8	3.7	2.5	2.2
Government consumption	3.7	5.4	4.0	2.6	2.3
Gross fixed capital formation	2.4	5.3	3.9	2.5	2.2
Exports of goods and services	4.6	8.5	3.5	2.5	2.4
Exports of goods	6.9	11.8	3.3	2.4	2.2
Exports of services	2.1	4.9	3.7	2.7	2.5
Imports of goods and services	6.7	11.0	3.3	2.2	2.0
Imports of goods	7.4	12.1	3.3	2.2	2.0
Imports of services	2.9	4.5	3.5	2.4	2.3
Consumer price index, change (%)	**2.6**	**7.8**	**3.7**	**2.5**	**2.2**

Note: Data for 2021 are preliminary
Source: Croatian Bureau of Statistics, Ministry of Finance

In 2022, the consumer price inflation is expected to accelerate to 7.8%. The rise in consumer prices will be strongly contributed by the rise in food prices, influenced by rising oil prices and the cost of other inputs in agricultural production, and by the trends in food prices in the global and EU markets. The rise in food prices will be mitigated by reducing the VAT rate on certain categories of food products. Furthermore, consumer prices without food and energy will have a significant effect on accelerating inflation, which could accelerate significantly under the influence of the further spill-over of strong growth in raw material prices and producer prices in the EU and Croatia to consumer prices. At the same time, the rise in energy prices, along with the increase in oil and other energy prices on world markets, will be affected by the increase in gas prices by an average of 16% and electricity by 9.6% in April this year[5].

In 2023, the consumer price inflation will slow to 3.7%, due to lower prices of energy and other raw materials on the world market, as well as to the disappearance of base effects of price growth in 2022, including the increases in gas and electricity prices. Inflation trends will also be affected by the slowdown in the inflation in the EU and the expected easing of pressures in global supply chains. As a consequence of the above, the significantly lower contribution to inflation in 2023 will come from energy and food prices, while consumer prices without energy and food are expected to maintain slightly higher growth dynamics, which will still be slightly milder compared to 2022. In the rest of the projection period, the inflation is expected to stabilize at significantly lower levels compared to the first two years of the projection period. Thus, in 2024 and 2025, the average inflation of 2.5% and 2.2%, respectively, is expected.

[5] Without the introduction of a package of measures by the Government of the Republic of Croatia, the growth of energy prices would be significantly higher, with projections showing that the price of gas would increase by 79%, while the price of electricity would grow by 23%.

2.3. Labour Market

Although the labour market reacted quickly immediately after the outbreak of the COVID pandemic, through an increase in the number of unemployed and a decrease in the number of employed persons, its recovery followed relatively quickly. Administrative data indicate favourable trends in the labour market during 2021. Thus, in 2021, the year-on-year increase in the number of insured persons of the Croatian Pension Insurance Institute (hereinafter referred to as: HZMO) of 2.2% was recorded, while the number of the unemployed registered with the Croatian Employment Service (hereinafter referred to as: HZZ) decreased by 9, 3%. As the survey data show, in 2021 the number of employees (according to the domestic concept) increased by 1.2%. The significant growth of the labour force in 2021 contributed to keeping the survey unemployment rate at a similar level as in 2020, and in 2021 it was 7.6%. Furthermore, labour demand (as measured by the OVI index[6]) has grown significantly over the past year and since May 2021 has exceeded pre-pandemic levels from the same period in 2019. With the outbreak of the COVID crisis, the restrictions on domestic labour supply were only partially damped, while during 2021, an increase in labour force shortages was again recorded, which was particularly pronounced in the construction and industrial sectors.

The data available for the beginning of 2022 indicate the continuation of favourable trends in the labour market. In the first quarter of this year, the growth of the seasonally adjusted number of HZMO insured persons continued, along with a simultaneous decrease in the number of unemployed persons registered with the HZZ. Furthermore, labour demand (measured by OVI index) increased significantly in the first quarter of this year and exceeded pre-pandemic levels in the same quarter of 2019 by 30%. The results of the survey of companies, which show the expected continuation of the employment growth in the coming months, but also the increasingly pronounced shortages of workers, point to similar trends.

Table 2.2. Labour Market Developments

	2021	2022 projection	2023 projection	2024 projection	2025 projection
	change, %	change, %	change, %	change, %	change, %
Labour force (15+)[1]	1.4	0.4	0.2	0.1	0.1
Unemployment rate, level (%)[1]	7.6	6.3	5.6	5.2	5.0
Employment[2]	1.2	2.8	1.5	1.1	0.9
Labour productivity, persons[2]	8.9	0.2	2.9	1.7	1.6
Unit labour cost[2]	-3.6	7.5	2.1	2.3	2.1
Compensation per employee[2]	5.0	7.6	5.0	4.1	3.8
Gross earnings in legal entities[3]	4.2	6.3	3.8	3.5	3.3

[1] According to the labour force survey
[2] According to the national accounts definition
[3] Administrative sources

Source: Croatian Bureau of Statistics, Ministry of Finance

[6] The Online Vacancy Index (OVI) is a monthly index of online job vacancies developed at the Institute of Economics, Zagreb in cooperation with the MojPosao portal, with the aim of providing timely information on the current state of job demand.

The economic growth in the coming years is expected to lead to an increase in the number of employees at a rate of 2.8% in 2022, which will then slow to 1.5% in 2023, 1.1% in 2024 and 0.9% in the last year of the projection period. In 2022, the survey unemployment rate is expected to decrease to 6.3%, after which it will continue to decline to record low levels in the last two years of the projection period. This macroeconomic scenario assumes further planned immigration through the system defined by new legal provisions on the import of workers, which introduces a labour market test instead of the quota system. In line with the expected trend in labour demand, along with still present labour shortages, as well as the inflation trends, the nominal growth in gross salaries is expected to accelerate to 6.3% in 2022, which will then slow to an average of 3.6% in the rest of the projection period.

2.4. Monetary Developments

The coronavirus pandemic has once again shown that the Croatian financial system is characterized by resilience and the ability to quickly adapt to the new situation. The banking system continued to increase its liquidity in 2021. With the expiration of the moratorium on loans given to numerous business entities in response to the coronavirus pandemic, the credit portfolio of banks has not been disrupted and the entire system is still characterized by extremely high profitability, capitalization and stability. The end of 2021 and the beginning of 2022 were marked by increasing inflationary pressures that pose numerous challenges to monetary policy-makers in the world. After it became clear that inflationary pressures were not temporary and short-lived as originally thought, many central banks around the world began to change the direction of monetary policy. There are issues of the extent to which the global financial system has become dependent on the issuance of reserve money and of the delicate situation central banks may find themselves in. This change in the nature of monetary policy began to be felt in world financial markets, which was only further contributed by the new negative situation in the context of Russia's aggression against Ukraine. Government bond yields began to grow, similar to EURIBOR, with the 12-month EURIBOR coming out of the negative zone for the first time since February 2016. If the aforementioned trend of the tightening the monetary policy of central banks and increasing reference interest rates continues, this will be reflected in the Croatian financial system with a certain margin. However, extremely high liquidity and capitalization of the entire system are the basis of expectations that the situation in the Croatian financial system will remain stable in the coming period. Given the described high liquidity of the system, as well as the stable premium on the country risk, no more pronounced growth of bank interest rates to the private sector is expected in the coming period.

2.5. Risks to the Macroeconomic Projections

Economic activity is exposed to predominantly negative risks, while the risks to achieving the projected inflation rate are more balanced. If all relatively non-structural factors of supply chains, such as shortages or logistical disruptions, are not addressed quickly enough, if the monetary policy response to inflationary pressures is inadequate or if the crisis affects the global financial system, the world economy might fall into recession, which would significantly limit inflationary tendencies.

Over the past two years, macroeconomic projections have been exposed to a significantly increased level of uncertainty compared to the pre-pandemic period. Although still present, the coronavirus pandemic is no longer a major source of economic risk. On the other hand, the Russian invasion of Ukraine added a new dimension to the existing economic risks, which are related to the growing inflation rate and the present disturbances in the world supply chains. In the light of the war in Eastern Europe, these inflation risks are becoming even more pronounced, given the high dependence of some EU member states on imports of energy, especially natural gas and oil from Russia. The introduction of sanctions has caused marked fluctuations in the world commodity exchanges, given the increased uncertainty in the supply of food and key raw materials from Russia and Ukraine. The high uncertainty of the development of the conflict and the associated economic risks are closely linked to possible more permanent supply chain disruptions and monetary policy decisions to curb rising inflation.

The main economic risk to the realization of the macroeconomic scenario from this document is related to the trends in the inflation rate and the consequent reaction of central banks to the restraint thereof, as well as the reaction of other market participants negatively affected by high inflation rates. The central banks of the most developed countries, led by the US Fed and the Bank of England, have already begun raising reference interest rates, with the exception of the European Central Bank, which has announced the end of its securities purchase programmes in the third quarter of 2022. The markets reacted to these trends by reducing government bond prices and the consequent increase in yields, which will negatively affect public finances of highly indebted countries and their opportunities for new borrowing. Concerns about the impact of the war in Ukraine on the short-term economic outlook and rising inflationary pressures have also led to a significant drop in consumer and business confidence, which will affect their willingness to spend and invest. High inflation rates are eroding purchasing power, especially of the most vulnerable groups of consumers who spend a high share of income on food and energy. In the short term, disruptions in world supply chains are expected to worsen followed by their subsequent very gradual normalization, which could negatively affect the results of Croatian exports of goods, one of the main sources of economic growth in recent years. The increase in inflation and fuel prices could also have a negative impact on the results in the tourism sector, since the Republic of Croatia is mainly a car destination, compared to the competition in the Mediterranean.

Among other domestic risks, the medium-term vulnerability of the real estate market stands out, as warned by the European Systemic Risk Board, which could negatively affect the stability of the Croatian financial system. The accelerated growth in housing property prices and indications of the overvaluation thereof will be given special attention in the next period. The risks of this macroeconomic scenario are additionally related to the use of funds from the EU structural funds, as well as those related to projects financed under the NRRP. Following all the above, the described macroeconomic scenario is subject to significant downward changes due to the predominant negative risks.

3. GENERAL GOVERNMENT BUDGET AND PUBLIC DEBT

3.1. Fiscal Policy

Many years of responsible fiscal policy management have created space for the Government of the Republic of Croatia to act promptly in managing the challenges caused by the coronavirus pandemic. Thus, the negative economic consequences in 2020 were reflected in a significant decline in tax revenues and social contributions, but also in a strong increase in expenditures due to the financing of measures to preserve jobs and health of citizens. Consequently, in 2020 the budget deficit recorded a level of 7.3% of GDP, while public debt rose to 87.3% of GDP. At the same time, interest expenses decreased by HRK 1.5 billion compared to the previous year, primarily as a result of THE active public debt management in line with financial market conditions.

The last year was marked by extremely strong growth in gross domestic product, as well as by other positive economic indicators, which were also reflected in the increase in income. At the same time, the expenditure side of the budget was marked by further rationalization of public spending, reduction of COVID support to the economy and interest expenditure due to favourable conditions in financial markets, but also by the increase in health expenditure and social benefits reflecting the still present consequences of the COVID pandemic. All of this resulted in a budget deficit of 2.9% of GDP, as well as in the reduction in the public debt-to-GDP ratio to 79.8%.

However, even in the challenging circumstances of the continuation of the COVID pandemic, damage due to devastating earthquakes, and then growing geopolitical tensions, credit agencies have maintained confidence in the Croatian economy. In 2021, the rating agency Moody's confirmed the credit rating of the Republic of Croatia Ba1 with a stable outlook. Then, in November 2021, the Fitch agency raised its estimate for the Republic of Croatia by one level, from BBB- to BBB with a positive outlook, which is also historically the best result of the Republic of Croatia. In March 2022, the rating agency Standard & Poor's confirmed the investment rating of the Republic of Croatia BBB- with a stable outlook. Credit agencies base the positive ratings and outlook for the Republic of Croatia on the implementation of efforts to join the euro area and the implementation of Next Generation EU projects, structural funds and the reconstruction of areas damaged by devastating earthquakes, particularly emphasizing political stability and responsible economic policy management.

In July 2020, the Republic of Croatia joined the ERM II mechanism, which is also the last phase before joining the euro area and the introduction of the euro as the official currency and legal tender. The planned earliest date for Croatia's accession to the euro area is January 1, 2023, but it depends on meeting the nominal convergence criteria and the measures agreed with the EU institutions and Member States. For example, upon joining ERM II, the Republic of Croatia committed itself to implementing additional reform measures and it expressed its firm intention to introduce the euro when the convergence criteria are met. These measures include strengthening the anti-money laundering framework, further simplifying administrative procedures and reducing para-fiscal and non-tax levies, improving corporate governance in state-owned enterprises, and strengthening the national bankruptcy framework. In March 2022, all preconditions and measures agreed with the institutions and member states of the euro area were met. Therefore, the process of introducing the euro will result in the full membership of the Republic of Croatia in the euro area when all the remaining conditions contained in the Convergence Report are met and the accession acts are adopted by the European institutions and Member States.

Despite the sharp decline in the economic activity in 2020 and the continuing uncertainty in 2021, in an environment of high levels of liquidity and low interest rates, positive trends in borrowing in the domestic and international financial markets remain. In 2021, there were three primary bond issuances, one on the domestic market and two on the foreign financial market, where historically low levels of interest rates and maturities were achieved. In the challenging market conditions of the Ukrainian-Russian conflict, rising inflation, tightening monetary policy of central banks and, consequently, rising interest rates and market yields, government bond yields began to rise, so in 2022, primary government bond issuances recorded significantly higher coupon interest rates compared to 2021.

Following the outbreak of the COVID crisis, in March 2020 the EU Council approved the application of a general escape clause from the budgetary rules defined by the Stability and Growth Pact. The Member States have been given the opportunity to provide fiscal incentives to their economies to mitigate the negative effects of the pandemic. At the national level, the Fiscal Responsibility Act also allows for the temporary postponement of the application of fiscal rules in case of extraordinary circumstances, and in April 2020, the Government of the Republic of Croatia, in line with the recommendation from the Fiscal Policy Committee, adopted a Decision on the temporary suspension of the application of fiscal rules referred to in Articles 6, 7 and 8 of the Fiscal Responsibility Act. With the adoption of the Fiscal Policy Guidelines for 2023 by the Council of EU Finance Ministers in March 2022, the general escape clause was activated again in 2022, and the Decision on the temporary suspension of the application of national fiscal rules is still in force.

During 2022, the Government of the Republic of Croatia planned to continue rehabilitating the health and socio-economic consequences of the coronavirus pandemic and to intensify the reconstruction of the earthquake-affected areas of Zagreb, Petrinja and its surroundings. However, new challenges have emerged, such as geopolitical realignments, continued supply chain disruptions, financial market instability, in the context of growing inflationary pressures, resulting in strong challenges in economic and fiscal policy-making.

In this sense, the Government of the Republic of Croatia plans a gradual transition from the stimulus direction of the overall fiscal policy to a neutral one, i.e. a change in the so-called fiscal impulse[7] from the expansive one to the neutral one. In doing so, changing external and domestic circumstances it will be closely monitored in order to respond to potential risks. Furthermore, efforts will be made to gradually reduce public debt in order to support the existing recovery and to contribute to potential growth.

Fiscal adjustment will be supported by investment and reforms that boost potential growth, ensuring a sustainable trajectory to reduce the public debt-to-GDP ratio. These investments and reforms will be

[7] Fiscal impulse refers to the change in primary current expenditures without discretionary measures on the revenue side and one-off measures on the expenditure side of the budget, excluding temporary measures for COVID crisis management and expenditures financed through grants from the Recovery and Resilience Facility and other EU funds against medium-term potential growth (10-year average).

implemented in particular through EU-funded projects via the Recovery and Resilience Facility[8], as well as the Structural Funds and the Solidarity Fund. In addition, fiscal consolidation will be implemented primarily through improving the structure of expenditures (nationally funded current expenditures without discretionary revenues will not grow faster than the medium-term potential growth rate) while preserving investments, especially those aimed at green and digital transition.

Table 3.1. Fiscal impulse in the period 2021-2025

	2020.	2021.	2022.	2023.	2024.	2025.
TOTAL EXPENDITURE	206.3	212.1	234.6	246.6	256.3	265.4
Interest expenditure	7.5	6.7	6.7	6.4	6.1	5.8
EU-FUNDS (current expenditure)	5.1	4.8	6.2	6.3	5.5	5.2
CAPITAL EXPENDITURE	29.4	27.4	37.3	40.9	42.5	42.8
Temporary emergency measures (Covid measures):						
- expenditure	11.0	7.7	2.5			
- revenue	-3.2	-1.8	-0.2			
One-offs (expenditure)	0.0	0.0	-1.3	-0.7	0.0	0.0
Nationally-financed primary current expenditure	**150.1**	**163.7**	**180.4**	**192.3**	**202.3**	**211.6**
Nationally-financed primary current expenditure, nominal growth	**-1.6**	**9.1**	**10.2**	**6.6**	**5.2**	**4.6**
Ten years potential growth, nominal growth	**1.6**	**5.2**	**8.5**	**6.4**	**4.9**	**4.6**
Change in net nationally financed primary current expenditure	**0.9**	**-1.8**	**-0.9**	**-0.2**	**-0.1**	**0.0**

1 Adjusted for discretionary measures on income.

Note: The calculation of the Ministry of Finance in accordance with the 2023 Fiscal Policy Guidelines adopted by the EU Council of Finance Ministers in March 2022.

Source: Ministry of Finance, EC for potential ten-year GDP growth

Following all the above, fiscal trends on both the revenue and expenditure side of the budget in the next medium term will result in a gradual reduction of the budget deficit from 2.9% of GDP in 2021 to 2.8% of GDP in 2022. In 2023 and 2024, the general government budget deficit is projected at 1.6% of GDP, and in 2025 at 1.2% of GDP. At the same time, the public debt-to-gross domestic product nominal value ratio will decrease annually at an average rate of 3.1 percentage points, from 76.2% of GDP in 2022 to 71.7% of GDP in 2023, 68.9% of GDP in 2024 and 66.9% of GDP in 2025. By this, the public debt rule will be met, while ensuring fiscal sustainability in the medium term.

Table 3.2. General Government Budget by Sub-sectors 2022 – 2025

ESA 2010 methodology (in mil. HRK)	deficit/surplus 2022	deficit/surplus 2022 % of GDP	deficit/surplus 2023	deficit/surplus 2023 % of GDP	deficit/surplus 2024	deficit/surplus 2024 % of GDP	deficit/surplus 2025	deficit/surplus 2025 % of GDP
GENERAL GOVERNMENT	**-13.359**	**-2,8**	**-8.082**	**-1,6**	**-8.587**	**-1,6**	**-7.021**	**-1,2**
CENTRAL GOVERNMENT	-12.192	-2,6	-5.957	-1,2	-5.784	-1,1	-3.544	-0,6
of which:								
HAC	933	0,2	1.162	0,2	1.256	0,2	1.403	0,2
HC	-169	-0,04	-202	-0,04	-239	-0,04	-277	-0,05
HV	-145	-0,03	-89	-0,02	-95	-0,02	-80	-0,01
HRT	-64	-0,01	-76	-0,01	-114	-0,02	-121	-0,02
HŽ INFRASTRUKTURA	-399	-0,1	-371	-0,1	-256	-0,05	-250	-0,04
HŽ PUTNIČKI PRIJEVOZ	-273	-0,1	-37	-0,01	-117	-0,02	53	0,01
HBOR	343	0,1	323	0,1	311	0,1	287	0,1
APN	-45	-0,01	-55	-0,01	-75	-0,01	-100	-0,02
LUČKE UPRAVE	0	0,0	0	0,00	0	0,0	0	0,0
JPP I KONCESIJE	-289	-0,1	-137	-0,03	254	0,05	345	0,1
SOCIAL SECURITY FUNDS	-96	-0,02	-456	-0,1	-788	-0,1	-1.092	-0,2
LOCAL GOVERNMENT	-1.072	-0,2	-1.669	-0,3	-2.016	-0,4	-2.385	-0,4

Source: Ministry of Finance

[8] The Recovery and Resilience Facility provides the Republic of Croatia with grants to finance high-quality investments and reforms aimed at increasing productivity without necessarily increasing the budget deficit or debt.

3.2. General Government Budget in 2021

Although, in 2021, the economic trends continued to be affected by the coronavirus pandemic, the domestic economy has successfully adapted to the new conditions, as evidenced by the strong recovery in the economic activity. The increase in total revenues was mostly due to the strong growth of tax revenues and social contributions, caused primarily by the recovery of personal consumption and tourism activities, as well as favourable trends in the labour market, i.e. the increase in salaries and employment. Non-tax revenues had the same effect, the growth of which is largely due to the increased dynamics of the use of EU funds. On the other hand, lower revenues are recorded in revenues from income tax and corporate income tax as a result of tax amendments that came into force on January 1, 2021. The reduction in subsidies paid to the economy related to the pandemic, to the great extent mitigated the increase in the expenditure side of the budget, as well as decreased interest expenses, as a consequence of favourable financing conditions on the capital market. In addition, there has been an increase in social benefits, which along with monetary benefits include goods and services provided to citizens by the state, as a result of increased health expenditures and higher social aid, including the COVID-19 allowance for retirees.

Table 3.3. Fiscal effects of the most significant measures due to the coronavirus pandemic

List of measures		ESA category	Fiscal effect, % of GDP	Fiscal effect, HRK 000
COVID-19 MEASURES IN 2020	**Writte-offs of direct taxes and contributions**			
	personal income tax	D.5R	0,0	115.296
	pension and healthcare insurance contributions	D.61R	0,8	2.884.219
	corporate income tax	D.5R	0,0	40.593
	Non-collectible amounts			
	taxes	D.2 + D.5	0,0	67.105
	pension and healthcare insurance contributions	D.61R	0,0	77.922
	COVID related subsidies to sectors of agriculture, transport, culture, sports and tourism	**D.3P**	**0,1**	**347.807**
	Subsidies to preserve employment	**D.3P**	**1,9**	**7.321.649**
		D.62P	**0,1**	**382.037**
	Remuneration due to temporary incapacity for work	**D.62P**	**0,0**	**111.712**
	Social transfers in kind in health sector	**D.632P**	**0,1**	**515.150**
	Capital injections treated as capital transfer to Croatia Airlines	**D.99P**	**0,2**	**600.000**
	Acquisition of medical and protective equipement to combat COVID-19	**P.2 + P.52 + D.1P**	**0,5**	**1.737.813**
	TOTAL FISCAL EFFECTS OF COVID-19 MEASURES IN 2020		**3,8**	**14.201.302**
COVID-19 MEASURES IN 2021	**Writte-offs of direct taxes and contributions**			
	pension and healthcare insurance contributions	D.61R	0,4	1.812.243
	COVID related subsidies to sectors of agriculture, transport, culture, sports and tourism	**D.3P**	**0,1**	**351.984**
	Subsidies to preserve employment	**D.3P**	**1,1**	**4.602.523**
		D.62P	**0,1**	**222.949**
	Remuneration due to temporary incapacity for work	**D.62P**	**0,0**	**138.311**
	Supplement to pensions due to COVID-19 pandemic	**D.62P**	**0,1**	**430.336**
	Social transfers in kind in health sector	**D.632p**	**0,2**	**693.343**
	Acquisition of vaccine, medical and protective equipement to combat	**P.2 + P.52 + D.1P**	**0,3**	**1.260.787**
	TOTAL FISCAL EFFECTS OF COVID-19 MEASURES IN 2021		**2,2**	**9.512.476**
COVID-19 MEASURES IN 2022	**Writte-offs of direct taxes and contributions**			
	pension and healthcare insurance contributions	D.61R	0,0	220.108
	COVID related subsidies to sector of agriculture	**D.3P**	**0,0**	**223.114**
	Subsidies to preserve employment	**D.3P**	**0,1**	**308.000**
		D.62P	**0,0**	**5.000**
	Remuneration due to temporary incapacity for work	**D.62P**	**0,0**	**95.000**
	Social transfers in kind in health sector	**D.632p**	**0,1**	**688.300**
	Acquisition of vaccine, medical and protective equipement to combat COVID	**P.2 + P.52 + D.1P**	**0,2**	**1.146.921**
	TOTAL FISCAL EFFECTS OF COVID-19 MEASURES IN 2022		**0,6**	**2.686.443**

Source: Ministry of Finance

Consolidated General Government Revenues

In 2021, the realization of general government revenue was influenced by positive trends in the economy, year-round fiscal effects of tax relief carried out in 2020, and the effects of tax amendments that came into force on January 1, 2021, and they relate to tax amendments within the system corporate income tax, income tax, value added tax and regulation on excise duties.

As of January 1, 2021, the corporate income tax rate for all entrepreneurs with a turnover of up to HRK 7.5 million has been reduced from 12% to 10%, while, in the personal income tax system, the personal income tax rate has been reduced from 36% to 30%, and from 24% to 20%. In terms of value added tax, as of July 1, 2021, the exemption from VAT on imports of low-value goods is abolished.

From the beginning of April 2020, a new Regulation on the level of excise duty on tobacco derivatives and tobacco products came into force, which had a year-round effect during 2021. Furthermore, a new increase in excise duties on cigarettes and other tobacco products has been implemented since March 2021. The specific excise duty on cigarettes now amounts to HRK 400 per 1,000 cigarettes, the proportional excise duty 34% of the retail price of cigarettes, and the minimum excise duty on cigarettes is HRK 888 per 1,000 cigarettes. The excise duty was also increased on fine-cut tobacco for rolling cigarettes and other smoking tobacco, which amounts to HRK 860 per 1 kilogram, and on cigars and cigarillos, which amounts to HRK 860 per 1,000 pieces. The amount of excise duty for heated tobacco products and new tobacco products is HRK 1,400 per kilogram for heated tobacco and HRK 860 per kilogram for new tobacco products. The amount of excise duty for e-liquids is still HRK 0.00 per 1 millilitre. In addition, since April 2020, the amendments have been made in the system of excise duties on alcohol and non-alcoholic beverages, which show their year-round effect in 2021. These amendments increased the excise duty on strong alcoholic beverages, while within the system of the taxation of coffee and non-alcoholic beverages the method of calculating excise duty changed. The special tax on non-alcoholic beverages is calculated according to the volume and sugar content, whereby a lower tax is paid for beverages with lower sugar content paying. Energy drinks are taxed separately depending on the volume and content of methyl xanthine and taurine.

The funds from EU funds also have a significant effect on budget revenues, primarily from the Multiannual Financial Framework 2014-2020, but also from the new financial perspective in the part related to the REACT-EU instrument related to job preservation.

Taxes on production and imports amounted to 19.3% of GDP and recorded a year-on-year growth of 17.5%. Within their structure, the most generous income is value added tax, which was 20.9% higher than a year earlier. The collected VAT revenues are the result of the growth of personal consumption, the good tourist season, and the previously mentioned tax reliefs that have been in force since the beginning of 2021. The turnover in retail trade increased in nominal amounts by 15.5% in 2021. The collected revenues from excise duties were influenced by the increase in the intensity of turnover and consumption of excise products and the previously mentioned tax amendments.

Growth of 10.7% at a year-on-year level is also recorded in revenues from social contributions, which in 2021 amounted to 11.4% of GDP and were primarily influenced by labour market trends, i.e. the recovery of salaries and employment due to the increased economic activity.

Current taxes on income and wealth, which include income tax and corporate income tax, are reduced by 5.6% due to the tax amendments that came into force in early 2021 and the performance of companies and banks in 2020, as the corporate income tax in the current year is paid on the basis of the business operations of entrepreneurs from the previous year.

In addition to tax revenues, revenues from other current and capital transfers, which include funds from EU funds, are also significant, and in 2021 they amounted to 5.3% of GDP, whereby the revenues from EU funds increased by 14.4% at an annual level. These revenues are directly related to projects financed from the EU budget, but also to funds allocated to the Republic of Croatia from EU funds within the framework of aid in financing the consequences of coronavirus.

Consolidated General Government Expenditures

Total general government expenditures were executed at the level of 49.3% of GDP in 2021.

Compensations of employees amount to 12.5% of GDP. Compared to the previous year, they registered an increase of 6.7%. This increase is mostly the result of an increase in the base for calculating salaries based on collective agreements for civil and public servants (2% as of January 2020, 4% as of January 2021), an increase in coefficients in primary and secondary education, and for the police employees (1% as of June 2020, 2% as of January 2021), as well as corrections for years of service of 0.5%.

Intermediate consumption expenditures were executed at the level of 8.3% of GDP. This category includes material expenditures of all units of the general government sector, and larger allocations relate to the settlement of debts to suppliers of medicines, consumables and implantable medical supplies, and the increase in expenditures recorded at the position of the Croatian Institute of Public Health due to additional costs associated with the coronavirus pandemic.

Expenditures for subsidies register a level of 2.7% of GDP, and compared to 2020 register a decrease of 18.6%. The reason for the reduction is primarily due to the reduction of the amount of the aid for the preservation of jobs in activities affected by coronavirus due to the mitigation of measures to prevent infection and the associated reduction in the number of beneficiaries of the measures. This category also includes regular allocations for payments in agriculture from national sources, incentives for maritime and air transport, and allocations for the active labour market policy program. A significant amount of subsidies of 0.8% of GDP relates to subsidies of the Croatian Energy Market Operator d.o.o. (hereinafter referred to as: HROTE) for for renewable energy producers, which are financed from the fee for incentives for electricity from renewable sources.

Property income expenditure, which are determined by the trends in interest expenditure, were executed with a share of 1.6% in GDP and decreased by 0.4 percentage points of GDP compared to the previous year. Such trends are the result of the continuation of responsible fiscal policy management, accompanied by an active policy of public debt management, which also had an impact on the reduction of public debt service costs.

Social benefits and social transfers are the most important category of total general government budget expenditures and they register a level of 15.5% of GDP. These expenditures are largely determined by the trends in expenditures for pensions, maternity benefits, social welfare benefits, child allowances, unemployment benefits, temporary incapacity benefits as well as social transfers in the healthcare system provided to the institutions outside the public sector. Expenditures for pensions and pension benefits were realized at the level of 10.1% of GDP, and include a one-off COVID-19 pension supplement, which was paid to those pensioners who have a pension of less than HRK 4,000, ranging from HRK 400 to 1,200, depending on the level of the pension. The increase in pension expenditures compared to 2021 is the result of the adjustment of pensions earned according to general and special regulations from January 1, 2021 by 0.56% and from July 1, 2021 by 2.46%. In addition, pension expenditures are affected by the cumulative effect of changes in the number and structure of pension beneficiaries and the adjustment of pensions from 2020. Allocations for child allowance amount to 0.3% of GDP, and for maternity benefits 0.7% of GDP, which is a consequence of the increase in the maximum amount of salary compensation for employed and self-employed parents during parental leave to HRK 5,654.20 per month as of April 1, 2020. In addition, unemployment benefits amounted to 0.2% of GDP, and social welfare benefits to 0.7% of GDP. Social transfers through non-public sector institutions in the healthcare system amounted to 2% of GDP.

Other expenditures, mostly related to current and capital transfers, were executed at the level of 3.8% of GDP. They mostly relate to the payment of the Republic of Croatia's own contribution to the EU budget as well as to projects financed from EU funds, especially in the water and communal services sector. They also include commitments on the basis of subsidizing housing loans in this year, as well as capital transfers to households and other legal entities.

Gross fixed capital formation expenditures register a level of 4.8% of GDP and a year-on-year decline of 3.5%. This category of expenditures refers to the funds spent on the construction of road, railway and communal infrastructure, and the most important project is the continuation of the construction of the Peljesac Bridge.

Net Lending/Borrowing

Following the realized revenues and executed expenditures, the general government budget in 2021 registered a deficit of HRK 12.4 billion or 2.9% of GDP.

3.3. General Government Budget in 2022

Consolidated General Government Revenues

In 2022, total general government budget revenues are planned at 46.9% of GDP. The revenue side of the budget is determined by the expected recovery and further growth of economic activity. In order to mitigate the inflationary effects, a reduction in VAT on certain products was carried out, as well as a temporary reduction in excise duties on energy products and electricity. In addition, the withdrawal of funds from EU funds will have a significant effect on budget revenues. On the one hand, the withdrawal of contracted funds from the Multiannual Financial Framework 2014-2020 is expected to accelerate, and on the other hand, new funds from the Multiannual Financial Framework 2021-2027 are envisaged. Fiscal projections include the use of funds from the new Next Generation EU instrument that will focus on financing development, strategic and reform projects from the National Recovery and Resilience Plan. In addition to the above, the budget also projects funds from the EU Solidarity Fund to finance part of the reconstruction of public infrastructure, primarily educational, healthcare and cultural damage in the devastating earthquakes.

Taxes on production and imports are the most significant category of total revenues, and are projected at 19.3% of GDP. Value added tax revenue is projected at 13.4% of GDP, based on macroeconomic projections, i.e. growth in personal consumption, tourism services, intermediate consumption, investment and social transfers in kind, as well as the effect of the tax amendments entered into force on April 1, 2022 with the aim of mitigating inflationary effects. The VAT rate is reduced from 25% and 13% to 5% for baby food, edible oils and fats, butter and margarine, live animals, fresh meat and sausages, live and fresh fish, crabs, vegetables, fruits, eggs and seeds, fertilizers and pesticides, animal feed, but also tickets for concerts, sports and cultural events. The application of a reduced VAT rate of 13% is permanently extended to the supply of natural gas and heating from heating stations, firewood, pellets, briquettes and wood chips, and menstrual supplies. In addition, in the period from April 1, 2022 to March 31, 2023, gas supplies will be charged at a VAT rate of 5%. The total cost of this measure is 0.4% of GDP.

In the category of taxes on production and imports, in addition to VAT, revenues from excise duties and other consumption taxes are also included. Revenues from excise duties are projected at 4.2% of GDP, and they include expected consumption of excise products, revenues from fees for incentives for the production of electricity from renewable sources, assessment of consumption tax and the effects of the amendments in regulations in the excise system, especially in reduced excise duties on energy and electricity, and in order to mitigate the impact of inflation on citizens.

The second most significant group of general government budget revenues are social contributions, which are projected at the level of 11.4% of GDP. Their dynamics is primarily determined by employment and salary growth trends.

In 2022, estimated revenues from current taxes on income and wealth will register a level of 5.3% of GDP. Income tax revenue is planned on the basis of expected labour market trends. Corporate income tax revenue is projected at the level of 1.7% of GDP, which takes into account the business results achieved by economic entities in 2021.

The categories of other current and capital transfers, which are projected at the level of 5.9% of GDP, include revenues from the aids of EU institutions and bodies, which are directly linked to the projects financed from the EU budget, but also to funds allocated to the Republic of Croatia from EU funds within the financing of the reconstruction of public infrastructure damaged in the earthquake and the funds from the new Next Generation EU instrument and the Recovery and Resilience Facility.

Consolidated General Government Expenditures

Total general government budget expenditures are planned at a level of 49.8% of GDP in 2022. The expenditure side of the budget is focused on implementing activities aimed at recovering and strengthening the competitiveness and resilience of the economy, while ensuring adequate protection of all segments of the population, including the reception of and care for Ukrainian refugees. In addition, measures to mitigate the growth of energy prices that came into force on April 1, 2022, which relate to the aid to citizens and entrepreneurs, measures for socially vulnerable groups, and aid for farmers and fishermen, are also taken into account. Significant funds continue to be provided for the repair of earthquake damage, both from national sources of funding and from the EU Solidarity Fund. Taking into account the fiscal stability, but also ensuring an adequate standard of living for the citizens of the Republic of Croatia, additional funds have been provided for a more adequate system of social benefits, primarily for the implementation of the new Social Welfare Act.

Compensations of employees are projected at the level of 12.1% of GDP based on the expected trend in the level of the number of civil and public servants employed and the rights arising from collective agreements. As of May 1, 2022, the salary base in civil and public services is increased by 4%, and the projection includes the increases for the years of services of 0.5%, as well as an increase in the number of employees, especially in the education and healthcare sectors.

Intermediate consumption expenditures are planned at the level of 8.7% of GDP. The increase in this category of expenditures is primarily due to increased allocations for medicines and for consumables and sanitary material of state hospitals and healthcare institutions under the jurisdiction of local and regional self-government units. This category also includes the projected material costs of budgetary users as a consequence of repairing the damage caused by the Zagreb and Petrinja earthquakes. It also include increased energy costs of budgetary and extra-budgetary users as well as of local and regional self-government units.

In 2022, expenditures for subsidies are projected at the level of 2% of GDP. The reason for the reduction is primarily due to the reduction of the amount for the subsidies for the preservation of jobs in the activities affected by coronavirus (COVID-19) in the conditions of mitigating pandemic risks. The most significant part of subsidies relates to direct payments in agriculture and rural development measures of 1.1% of GDP and to HROTE subsidies for producers of energy from renewable sources of 0.7% of GDP financed from the fee for incentives for electricity from renewable sources. This category also includes subsidies for active labour market policy measures. In addition, the projected amount of expenditure for subsidies includes subsidies for gas to micro, small and medium-sized enterprises with an average annual consumption of up to 10 gwh and up to a maximum of HRK 1.5 million per entrepreneur.

Property income expenditure, which are mostly determined by the trends in interest expenditure and public debt service costs, register a level of of 1.4% of GDP in 2022.

Social benefits and social transfers are planned at the level of 15.1% of GDP. Expenditures for pensions and pension benefits amount to 9.6% of GDP, and their trend is affected by the transferred cumulative effect of changes in the number and structure of pension beneficiaries, indexation of pensions according to general and special regulations, and the one-off energy supplement for pensioners.

Maternity benefits are planned at the level of 0.6% of GDP, and they include the effect of the amendments to the Maternity and Parental Benefits Act. Allocations for child allowance amount to 0.3% of GDP, and unemployment benefits to 0.2% of GDP. Social welfare benefits are planned at the level of 0.7% of GDP, and the increase thereof is influenced by the implementation of the new Social Welfare Act as well as of the measures for the purpose of assisting social service providers. Social transfers in kind take into account the change in the scope and amount of compensation for the vulnerable energy buyer, as well as gas subsidies intended for households that subsidize a part of the gas price directly on the invoice. In addition, they include social transfers through the institutions outside the public sector in the healthcare system in the amount of 2% of GDP.

Other expenditures, mostly related to current and capital transfers, are planned at the level of 4.1% of GDP, and are largely determined by the payment of the Republic of Croatia's own contribution to the EU budget as well as projects financed from EU funds. New activities to be funded by the Recovery and Resilience Facility are also included. In addition, the allocations are also anticipated for receiving and providing the accommodation for Ukrainian refugees, as well as for the assumption of commitments on the basis of subsidizing housing loans in this year and capital transfers to legal entities.

Gross fixed capital formation expenditures are planned at the level of 5.7% of GDP, with the largest part of investments related to the road, rail and water infrastructure. Furthermore, the delivery of 10 new electric trains to *HŽ Putnički prijevoz* is planned. The funds for the purchase of military equipment to increase the combat capability of the Croatian Army are also included. Further intensified investment activities of local and regional self-government units are expected, with a significant part financed from the EU funds. In addition, there are also funds planned within this category for the reparation of the damage caused by the earthquake, which will be financed from the EU Solidarity Fund.

Net Lending/Borrowing

Following the projected revenues and expenditures, the general government budget is expected to register a deficit of HRK 13.4 billion or 2.8% of GDP in 2022.

3.4. Medium-Term Budgetary Framework (2023 – 2025)

Consolidated General Government Revenues

In the period 2023-2025, general government budget revenues will be determined by projected trends in economic activity, taking into account the fiscal effects of the implemented tax relief and aid from EU institutions and bodies. This primarily refers to funds from the previous and new Multiannual Financial Framework and from the Recovery and Resilience Facility, which will primarily strengthen the recovery and resilience of the economy, as well as the funds from the EU Solidarity Fund, which will focus on repairing the damage caused earthquake.

In 2023, consolidated general government revenues will register a level of 46.5% of GDP, in 2024 a level of 45.8% of GDP, and in 2025 a level of 45.5% of GDP. Taxes on production and imports are projected based on macroeconomic assumptions in the medium term and will register an average level of 19% of GDP. Revenues from value added tax and revenues from excise duties will be kept at an average level of 13.3% of GDP and 4% of GDP, respectively. Furthermore, revenues from current taxes on income and wealth will register the level of 5.3% of GDP in the observed period, and the share of revenues from social contributions will register an average level of 11.2% of GDP. Other current and capital revenues will be mainly determined by the absorption of funds from EU funds, but also from the new EU instrument of the EU –Next Generation and the Recovery and Resilience Facility.

Consolidated General Government Expenditures

In 2023, general government budget expenditures are projected at the level of 48.1% of GDP, in 2024 at 47.4% of GDP, and in 2025 at 46.7% of GDP.

Compensation of employees will register an average level of 11.6% of GDP due to the expected trends in the level of the number of the number of employed civil and public servants and the rights arising from collective agreements.

Intermediate consumption expenditures will move at an average level of 8.3% of GDP, primarily due to the expected trends in material expenditures of budgetary users, especially institutions in the healthcare sector and costs related to repairing the damage caused by the earthquakes, which will be financed from the EU Solidarity Fund.

Expenditures for subsidies will be at an average level of 1.8% of GDP as of 2023, which will be contributed by subsidies for the payment of incentives to privileged producers of renewable energy sources, as well as by regular subsidies to the agricultural, transport and labour market sectors. In addition, they include subsidies to subsidize gas prices to entrepreneurs, which are in force until the end of March 2023.

Property income expenditure, which are largely determined by the trends in the interest expenditure, will register an average level of 1.1% of GDP in the medium term.

Social benefits and social transfers will be at an average level of 14.7% of GDP. The increase in the allocations for pensions is anticipated as a result of the indexation of pensions and the expected trends in the number of pensioners, while increased social transfers to institutions outside the public sector are also expected, as well as increased allocations for organized care for the elderly.

Other expenditures, which mainly relate to other current and capital transfers, will be at an average level of 3.6% of GDP until the end of the projection period.

Gross fixed capital formation expenditures will record an average level of 6.1% of GDP until the end of 2025. They will be determined by the planned dynamics of investments of central government units and local and regional self-government units, and will be largely financed from the aforementioned EU funds. In addition, significant allocations for the reconstruction of public infrastructure in the areas affected by the Zagreb and Petrinja earthquakes have been projected. This category also includes the funds spent on the purchase of multi-purpose fighter jets and other military equipment for the purpose of further strengthening the international position of the Republic of Croatia, protecting airspace and increasing the overall combat capability of the Croatian Army.

Net Lending/Borrowing

In accordance with the projected trends in revenues and expenditures of the general government budget, a deficit of 1.6% of GDP is expected in 2023 and 2024, and a deficit of 1.2% of GDP in 2025.

3.5. Stock and Projection of Trends of Public Debt and Stock of Guarantees

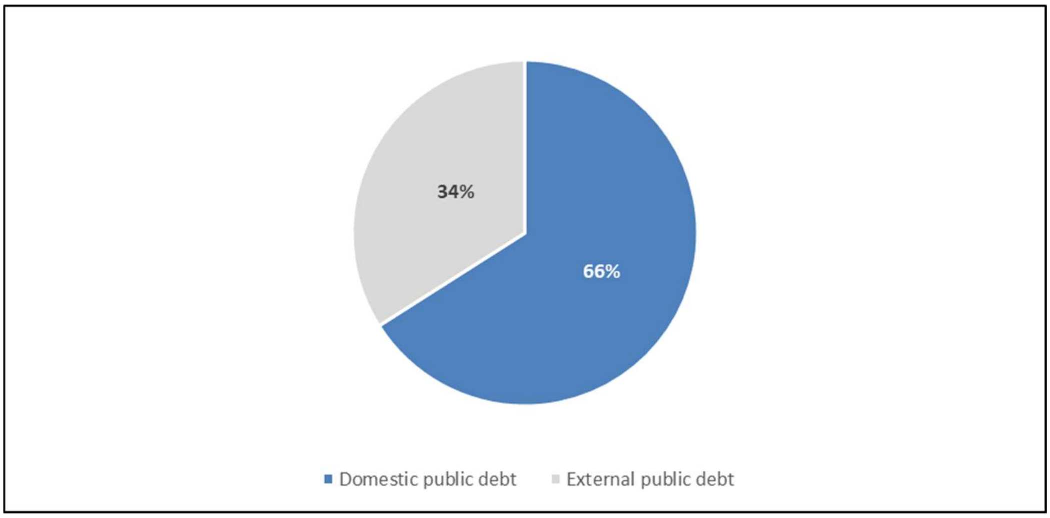
Stock of Public Debt and Guarantees

According to the data of the Croatian National Bank, at the end of 2021, public debt amounted to HRK 343.6 billion, or 79.8% of GDP. At the same time, the public debt-to-GDP ratio decreased by 7.5 percentage points compared to the previous year. This positive trends in public debt, after the historically high increase in the public debt-to-GDP ratio in 2020 of 16.2 percentage points, is due to the growth of the economic activity and a strong recovery of the entire Croatian economy after the crisis caused by the coronavirus pandemic. In 2021, nominal public debt, compared to 2020, is higher by HRK 13.2 billion. This increase in public debt is primarily due to the general government budget deficit and the consequent need for financing it, which in 2021 amounted to HRK 12.4 billion. The difference in nominal public debt in 2021 compared to 2020 is also affected by the appreciation of the kuna against the euro and, to a lesser extent, the depreciation of the kuna against the dollar. The exchange rate of the kuna against the euro was 7.5172 on 31 December 2021, while on 31 December 2020 the exchange rate was 7.5369, which is an appreciation of 0.26%. The exchange rate of the kuna against the dollar was 6.6435 on 31 December 2021, while on 31 December 2020 it was 6.1390, representing a depreciation of 8.22%. The change in the share of euro and dollar public debt in total public debt and the change in the exchange rate of the kuna against the euro and the dollar have a positive effect on nominal public debt in the amount of HRK 600 million. The rest of the change in nominal public debt in 2021 of HRK 1.3 billion relates to changes in the deposits of central government units resulting from higher borrowing in order to take advantage of favourable financial market conditions in the form of historically low interest rates and certain minor static deviations.

Regardless of the sharp decline in economic activity in 2020 and the continuing uncertainty in 2021, in an environment of high levels of liquidity and low interest rates, positive trends in borrowing in the domestic and international financial markets remain. The entry of the Republic of Croatia into ERM II, as well as the expected entry into the euro area in 2023, also contributed to this positive trend. In 2021, three primary bond issuances were realized, one on the domestic and two on the foreign financial market. Historically low levels of interest rates and maturities at which the Republic of Croatia borrowed were achieved on these bond issuances, which is an indicator of the confidence of domestic and international investors in the fiscal and economic policy of the Republic of Croatia. The Republic of Croatia issued two bonds with historically low interest rates and maturities on the foreign bond market, whereby the 12-year bond has a coupon interest rate of 1.125%, while the 20-year bond has a coupon interest rate of 1.750%.

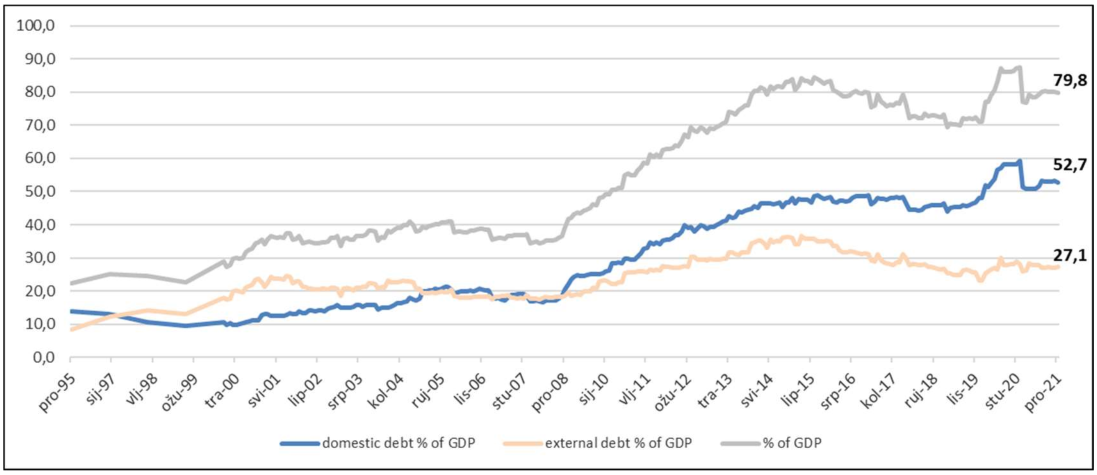
The domestic component of public debt increased by 1.1% compared to 2020, and it amounts to HRK 226.8 billion, thus accounting for 66% of total public debt, while the foreign component increased by 10.1% and it amounts to HRK 116.9 billion, or 34% of total public debt.

Chart 3.1. Share of domestic and external general government public debt, December 31, 2021



Source: Ministry of Finance

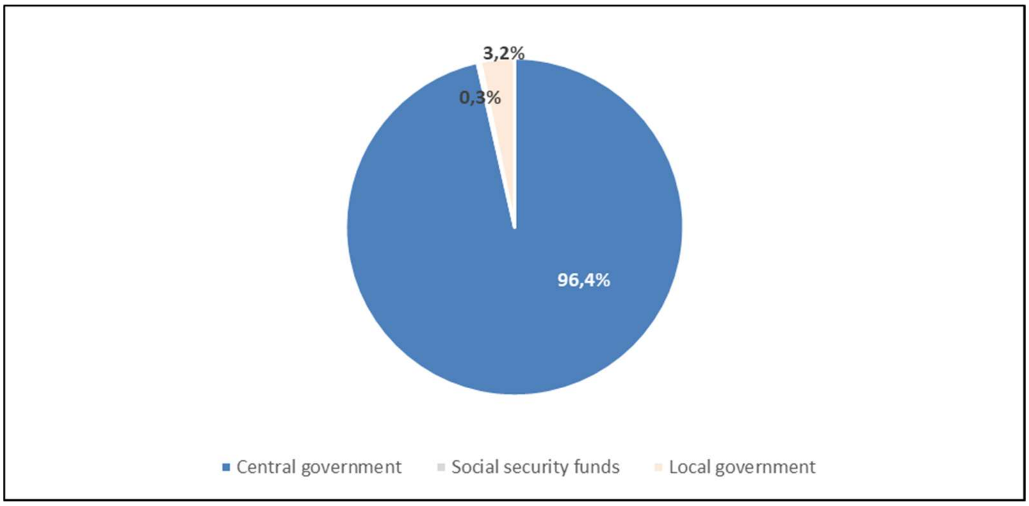
Chart 3.2. Trends in the public debt-to-GDP ratio



Source: Ministry of Finance

As observed by the levels of government, the majority of public debt relates to the central government sector in the amount of HRK 331.4 billion, while the remaining debt of HRK 11.2 billion relates to the local government sector, and HRK 1.1 billion to the debt of social security funds.

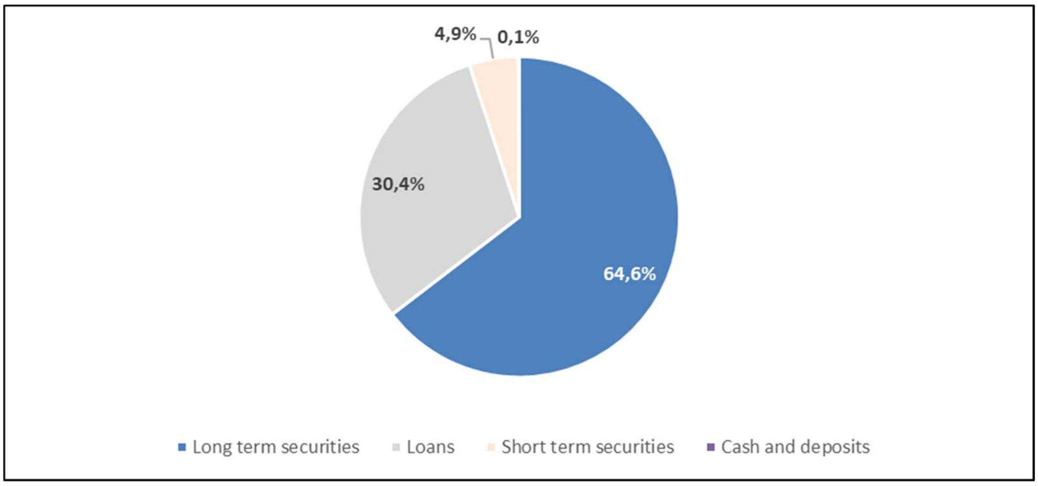
Chart 3.3. Public debt according to government levels, December 31, 2021



Source: Ministry of Finance

In terms of borrowing instruments, the largest part of public debt arose from borrowing through long-term securities, i.e. bonds (64.6%), followed by loans (30.4%) and short-term securities (4.9%).

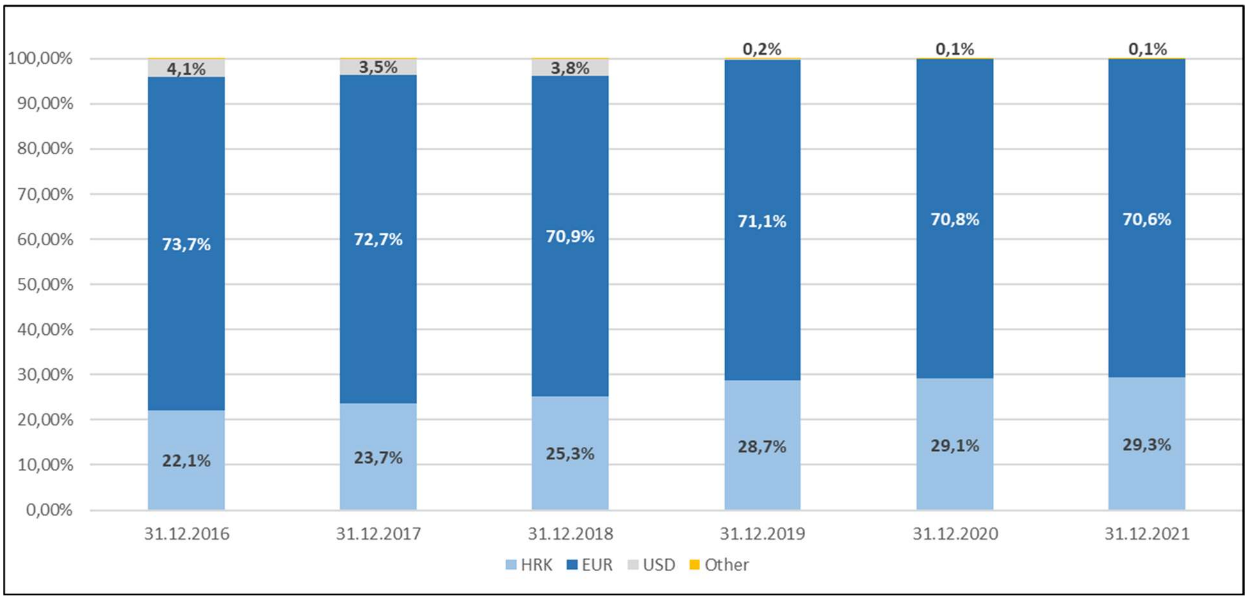
Chart 3.4. Public debt according to borrowing instruments, December 31, 2021



Source: Ministry of Finance

The currency structure of public debt shows that a significant part of the debt is denominated in a foreign currency, whereby the debt denominated in EUR accounts for 70.6% of public debt, the debt denominated in HRK for 29.3%, and the debt denominated in USD for 0.06% of the total public debt. An insignificant part of the public debt of 0.04% is denominated in other foreign currencies. In 2021, the share of public debt denominated in EUR decreased by 0.23 percentage points compared to 2020. The decrease in the euro share of public debt is the result of a greater orientation to the borrowing on the domestic market. Borrowing in domestic currency on the domestic bond market consequently reduced the exposure of public debt to exchange rate risk, which has a positive effect on the overall public debt.

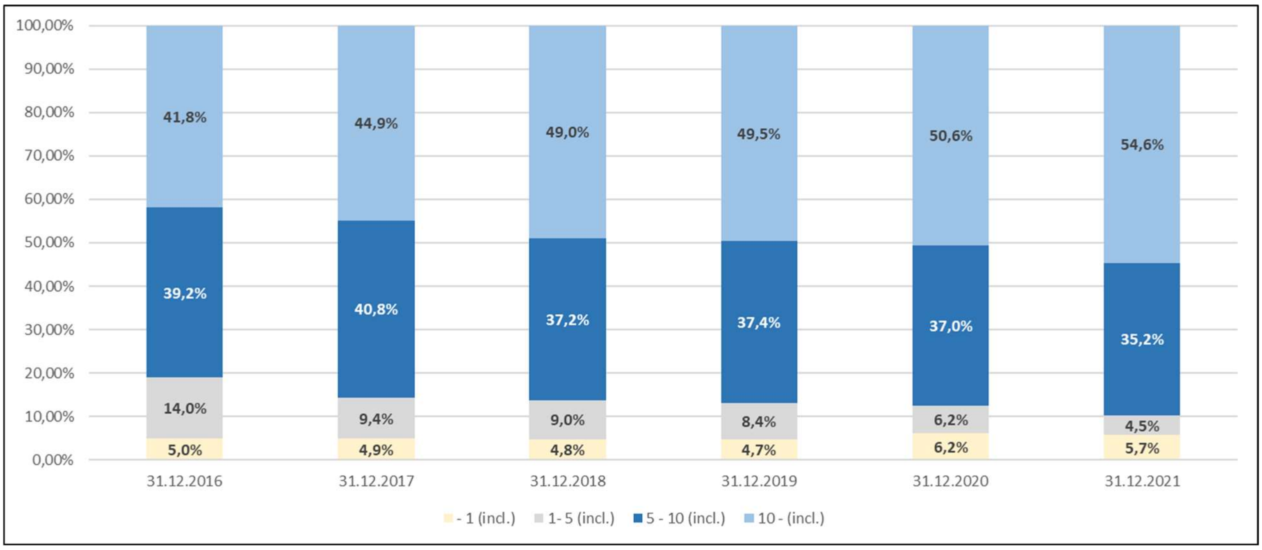
Chart 3.5. Currency Structure of Public Debt 2016 – 2021



Source: Ministry of Finance

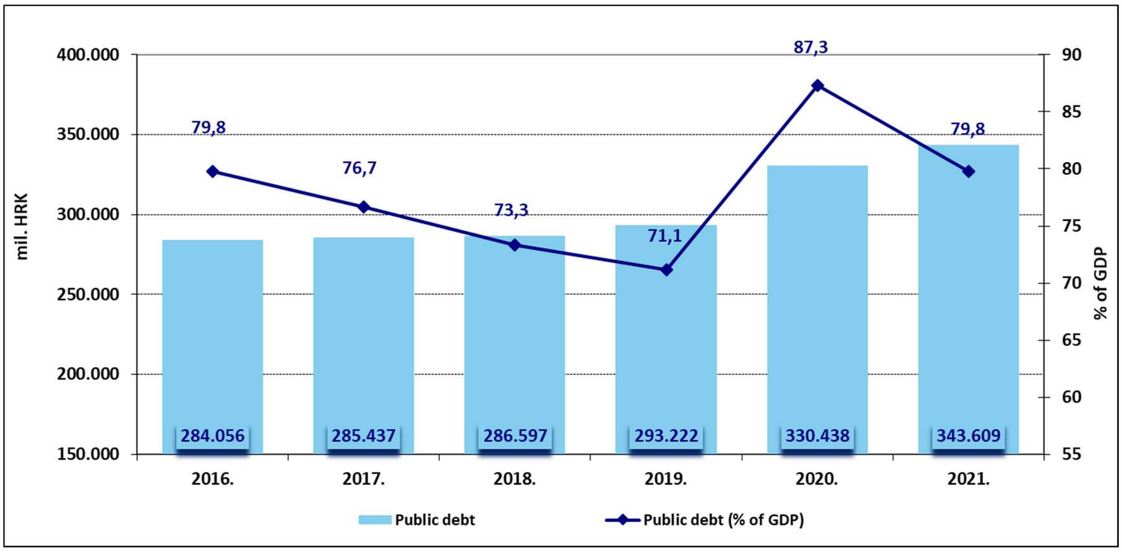
The maturity structure of public debt shows that at the end of 2021, the share of public debt with the maturity of up to 1 year amounted to 5.7% of total debt. The share of public debt with a maturity of 1 to 5 years amounted to 4.5%, while the share of debt with the maturity of 5 to 10 years amounted to 35.2%. The debt with the maturity of over 10 years accounted for 54.6% of total public debt. The debt with the maturity of over 10 years was by 4.1 percentage points higher in 2021 than in 2020, by which the negative exposure to interest rate risk was reduced and the advantage was taken of the favourable situation on financial markets in the form of historically low interest rates which the Republic of Croatia borrowed at with long maturity.

Chart 3.6. Maturity Structure of Public Debt 2016 - 2021



Source: Ministry of Finance

Chart 3.7. Public Debt Trends 2016 - 2021



Source: HNB, CBS

At the end of 2021, the total guarantees issued by the Republic of Croatia amounted to HRK 8.3 billion, i.e. 1.9% of GDP, and compared to the end of 2020, they increased by HRK 2 billion.

During 2020 and 2021, the Government of the Republic of Croatia adopted the decisions on guarantee programmes due to the coronavirus pandemic, within which guarantees for loans to entrepreneurs in the field of culture and creative industries and in the maritime, transport and transport infrastructure sectors and related activities, are granted in the form of state aid measures to the economy. These guarantee programmes are financed from the state budget, and in order not to constitute impermissible state aid, the programmes have been approved by the EC. Implementing bodies approving state guarantees from these programmes, the Croatian Agency for SMEs, Innovations and Investments - HAMAG-BICRO and the Croatian Bank for Reconstruction and Development (HBOR), are obliged to report on the implementation of the programme to the guarantee programme holders and the Ministry of Finance.

Table 3.4. National guarantees within COVID-19 crisis

		Date of adoption	**Maximum amount of contingent liabilities**[1] (% of GDP)	**Estimated take-up** (% of GDP)
Measures in response to COVID-19	COVID-19 Programmes for the Portfolio Insurance of Liquidity Loans for Exporters and for the Individual Insurance Policy of Liquidity Loans for Exporters	4.2020.	0,97	0,47
	Working Capital COVID-19 Measure for SMEs in the Tourism Industry	4.2020.	0,01	0,01
	Working Capital COVID-19 Measure for Entrepreneurs in Wood Processing and Furniture Production Industry	6.2020.	n.a.	0,01
	State aid Scheme to support the maritime, transport, transport infrastructure and related sectors and related sectors impacted by the COVID-19 outbreak	7.2020.	0,23	0,05
	State aid Scheme to support tourism and sport sectors impacted by the COVID-19 outbreak	2.2021.	0,35	0,06
	Guarantees for loans in sectors culture and creative industries impacted by the COVID-19 outbreak	7.2020.	0,07	0,01
Total				**0,61**

Source: Ministry of Finance

Financing the General Government Budget and Projection of Trends in the Public Debt

The total level of required financing will be determined by the trends in the fiscal balance, financial assets and general government budget liabilities that fall due in the observed medium-term period. The needs for financing the total budget deficit and due liabilities will be settled on the domestic and foreign financial markets, while in terms of borrowing instruments the focus will be on instruments with longer maturities, primarily on bonds. Borrowing by loans will be primarily focused on the domestic financial market, while foreign financing by loans refers to project loans of international financial institutions, as well as the planned issue of bonds on the international capital market.

The majority of maturing state budget liabilities, in the period 2022-2025, refer to twelve maturities of bonds, of which eight are domestic and four foreign. Of the domestic bonds, three are denominated in EUR, amounting to 2.9 billion euros, while five bonds are denominated in HRK in the total amount of HRK 28.8 billion. Foreign maturities refer to four Eurobonds. The first Eurobond in the amount of EUR of 1.25 billion matures at the end of May this year, the second Eurobond in the amount of USD 1.5 billion matures in April 2023, the third one in the amount of USD 1.75 billion matures in January 2024, while the fourth one in the amount of EUR 1.5 billion euros matures in March 2025.

Table 3.5. Overview of the Bonds Maturity of the Republic of Croatia in the Period 2022 – 2025

Bonds	Date of issue	Currency	Amount (in million)	Interest rate	Maturity
Bonds issued on domestic market					
Series 17 D-22 RHMF-O-227E	22.07.2011	EUR	1.000	6,500%	22.07.2022
Series 19 D-24 RHMF-O-247E	10.07.2013	EUR	1.400	5,750%	10.07.2024
Series 20 D-25 RHMF-O-257A	09.07.2015	HRK	6.000	4,500%	09.07.2025
Series 23 D-22 RHMF-O-222A	07.02.2017	HRK	3.000	2,250%	07.02.2022
Series 26 D-23 RHMF-O-23BA	27.11.2017	HRK	11.300	1,750%	27.11.2023
Series 28 D-22 RHMF-O-222E	05.02.2019	EUR	500	0,500%	05.02.2022
Series 29 D-24 RHMF-O-24BA	27.11.2019	HRK	3.500	0,250%	27.11.2024
Series 32 D-25 RHMF-O-253A	03.03.2020	HRK	5.000	0,250%	03.03.2025
Bonds issued on external market					
Euro-USD bonds / V	04.04.2013	USD	1.500	5,500%	04.04.2023
Euro-USD bonds / VI	26.11.2013	USD	1.750	6,000%	26.01.2024
Euro-EUR bonds / IX	29.05.2014	EUR	1.250	3,875%	30.05.2022
Euro-EUR bonds / X	11.03.2015	EUR	1.500	3,000%	11.03.2025

Source: Ministry of Finance

On the loans side, most maturities in the observed period relate to the loans issued on the domestic financial market and to the loans from international financial institutions. Thus, the total maturities of state budget loans range from HRK 7.2 billion in 2022, HRK 6.4 billion in 2023, HRK 2.6 billion in 2024 and HRK 9.1 billion in 2025.

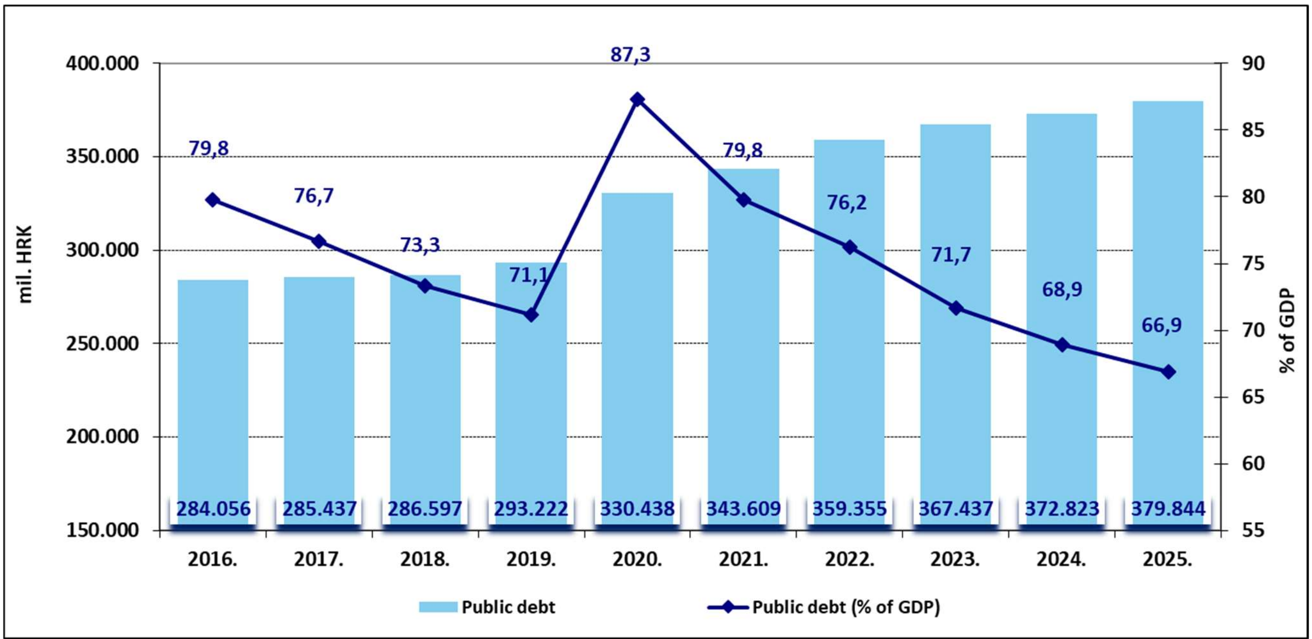
Table 3.6. Repayment of the principal of the debt paid directly from the state budget

Type of debt	Total balance of liabilities end of 2021	2022	2023	2024	2025
Treasury bills	23.984	23.984	0	0	0
Domestic bonds	121.526	14.276	11.300	14.024	11.000
External bonds	105.163	9.396	8.776	9.752	11.276
Loans (domestic market)	22.192	6.502	5.742	2.130	4.313
Loans (external market)	21.699	740	610	508	4.805
Total	**294.563**	**54.899**	**26.428**	**26.414**	**31.393**

Source: Ministry of Finance

Based on the trends in the fiscal balance of the general government budget, in 2022, the public debt-to-GDP ratio is expected to decrease by 3.6 percentage points and it will amount to 76.2% of GDP. Furthermore, in the medium term, the public debt-to-GDP ratio will continue to decline by an average of 3.1 percentage points per year, to 71.7% of GDP in 2023, 68.9% of GDP in 2024, while in 2025 it will amount to 66.9% of GDP.

Chart 3.8. Overview of Public Debt Trends 2016-2025



Source: Croatian Bureau of Statistics, HNB, Ministry of Finance

Table 3.7. Stock of general government debt according to sub-sectors 2021 – 2025

ESA 2010 methodology (in mil. HRK)	2021	2021 % of GDP	2022 % of GDP	2023 % of GDP	2024 % of GDP	2025 % of GDP
CONSOLIDATED DEBT OF GENERAL GOVERNMENT	**343.609**	**79,8**	**76,2**	**71,7**	**68,9**	**66,9**
Consolidated debt of Central Government	334.776	77,7	73,6	68,8	66,3	63,8
of which:						
HAC	17.020	4,0	3,4	2,9	2,5	2,2
HC	5.027	1,2	1,1	1,1	1,0	1,0
HV	1.024	0,2	0,2	0,2	0,3	0,3
HRT	250	0,1	0,1	0,1	0,1	0,1
HŽ INFRASTRUKTURA	1.155	0,3	0,3	0,4	0,4	0,4
HŽ PUTNIČKI PRIJEVOZ	552	0,1	0,2	0,2	0,2	0,2
HBOR	15.034	3,5	3,1	2,8	2,6	2,4
APN	1.038	0,2	0,2	0,2	0,2	0,2
LUČKE UPRAVE	1.667	0,4	0,4	0,3	0,3	0,3
JPP I KONCESIJE	6.476	1,5	1,4	1,3	1,2	1,1
Consolidated debt of Social Security Funds	9	0,0	0,0	0,1	0,2	0,4
Consolidated debt of Local Government	8.824	2,0	2,1	2,3	2,5	2,8

Source: Ministry of Finance

4. SENSITIVITY ANALYSIS AND COMPARISON WITH THE PREVIOUS PROGRAMME

4.1. Fiscal Risks and Public Debt Trend Sensitivity Analysis

Fiscal projections for the medium term are based on the macroeconomic assumptions presented in this document. Risks associated with a lower level of economic activity compared to the presented macroeconomic scenario would have significant implications on expected trends and results of fiscal variables, especially tax revenues and social contributions revenues in the coming period, which would have a direct impact on general government budget balances.

The pension system of the Republic of Croatia is facing very unfavourable demographic trends, which are primarily related to the aging population and the decrease in the number of inhabitants in younger age groups. The continuation of such trends would create additional pressure on the generational solidarity system, which could have a negative impact on the long-term sustainability of public finances. Furthermore, the stock of outstanding liabilities in the healthcare system represents an additional fiscal risk that needs to be addressed by implementing structural measures aimed at the financial sustainability of the entire healthcare system.

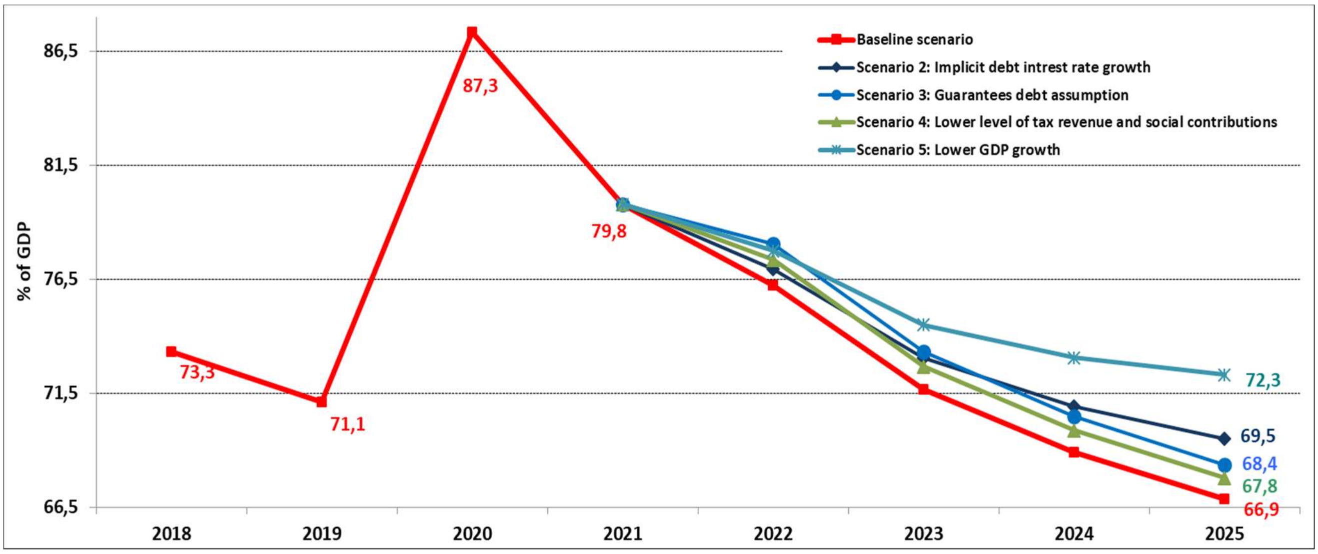
Public debt was reduced by 12.2 percentage points between 2015 and 2019, but due to the unprecedented crisis caused by the coronavirus pandemic that led to high borrowing needs, in 2020, public debt increased by high 16.2 percentage points compared to the previous year. However, a strong recovery in the economic activity in 2021 led to a reduction in public debt by high 7.5 percentage points. The high level of public debt of HRK 343.6 billion is a significant source of vulnerability for the Croatian economy. Given the level of debt, a long-term increase in reference market interest rates would pose a significant threat to fiscal sustainability. An increase in the cost of financing would lead to high debt service costs, which would also put pressure on the financing of other government needs. Thus, in the scenario of increasing the implicit interest rate on debt by 1 percentage point in the period 2022-2025, public debt would register an increase of above the projected one, and at the end of the projection period it would be by 2.6 percentage points higher than in the baseline scenario, i.e. it would reach the level of 69.5% of GDP.

Although the Republic of Croatia is at the bottom in terms of the level of contingent liabilities compared to other EU member states, such liabilities still pose a potentially high risk to public finances. Thus, under the suggested scenario of taking over all guarantees in the public debt, which, in 2021, amounted to 1.9% of GDP, public debt would reach the level of 78.1% of GDP in 2022, i.e. public debt would be higher by 1 .8 percentage points compared to the initial scenario, while the nominal increase in public debt would amount to HRK 8.6 billion.

Lower tax revenues and contribution revenues would lead to a larger general government budget deficit and consequently increased borrowing needs. From the conducted sensitivity test, in case the realization of tax revenues and contributions is 3% less than projected by the Programme, the public debt would amount to 77.3% of GDP in 2022, and would record an increase of 1.1 percentage points compared to the initial projection.

In the scenario when in the projection period the real GDP growth rate would be 2 percentage points lower than projected by the Programme, the realized nominal GDP would be lower by HRK 42.8 billion at the end of the projection period, while in 2025, the public debt-to-GDP ratio would amount to 72.3%, or 5.4 percentage points more than initially projected.

Chart 4.1. Trends in public debt-to-GDP ratio according to Specific Scenarios



Source: Ministry of Finance

4.2. Comparison with the Previous Programme

The comparison of total general government budget revenues, expenditures and deficit in the new Convergence Programme and the previous one shows some differences, which primarily arise from different levels of nominal and real gross domestic product, as well as from different budgetary trends on both the revenue and expenditure side in relation to the previously expected.

The Convergence Programme for the period 2022-2024 was based on the assumption of real gross domestic product growth of 5.2% in 2021 and real GDP growth of 6.6% in 2022. In 2021, the realized real GDP growth was 10.2%, which is a better result than previously projected by 5.1 percentage points. The planned GDP growth for 2022 is 3.02%, which is by 3.5 percentage points lower than projected in the previous Programme.

Furthermore, in 2021, the revenues and the expenditures of the general government sector were lower by 0.7% and 2%, respectively, than originally planned. Such trends affected the general government budget deficit by 1 percentage point. In 2022, the new general government sector revenue projections are by 0.5% higher than last year's Programme. At the same time, the expenditures are by 1.3% higher than in the previous Programme. Such trends lead to a bigger general government budget deficit in 2022 than planned by the previous Programme, by 0.2 percentage points.

Table 4.1: Comparison of Revenue, Expenditure and Net Lending/Borrowing of the General Government

	ESA Code	2021	2022	2023	2024	2025
Real GDP growth (%)						
Previous update		5,2	6,6	4,1	3,4	n.a.
Current update		10,2	3,0	4,4	2,7	2,5
Difference		5,1	-3,5	0,3	-0,6	n.a.
General government net lending (% of GDP)	B.9					
Previous update		-3,8	-2,6	-1,9	-1,5	n.a.
Current update		-2,9	-2,8	-1,6	-1,6	-1,2
Difference		1,0	-0,2	0,4	-0,04	n.a.
General government gross debt (% of GDP)						
Previous update		86,6	82,5	79,5	76,8	n.a.
Current update		79,8	76,2	71,7	68,9	66,9
Difference		-6,8	-6,3	-7,9	-7,9	n.a.

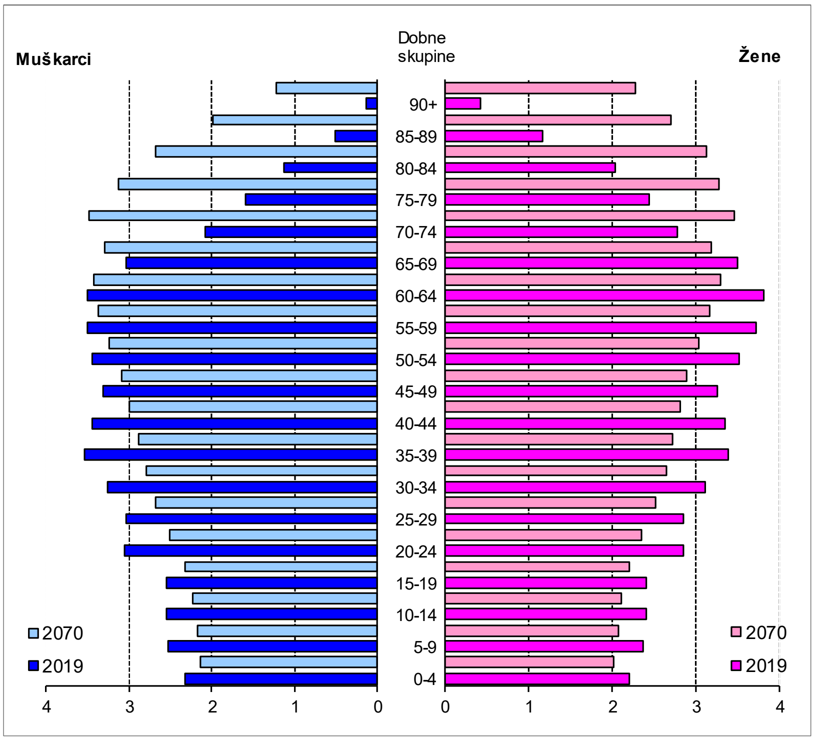
Source: Ministry of Finance

5. SUSTAINABILITY OF PUBLIC FINANCES

Aging is one of the biggest social, economic and health challenges of the 21st century, especially in Europe, which is the continent with the largest share of people over the age of 65 in the total population (15%)[9]. Like most European countries, the Republic of Croatia belongs to countries with a very old population. The share of the elderly population became higher than 10% as early as in 1971, and the trend of progressive aging continued.

The European Commission's Aging Report 2021[10] indicates the continuation of negative demographic trends (Chart 5.1). Thus, in the period 2019-2070, the population of the Republic of Croatia is projected to decrease from 4.1 to 3.0 million. The working-age population group (15 – 64 cohort) will decrease significantly, and at the same time the population group of above the age of 65 (65+ cohort) will increase, or the number of people above the age of 75 and the number of 100-year-olds will increase.

Chart 5.1. Age-Sex Pyramid of Population of the Republic of Croatia as the share in total population



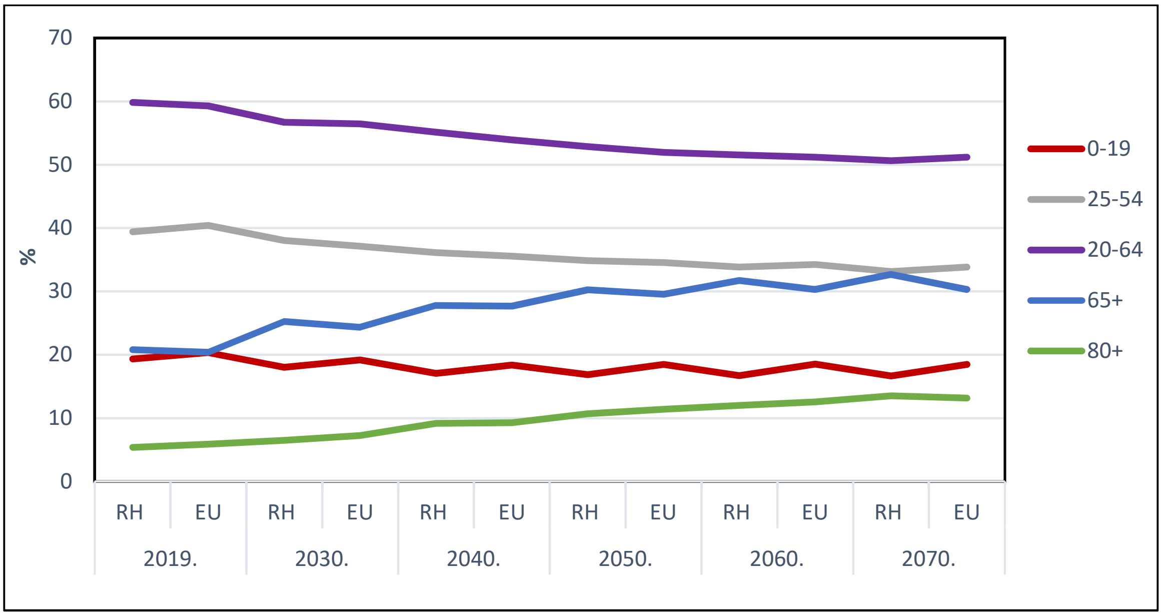
Source: European Commission

As it can be seen in Chart 5.2, in the period 2019-2070, the share of the population in both the Republic of Croatia and the EU in the younger and moderately active population is expected to decrease, while the age groups 65+ and 80+ are projected to increase.

[9] *In most developed countries, the chronological age of 65 is accepted as the age limit in the definition of the elderly.*

[10] https://ec.europa.eu/info/publications/2021-ageing-report-economic-and-budgetary-projections-eu-member-states-2019-2070_en

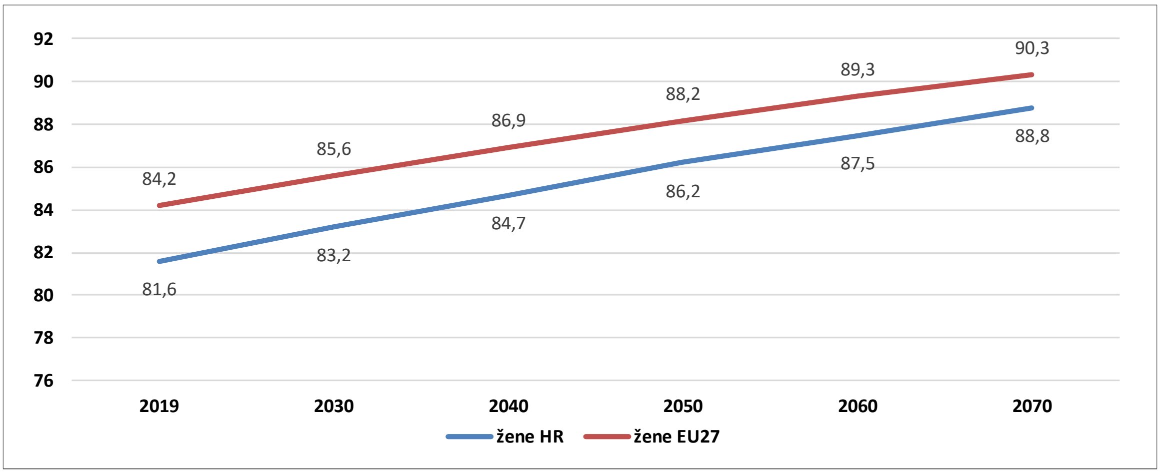
Chart 5.2: Trends in Number of Residents per Age Groups, Republic of Croatia and EU



Source: European Commission

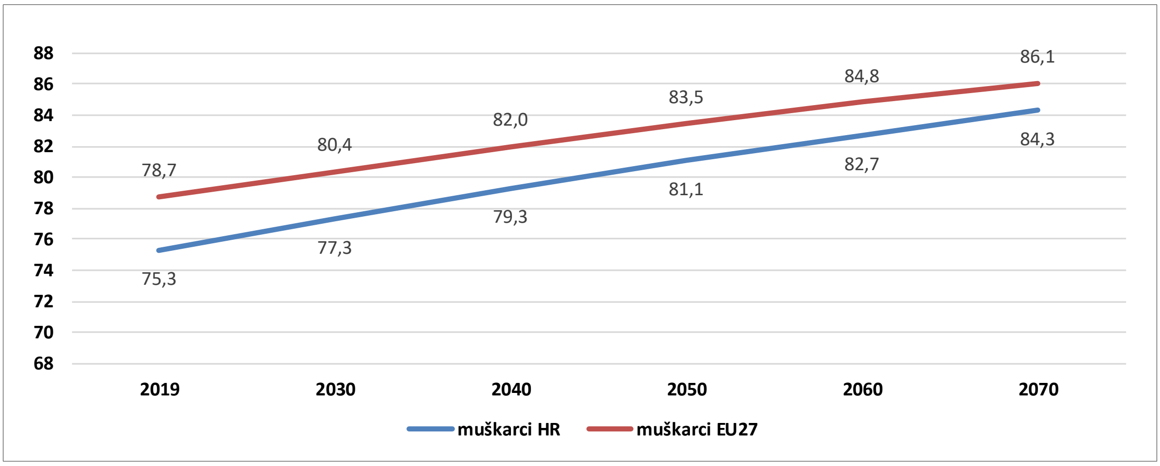
With the decrease in the number of inhabitants, the Republic of Croatia continues to follow the European trend of increasing life expectancy. In 2019, life expectancy at birth was 81.6 years for women and 75.3 years for men. This is less than the EU average, where life expectancy at birth was 84.2 years for women and 78.7 years for men. However, the data for the Republic of Croatia indicate a tendency of the increase in life expectancy by 2070 by 9.0 years for men and 7.2 years for women, while in the EU the increase in the age for men is expected by 7.4 years and 6.1 years for women..

Chart 5.3: Life Expectancy at Birth, women



Source: European Commission

Chart 5.4: Life Expectancy at Birth, men



Source: European Commission

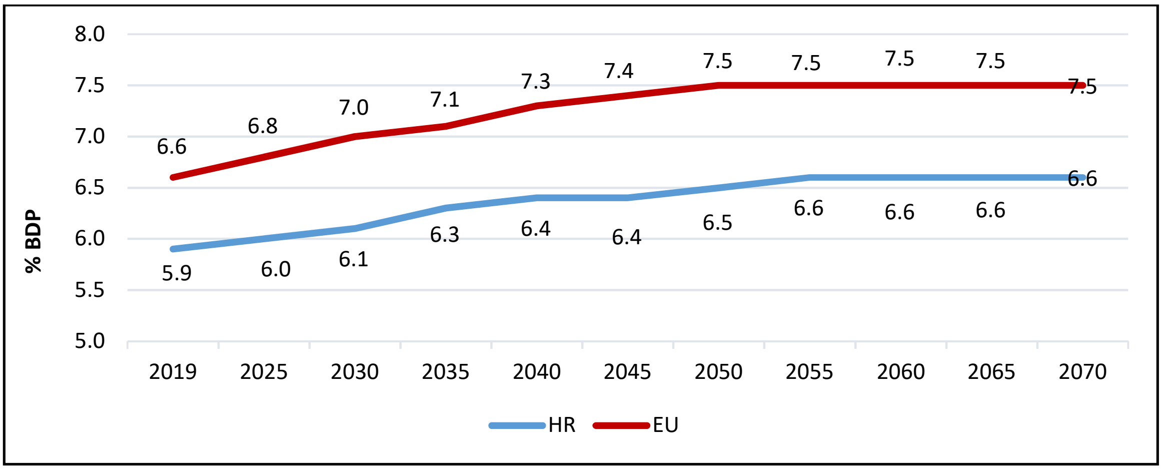
By comparing the EU and the Republic of Croatia in the period 2019-2070, the remaining life expectancy at the age of 65 will be extended for both women and men, thus creating strong pressure on the sustainability of public finances, including the system of generational solidarity.

Healthcare System and Social Welfare

The growth of public spending on healthcare is determined by the aging population and innovations in healthcare technologies, as well as by the COVID-19 pandemic. This area represents a challenge in conducting the country's public policies because it seeks to guarantee the access to quality care, but also to ensure long-term fiscal sustainability.

According to the Aging Report 2021, in 2019 total healthcare expenditure in the Republic of Croatia amounted to 5.9% of GDP, which is by 0.7 percentage points lower than the EU average. It is projected to amount to 6.6% of GDP by 2070, while in the EU it will be at the level of 7.5% of GDP.

Chart 5.5: Spending for Healthcare (as % of GDP)



Source: European Commission

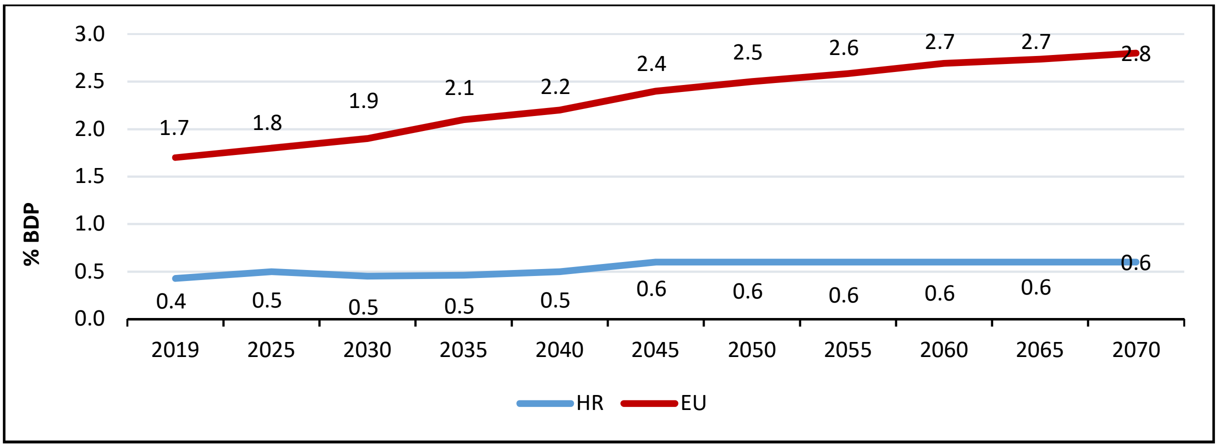
A number of reforms will be implemented to address these challenges and strengthen the resilience and sustainability of the healthcare system. By rationalising the hospital system, the healthcare will be improved and the overspending reduced. The functional integration of hospitals will continue, by strengthening outpatient clinics that provide modern, economical and multidisciplinary treatment which significantly improves the quality of healthcare, and by reducing acute inpatient capacity in hospitals as the most financially expensive form of treatment, which will contribute to financial stabilization, rationalisation and sustainability of the healthcare system. The re-categorization of hospital-healthcare institutions will set a transparent scale of excellence in the healthcare system. Special emphasis will be placed on strengthening human resources and improving working conditions in the healthcare system, with the lifelong development of professional competencies.

The improvement of the system of joint public procurement of medicines and hospital consumables, and other procurement categories, with the application of the system of central preparation of parenteral medicines and the use of digital monitoring of medicines, will achieve significant savings in the consumption of medicines in hospitals. The public healthcare system will be strengthened, as well as the system of preventive medicine and the role of the network of public health institutes, with special emphasis on the prevention and early diagnosis of chronic non-communicable diseases that account for the largest part of mortality and morbidity, but also the healthcare security through a well-organized epidemiological service. Digital platforms, registers and databases for collecting and monitoring public health data will be improved.

The investments envisaged within the National Recovery and Resilience Plan will improve the emergency medical care system and ensure the raising of the necessary competencies for independent work of teams without doctors, as well as ensure equal distribution of health workers through central funding of primary care and public health specializations. The foundation of the healthcare system remains primary healthcare, which will be strengthened by investments for the most successful preventive action, expansion of curative services and raising the quality of care through continuous education.

In 2019, public spending in the Republic of Croatia on long-term care amounted to 0.4% of GDP, while at the EU level it amounted to 1.7% of GDP. It is projected to increase minimally to 0.6% of GDP by 2070, while at EU level it will amount to 2.8% of GDP.

Chart 5.6: Spending for Long-Term Care (as % of GDP)



Source: European Commission

In order to reduce the risk of poverty and social exclusion, special attention will be paid to the development and availability of social services for particularly vulnerable groups, as well as to the implementation of employment measures and the promotion of lifelong learning to adapt to labour market needs.

The consolidation of social benefits in the social welfare system is planned to be carried out by merging the existing social benefits aimed at mitigating the consequences of poverty into one benefit. The existing social benefits intended for the protection of persons with disabilities will be consolidated in the same way. This will enable more efficient use of public funds, reduction of inequalities, greater transparency, as well as administrative relief of the system.

For the purpose of the efficient use of funds for social benefits, mutual exchange of data on social benefits between the national and local level will be enabled. This will be achieved through the development of the IT social protection system through the exchange of data on social benefits at the national and local level, as well as by developing a web application that combines social benefits and conditions for the realization thereof in the social protection system. In addition, measures will be implemented in order to increase the inclusion of working-age beneficiaries of guaranteed minimum benefit into the labour market.

A social mentoring service will also be developed for users of guaranteed minimum benefits and hard-to-employ groups of beneficiaries with the aim of returning to or entering the labour market, i.e. strengthening social and life skills and social integration. Further development of sufficient and accessible services in the community aimed at supporting individuals and families (counselling and assistance, psychosocial support, early intervention, assistance in the inclusion in education programmes, assisted living, daily stay, and community based supported housing), standardization, improvement and implementation of measures of family-legal protection and ensuring the sustainability thereof, will prevent the entry of new beneficiaries into the institution and enable further process of deinstitutionalization. The improvement of the availability of integrated comprehensive care for the elderly will continue by improving the infrastructure through the construction and equipping of centres for the elderly.

Pension System

The increase in life expectancy, with unfavourable expectations of natural increase and net migration, as well as the growth of the share of older people in the total population, has a negative impact on costs in the pension system.

Tables 5.1. and 5.2. show long-term projections of revenues and expenditures in the pension system based on EC projections prepared for the needs of the Aging Report 2021, and supplemented in accordance with the realized revenues and expenditures for pensions in 2021 and the GDP estimate for 2021.

The results of long-term projections for the Republic of Croatia for the period 2021-2070 show that expenditures for first pillar pensions should be gradually reduced from 10.1% of GDP in 2021 to 9.5% of GDP in 2070.

Given that in the projected period the share of pension insurance contributions paid in the first pillar is expected to gradually increase from 5.9% in 2021 to 7.1% by 2030, followed by a stable share until 2070, the transfers from the state budget for covering the deficit will be gradually decrease from the current 4.2% to about 2.4% of GDP by 2070. The expenditures for pensions from the second pillar should increase gradually to 0.4% by 2070, which means that total expenditure for the first and the second pillar pensions would decrease from 10.1% in 2021 to 9.8% of GDP in 2070.

Table 5.1: Expenditures for Pensions and Pension Contributions in the Period 2021-2070 (as % of GDP)

Pension expenditure	2021.*	2030	2040	2050	2060	2070
Expenditures of first pension pillar	10.1	11.0	10.4	9.9	9.7	9.5
Expenditures of second pension pillar	0.0	0.2	0.3	0.3	0.3	0.4
Total pension system expenditure	**10.1**	**11.1**	**10.7**	**10.2**	**10.0**	**9.8**
Pension insurance contributions	**2021.***	**2030**	**2040**	**2050**	**2060**	**2070**
Contributions paid into first pillar	5.9	7.1	7.2	7.1	7.1	7.1
Contributions paid into second pillar	1.7	1.7	1.7	1.8	1.8	1.8
Total paid contributions	**7.6**	**8.9**	**9.0**	**9.0**	**8.9**	**8.9**

**Note: Data for 2021 are presented in accordance with the realized revenues and expenditures for pensions in the State Budget of the Republic of Croatia for 2021 and the estimate of GDP for 2021 published by the Croatian Bureau of Statistics, while the GDP growth rates from the Ageing Report 2021 were used for the period 2022-2070.*

Source: Ministry of Labour and Pension System

According to the projections of long-term trends in the pension system, a slight increase in the total number of insured persons can be expected in the next few years, primarily due to the expected growth in employment. In the long-term period, the impact of more unfavourable demographic trends and a reduced number of population in the younger age groups will prevail, which will cause a gradual decline in the total number of insured persons.

On the other hand, there are important factors that will reduce the expenses of the pension system in the future. Given the functioning of the mandatory second pillar pension since 2002, as of 2030 the number of pensioners who will receive a basic pension from the first pillar and a pension from the second pillar will increase significantly. This means that expenditures for pensions paid from the first pillar will gradually decrease. The pensions realized from the first and the second pension pillars were lower than pensions realized only from the first pension pillar with a pension supplement, and therefore the 2019 pension reform, among other things, introduced a pension supplement for first-pillar insured persons who are compulsorily insured in the second pension pillar as well. This reduces the difference in the amount of pension for beneficiaries from both mandatory pension pillars in relation to the pensions realized only in the first pillar, and, thus, it affects the adequacy of their pensions.

The key measure for the improvement of the efficiency of the pension system is the stimulation of longer years in service, which has been achieved by expanding the circle of beneficiaries who can work and receive a pension, and by equalizing the age for early retirement for women and men to 60 years and 65 years, respectively, as of 2030.

Table 5.2 shows the projected values of expenditures for certain types of pensions, according to which a slight increase in expenditures for statutory-age and early-age retirement pensions is expected by 2030, followed by their reduction due to a significant share of pension disbursements from the second pension pillar. The gradual reduction of the share of pension expenditures in GDP is also influenced by the valorisation and adjustment (indexation) of pensions from the first pillar to the growth of wages and consumer prices in the ratio of 70:30.

A significant reduction in the number of disability-pension beneficiaries is projected by 2070, which is the result of stricter criteria for exercising the right to a disability pension. The large share of disability pensions is a consequence of less strict criteria for acquiring disability pensions in the previous period, as well as of a relatively large number of disability pensions received by Homeland War veterans. Since 2015, disability pensions have been translated into statutory-age pensions when a beneficiary reaches the age for receiving a statutory-age pension, resulting in a decline in expenditures for disability pensions and in an increase in the expenditures for statutory-age pensions in relation to the previous period. The share of expenditure for family pensions will also gradually decrease, primarily due to demographic trends and the increase in the female employment rate.

Table 5.2.: Expenditures from the 1st Pension Pillar in the Period 2021-2070 (% of GDP)

Pension types	2021.*	2030	2040	2050	2060	2070
Expenditures of first pension pillar	**10.1**	**11.0**	**10.4**	**9.9**	**9.7**	**9.5**
Old age and early retirement pensions	6.8	7.9	7.7	7.5	7.5	7.4
Disability pensions	1.7	1.4	1.1	0.8	0.7	0.7
Family pensions	1.6	1.7	1.6	1.5	1.5	1.4

**Note: Data for 2021 are presented in accordance with the realized revenues and expenditures for pensions in the State Budget of the Republic of Croatia for 2021 and the estimate of GDP for 2021 published by the Croatian Bureau of Statistics, while the GDP growth rates from the Ageing Report 2021 were used for the period 2022-2070.*

Source: Ministry of Labour and Pension System

6. QUALITY OF PUBLIC FINANCES

6.1. Strategic Framework

During 2022, the Government of the Republic of Croatia planned to continue rehabilitating the health and socio-economic consequences of the coronavirus pandemic and to intensify the reconstruction of the earthquake-affected areas of Zagreb, Petrinja and its surroundings. However, new challenges have emerged in the form of geopolitical realignments, continued supply chain disruptions, financial market instabilities, all in the context of growing inflationary pressures, resulting in strong challenges in economic policy-making.

Thus, on the revenue side, measures will be implemented aimed at fair and efficient collection of public revenues, cooperation of the Tax Administration with citizens and entrepreneurs, and the development of a simpler and more socially just tax system that successfully adapts to changing market circumstances.

On the expenditure side, efforts will be made to continuously improve the budgetary framework and medium-term projections, and to allocate limited budget funds effectively, which will contribute to the sustainable fiscal consolidation. Great attention will be paid to quality public investments that strengthen potential growth, especially through projects financed by the Next Generation EU and the structural funds.

6.2. Measures on the Revenue Side of the Budget

Changes in the Taxation by Value-Added Tax

The Act on the Amendments to the Value Added Tax Act[11] entered into force on April 1, 2022, and it prescribes a reduction in the VAT rate from 25% to 5% and 13% for certain goods and services. Thus, the VAT on baby food, edible oils and fats, butter and margarine, live animals, fresh meat and sausages, live and fresh fish, crabs, vegetables, fruits, eggs and seeds, fertilizers and pesticides, animal feed, but also tickets for concerts, sports and cultural events is reduced to 5%.

The application of a reduced VAT rate of 13% for the delivery of natural gas and heating from heating stations, firewood, pellets, briquettes and wood chips, and menstrual supplies is being permanently expanded. In addition, in the period from April 1, 2022 to March 31, 2023, gas supplies will be charged at a VAT rate of 5%.

Changes in the Tax Treatment of Excise Duties

[11] Official Gazette, number 39/2022

The Government of the Republic of Croatia adopted the Regulation amending the Regulation on excise duty on energy products and electricity, which reduces the amount of excise duty by 40 lipa per litre of unleaded motor gasoline and by 20 lipa per litre of diesel fuel for a period of 90 days. The Regulation on determining the highest retail prices of petroleum products was also adopted, which determined the premiums of energy entities for motor gasoline and diesel fuels in the amount of HRK 0.75/l and blue diesel in the amount of HRK 0.5/l for a period of 90 days. The highest retail prices prescribed by this Regulation therefore apply only to petroleum products without added multifunctional additives (eurosuper 95, eurodiesel, blue diesel), while in terms of petrol with more octane and all so-called "premium" fuels, the prices can still be formed freely.

6.3. Measures to Improve the Efficiency of Budget Expenditures

More Efficient System of Financial and Statistical Reporting

The state budget, budgets of local and regional self-government units, and budgetary and extra-budgetary users determined by the Register of Budgetary and Extra-Budgetary Users are obliged to submit financial statements in accordance with the Budget Act and the Ordinance on Financial Reporting in Budget Accounting.

The financial statements of entities obliged to implement budget accounting used to be submitted to the Financial Agency (hereinafter referred to as: FINA), as the institution authorized to collect and process the data from the financial statements, along with the annual financial statements until 2021.

Given the need for the direct access to the data from financial statements, especially in the context of increasingly complex requirements by EUROSTAT (EU statistical authority) and other institutions at the EU level, in 2018 the project "More efficient system of financial and statistical reporting" was launched, within which a new application - Financial Reporting in the Budget System and the Register of Budgetary and Extra-budgetary Users, was developed. It supports the collection and processing of financial statements of entities obliged to implement budget accounting, and the management of the data from the Register of Budgetary and Extra-budgetary Users. As a result, FINA's IT support system has been replaced by a new web application from the Ministry of Finance.

The application was launched in early March 2022, and the first financial statements through the new application were collected for the first reporting period in 2022, i.e. for the period from January 1 to March 31, 2022. Financial statements are submitted on the forms in the MS Excel format that is uploaded directly into the application.

An important part of the application is the Register of Budgetary and Extra-budgetary users, which contains a list of all budgets, budgetary and extra-budgetary users that are also obliged to submit financial statements, along with their key data. Within the new application, local and regional self-government units, budgetary and extra-budgetary users will be provided with a direct overview of the data from the Register. In addition, all activities related to the Register (entry of a new user, changes in the data and the deletion of users from the Register) will take place through the application in the form of forms prescribed by the relevant Ordinance, but without the use of paper forms.

Given the number of extra-budgetary users of the state budget of the first group[12], that are organizationally outside the budget, there was a need to modernize and harmonize the way of preparing financial plans and reports on the implementation thereof, and consequently to improve financial planning and allocation of public funds. The final testing of the application solution for financial planning of extra-budgetary users is underway, and the first use of the application is expected during the preparation of the semi-annual execution of financial plans of extra-budgetary users for 2022.

In addition, a platform for open budget data of local and regional self-government units is being established, which would enable the implementation and the establishment of a system for input, acceptance and public disclosure of budget data (budget plans and executions, records of documents and all payments) in all local and regional self-government units. This activity is carried out as part of the implementation of reform measures contained in the National Recovery and Resilience Plan. The first draft of technical specifications has been prepared and by the end of 2022 the building and testing of the system is planned in cooperation with the Central State Office for Digital Society Development and APIS IT d.o.o., and then by the end of 2023 the implementation of the system in all local and regional self-government units.

The implementation of the project "Strengthening the fiscal responsibility and internal control system", funded by the Operational Programme Effective Human Resources, is underway, and it aims to establish a new information system for collecting and processing the data from the Statement on Fiscal Responsibility. The new information system will ensure, among other things, filling in the Questionnaire and submitting the Statements and prescribed attachments to the central database, creating and storing Statements on Fiscal Responsibility in an electronic format, monitoring trends over the years, and faster and better analysis and processing of received data, as well as updating the Government of the Republic of Croatia. In 2022, it is planned, based on the prepared technical and functional specifications for the development of the IT system, to conduct an open public procurement procedure, conclude a contract with the selected supplier and start with business analysis and establishment of the information system. By May 2023, it is planned that the information system will be established, functionally tested, and that a training programme for the entities obliged to submit the Statement on Fiscal Responsibility for the application of the IT system, will be implemented.

All these projects will enable more efficient management of business processes, greater transparency and, finally, greater efficiency of financial and statistical reporting.

Fiscal assessment of legal acts, other regulations and strategic planning acts

With the new Budget Act, and for the purpose of more efficient management of limited state budget funds, the current obligation to prepare a fiscal assessment of the consequences of legal acts, other

[12] Extra-budgetary users of the state budget of the first group are: Croatian Health Insurance Institute, Hrvatske vode, Hrvatske ceste d.o..o, Restructuring and Sale Centre, Environmental Protection and Energy Efficiency Fund, State Agency for Deposit Insurance and Bank Resolution, Croatian Motorways Ltd. (Hrvatske autoceste d.o.o.), Hrvatske željeznice Infrastruktura d.o.o. and HŽ Passenger Transport Limited Liability Company (Hrvatske željeznice Putnički prijevoz d.o.o.)

regulations and strategic planning acts adopted by the Croatian Government for the budget, has been extended to amendments and official interpretations of collective agreements. Budgetary users of the state budget that propose legal acts, before adopting the amendments to draft acts submitted to the Parliament, and which change the fiscal assessment in relation to the assessment given with the draft act, are obliged to submit a new fiscal assessment to the Ministry of Finance. Furthermore, the representatives of the Government in the body responsible for the interpretation of collective agreements, whose official interpretations change the fiscal assessment of the implementation of the collective agreement in relation to the fiscal assessment given before the conclusion on the acceptance of collective agreements, or its amendments, supplements or annexes, are obliged, before giving an official interpretation, to obtain from the competent budgetary user of the state budget, within the scope of which the collective agreement is, a new fiscal assessment that has to include the opinion of the Ministry of Finance.

In addition, budgetary users are obliged to make an assessment of the fiscal impact for ordinances and other regulations not adopted by the Government, which are adopted on the basis of legal acts, other regulations and strategic planning acts, if they have the fiscal impact, which they have not been required to so far.

In accordance with the above, the Regulation on the procedure for issuing fiscal impact assessment is being drafted, which will strengthen the fiscal impact assessment as an essential tool for adopting fiscally enforceable regulations/strategic planning acts, while simplifying the existing fiscal impact assessment system.

Ex-post evaluation of expenditures and expenses

With the adoption of the new Budget Act, as of the beginning of 2022, the *ex-post* evaluation of fiscally significant programmes, activities and/or projects of the state budget and financial plans of extra-budgetary users has become a formally integral part of the budget process. It will also contain the recommendations for improving the efficiency and soundness of budget spending, whereby special attention will be paid to the justification of the implementation, cost-effectiveness, optimization and sustainability of results. Such evaluations will therefore contribute to the continuous improvement of the budgetary framework and medium-term projections, the efficient allocation of limited budget funds and the quality of fiscal consolidation. During 2021, within the EC Structural Reform Support Programme, external experts in cooperation with the Ministry of Finance conducted a comprehensive analysis of selected activities in the field of water management and environmental protection. In addition, in 2021, the necessary training of employees of the Ministry of Finance and other ministries was carried out for the purpose of conducting *ex-post* evaluations of the impact of programmes, activities and projects of budgetary and extra-budgetary users of the state budget.

The Budget Act defines that the Minister of Finance shall adopt an annual plan for conducting these evaluation by March 31 each year, and the Ministry of Finance shall submit a report on the results thereof to the Government of the Republic of Croatia by the end of the current year. For the purpose of conducting these evaluations, it shall be possible to establish appropriate working groups. Pursuant to the above, on March 30, 2022, the Minister of Finance issued a Decision on the adoption of an annual plan for conducting ex-post evaluations of expenditures and expenses in 2022. In the mentioned period, *ex-post* evaluations of the efficiency of financing and spending of public institutes in the Republic of Croatia for the period 2019-2021 will be conducted. Following this Decision, another Decision was adopted on the establishment of an interdepartmental working group the members of which are the representatives of the Ministry of Finance, the Ministry of Science and Education, and the Ministry of the Sea, Transport and Infrastructure, and they will participate in conducting the aforementioned evaluation.

7. INSTITUTIONAL FEATURES OF PUBLIC FINANCES

7.1. Budget Act

At its session on December 15, 2021, the Croatian Parliament adopted the Budget Act, which entered into force on January 1, 2022. The previous Budget Act largely achieved its original objectives, including the fiscal discipline, which is a prerequisite for macroeconomic stability, but further development is needed in terms of the institutional framework that will be more focused on ensuring the strategic allocation of funds, more efficient provision of public services and increasing transparency. The new Act is also in line with the requirements of Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States, and with the best European and international practice in the area of borrowing and public debt management.

Compared to the previous Budget Act in force, the most important changes are present in 3 areas: budget planning and adoption, budget execution related to expenditure control as well as borrowing of local and regional self-government units, and the establishment of a more efficient financial and statistical reporting system. The key novelties are presented below.

Budgetary and extra-budgetary users are defined in more detail, which is especially important in the context of the obligations of the Republic of Croatia towards the EU in the process of planning and reporting on budget execution according to ESA 2010 statistical methodology. The founder of an extra-budgetary user is the Republic of Croatia or a local and regional self-government unit, or it is a part of the institution/body founded by the Republic of Croatia or a local and regional self-government unit. Extra-budgetary users are classified into 2 groups, one of which is subject to certain provisions of the act almost almost equally as budgetary users, while the other group is subject only to the obligation of submitting certain data. In other words, the first group includes institutions, companies and legal persons that are not budgetary users, but are founded or owned by the Republic of Croatia or a local and regional self-government unit, or they have a decisive influence in them, and are included in the general budget according to the way of financing. They are, also, according to the rules of ESA 2010 methodology, classified into the general government sector. The second group includes those extra-budgetary users that belong to the general government sector only according to the rules of the ESA 2010 methodology.

Furthermore, the obligation to draft strategic plans for ministries and other state bodies is abolished due to the introduction of drafting an implementation programme based on the Act on Strategic Planning and Development Management System of the Republic of Croatia. The obligation of preparing a plan of development plans for local and regional self-government units is also abolished due to the introduction of new strategic planning acts, and a budget justification is introduced, which will contain an overview of budget activities and projects with objectives and performance indicators.

The content of the convergence programme, which defines the macroeconomic and fiscal framework of the Republic of Croatia in the medium term, and the drafting of which represents the beginning of **the budget process**, is regulated more precisely. The framework now includes assumptions and basic parameters on the basis of which macroeconomic projections are made, comparison of macroeconomic projections with the latest available European Commission projections, projections by type of general government budget revenue and expenditure based on fiscal effects of unchanged policies and projected medium-term policies, multiannual budget objectives represented by the indicators of general government budget deficit or surplus, public debt or general government debt and general government budget expenditures that have to be harmonized with fiscal rules from the act governing fiscal responsibility, as well as the presentation of deficit or surplus and debt of the units classified in the general government sector according to the rules of the ESA 2010 statistical methodology and they have a significant impact on the trends in the general government budget deficit or surplus and general government debt. In this way, the content of the macroeconomic and fiscal framework is elaborated and thus fully harmonized with Council Directive 2011/85/EU.

Furthermore, it is established that, based on the Convergence Programme, the Government adopts the Decision on the budget framework for the next three years instead of the current guidelines of economic and fiscal policy, and its content is also prescribed (appropriate level of expenditures of budgetary users or deficit/surplus of extra-budgetary users). Based on the mentioned Decision, the Ministry of Finance prepares instructions for drafting the state budget proposal and submits it to the ministries, which then send their instructions for drafting and submitting draft financial plans to the users within their competence. According to the new Act, the budget process also includes the drafting of a budget plan that the Government will have to submit to the EC by 15 October each year, upon the entry of the Republic of Croatia into the euro area, in order to coordinate the economic policies of member states.

In addition to the introduction of the justification as an integral part of the budget, its content is also prescribed. The obligation is introduced for budgetary users being the proponents of acts to prepare and submit a new assessment to the Ministry of Finance before accepting **the amendments** to draft acts submitted to the Parliament, which change the fiscal assessment from the draft act previously submitted to the Government. A similar obligation is also introduced for the body responsible for the interpretation of collective agreements if it changes the previously adopted fiscal assessment. Another novelty is that the Parliament adopts the budget for the budget year and projections for the next 2 budget years at the level of the economic classification group (while it was previously adopted at the level of the subgroup).

For local and regional self-government units, the obligation to prepare a **multi-annual rebalancing plan** (which is adopted along with the budget, i.e. with the financial plan) is introduced if there are large transferred deficits or surpluses with which the budget, i.e. the financial plan cannot be balanced in one year.

In order to better prepare and more efficiently implement **projects co-financed by EU funds**, the flexibility of the budget system is being strengthened through a number of innovations. There is a possibility to redistribute funds within the source of financing -general revenues and receipts of up to 15% at the level of the economic classification group adopted by the Parliament or the representative body of the local and regional self-government unit if this increases funds for the participation in EU projects. A special report on the use of EU funds is introduced within the annual report on budget execution, and the manner of planning, recording and reporting on EU funds will be determined by an ordinance. The procedures related to pre-contracting, refund of incorrectly spent EU funds, as well as the way of executing refunds are also improved.

Better control over the creation of **multi-annual contractual obligations** is also introduced. Thus, in order to assume the commitments under contracts that require payment in the coming years, including the commitments under multi-annual contracts for EU projects, a Government Decision, previously approved by the Ministry of Finance, is needed if the value of the contract exceeds the amount determined by the act on state budget execution.

In order to **improve transparency**, budgetary and extra-budgetary users and local and regional self-government units are obliged to publish budget documents and information on budget spending on their websites, whereby the information should be easily accessible and searchable. The Ministry of Finance and local and regional self-government units are also obliged to publish the guidelines on budget documents for citizens. The publication by the relevant bodies in the Republic of Croatia of the statistical information is also regulated in accordance with the requirements for the budgetary frameworks of the EU Member States.

The obligation to report on the execution of the financial plan for all budgetary users is introduced. Furthermore, the content of the semi-annual and annual reports on the execution of the state budget and the budget of local and regional self-government units is harmonized with the new content of the budget. A novelty is the previously mentioned report on the use of EU funds as part of the annual report, while an annual report on the implementation of the multi-annual rebalancing plan is introduced for local and regional self-government units. The annual report on the execution of the state budget also introduces a special report on realized revenues and expenditures of the general government budget according to the categories of revenues and expenditures defined by the ESA 2010 methodology in relation to planned revenues and expenditures from the Convergence Programme. The ministries and local and regional self-government units become obliged to adopt acts that will regulate the realization and the use of non-earmarked donations and own revenues of their beneficiaries. In addition, the conditions under which budget revenues are classified as earmarked are elaborated.

The obligation of the Ministry of Finance to prepare an **ex-post evaluation of the efficiency and justification** of the implementation of programmes, activities and/or projects, i.e. certain types of expenses and expenditures of budgetary and extra-budgetary users of the state budget, is also introduced. This evaluation should also include recommendations for improving the efficiency of budget funds spending. The procedure for planning and executing the budget under **the circumstances of a crisis or a natural disaster** is also established, which enables greater flexibility in the distribution and spending of budget funds.

The new Act consolidates the provisions on **state guarantees** so far contained in various other acts. The procedure for issuing state guarantees, their amendments, supervision and monitoring of the implementation of a credit or loan agreement with a state guarantee, including the assessment of the impact on public finances, is prescribed in more detail.

The borrowing of local and regional self-government units is also made possible for capital aid to companies and other legal entities in their majority ownership or co-ownership, for the purpose of realizing investments co-financed through EU funds or regulated by special regulations. These units can also borrow for the purpose of reimbursing ineligible costs co-financed through EU funds. The amount, definition and coverage of the total annual liability of local and regional self-government units, related to the projects co-financed by EU funds, are also precisely regulated. The refinancing and reprogramming of existing credits and loans are also facilitated.

During 2022, the Ministry of Finance will draft a number of secondary legal acts in accordance with the provisions of the new Budget Act and in order to further improve budget processes, including the improvement of monitoring EU flows, with a more detailed elaboration of procedures in the processes of budget planning and execution, accounting and financial reporting.

7.2. The Act on the Introduction of the Euro as the Official Currency in the Republic of Croatia

The experience of the Member States that have adopted the euro shows that, generally, in the period before the introduction of the euro, an act regulating general issues related to the introduction of the euro is adopted and that certain acts and regulations containing provisions related to the existing national currency are amended. The Republic of Croatia also decided on such an approach, and in 2021 the Coordination Committee for Legislative Adjustments prepared the text of the Draft Act on the Introduction of the Euro as the Official Currency in the Republic of Croatia (hereinafter referred to as: the Draft Act). The adoption of the Act is expected in May 2022.

Introductory provisions

This part of the Draft Act stipulates that after the EU Council decides on the adoption of the euro in the Republic of Croatia and after the fixed conversion rate is known, the Government will issue a decision announcing: the day of the introduction of the euro, the fixed conversion rate, period of dual circulation and period of dual display. Therefore, this decision of the Government of the Republic of Croatia will initiate the implementation of the activities set out in the Draft Act.

The Draft Act also establishes five basic principles: the principle of consumer protection, the principle of prohibition of unjustified price increases, the principle of continuity of legal instruments, the principle of efficiency and economy and the principle of transparency and timely information.

The amounts stated in the kuna in legal instruments (documents with legal effect, secondary legal acts and registers), from the day of the introduction of the euro, will be considered amounts in the euro by applying the fixed conversion rate and in accordance with the rules on the conversion and rounding referred to in the Draft Act.

Supply and exchange of kuna cash for euro cash and dual circulation

A special part of the Draft Act is dedicated to the replacement of kuna cash with euro cash. The replacement will be possible in banks, branches of the Financial Agency (FINA) and HP Hrvatska pošta d.d. during 12 months from the day of the introduction of the euro, after which it will be possible to exchange the kuna into the euro at the Croatian National Bank, banknotes - with no time limit and coins - over the next three years. It will be possible to exchange 100 kuna banknotes and 100 kuna coins per transaction free of charge, and a fee will be charged for more than that. During these 12 months from the day of the introduction of the euro, it will be possible to exchange cash free of charge with a simultaneous deposit service on the account in the euro.

After the day of the introduction of the euro, during the first 14 days, the kuna and the euro will both be in circulation and used in cash transactions as legal tender at the same time. During the dual circulation period, the payee will be obliged to accept up to 50 kuna coins in one transaction and the appropriate number of kuna banknotes in cash (up to HRK 75,000 in cash, and above this amount through an account with a credit institution). Exceptionally, if the payee is unable to repay the rest of the amount in euro cash, the rest may be paid in kuna cash and euro cash or in kuna cash only.

Measures to protect consumers from unjustified price increases

In order to protect consumers from unjustified price increases, a period of dual display of prices is introduced in such a way that they are presented both in the kuna and the euro at the same time. The period of voluntary dual display starts from the day when the fixed conversion rate is set. Compulsory dual display is the period beginning on the first Monday of the month following the month in which thirty days will elapse from the date of publication of the EU Council decision on the introduction of the euro and the EU Council regulation setting the fixed conversion rate. The compulsory dual display period ends 12 months after the introduction of the euro. Therefore, assuming that the above-mentioned decision and regulation of the Council of the EU will be adopted in July 2022, the 30-day deadline will expire in August and the dual display obligation will take place on the first Monday in September, i.e. September 5, 2022.

It is explicitly prescribed which entities have the obligation to provide dual display to consumers. In addition to the dual display obligation for consumer contracts, the dual display obligation is also prescribed for issuing acts of public authorities, but also when submitting a document on the payment of salaries and other allowances, such as jubilee awards, vacation allowances, Christmas bonuses, etc., so that everyone can be appropriately acquainted with the future official currency.

Certain exceptions are provided for situations where dual display is not appropriate for practical reasons or would cause disproportionately high costs in relation the benefits for consumers (e.g. vending machines, stands, family farms, kiosks, itinerant trade, production facilities, occasional sales, in the premises of facilities for other purposes) or business entities (e.g. following the technical adaptation of the existing software or the purchase of new devices). The exceptions are allowed even when the price in the kuna is already indicated on the goods themselves, and reprinting/placing on the market of such items with dual-displayed prices would be an unnecessary and excessive cost. However, even in the case of these exceptions to the dual display obligation for certain business entities, they still have the obligation to provide dual display of the prices on the invoice they issue to consumers. The obligation of dual display will also exist for employers when stating salaries and other payments based on employment, for public authorities in individual acts they adopt, for clients in employment contracts and copyright contracts, for the Croatian Pension Insurance Institute or other entity that delivers notices on pensions, and in the writs of execution. The institutions in the financial sector will also be required to provide dual display of the essential information stated in the Draft Act, that are relevant to the consumer.

The principle of the prohibition of unjustified price increases is not applied mechanically but according to the circumstances of the individual case. The Draft Act elaborates in detail the provisions on supervisory bodies and the provisions on procedures related to the supervision. The way of acting based on the principle of opportunity was chosen, i.e. first there is a warning, and only if the observed irregularities are not eliminated, then there is sanctioning, i.e. initiating appropriate procedures. In addition, every business entity that does business directly with consumers will be invited to join the Code of Ethics initiative[13] with the aim of correctly converting and displaying prices and other monetary values, without unjustified increase in retail prices.

Application of the principle of continuity of legal instruments - conversion of funds on accounts, and deposits, loans and securities

The introduction of the euro will not affect the validity of existing legal instruments stating the kuna - **the principle of continuity of legal instruments**. In that sense, the Draft Act elaborates the rules related to the conversion of funds and the conversion in case of loan and leasing agreements, rules for adjusting interest rates, the obligation to inform clients of credit institutions, credit unions, payment institutions and electronic money institutions, as well as clients of financial service providers and the Croatian Bank for Reconstruction and Development. The institutions that keep deposit, savings and transaction accounts and other payment accounts, issue payment instruments and keep other records, are obliged to convert the amounts in these accounts kept in the kuna into the euro free of charge, by applying the fixed conversion rate and in accordance with the rules on the conversion and and rounding. When performing the conversion, the unique account number shall not be changed in order not to impose additional requirements on the holders.

Conversion of salaries, pensions, social benefits and other benefits to citizens and households

---

[13] The Code of Ethics is envisaged as a document of a declaratory nature, by which business entities that have acceded to the initiative guarantee they will operate transparently and reliably. The business entities that accede to the Code of Ethics will obtain a logo to be placed in order to signal to consumers that they are a reliable business entity that correctly converts and displays prices and other monetary values, and that it has not increased the price of goods or services to consumers without justified reason. Consumers will be able to report their complaints on business entities that they believe have violated the principles of the Code of Ethics to the relevant supervisory bodies, which will also apply the misdemeanour provisions for irregularities and illegalities found during supervisions. The Complaints, but also the praises, will be able to be submitted during the entire period of the dual display obligation.

In accordance with the principle of continuity of legal instruments, there will be no need to change contracts and other acts determining the amount of salary, but the amount in the kuna in contracts will be considered the amount in the euro. When calculating, the amount in the kuna will be converted into the amount in the euro by applying the fixed conversion rate and in accordance with the rules on the conversion and rounding. The same rule will apply to the payment and conversion of pensions and other benefits from pension insurance, and social benefits.

Budgets and financial plans, financial records, financial statements and taxes

The rules related to the preparation of the budget and financial plans in the year preceding the year of the introduction of the euro have also been clarified. In addition, the rules for recording in the financial records have been established, as well as the rules for reporting, in the budget system and in all other entities. At the end, a review of tax and other public levies, and the obligations of official statistics, is given.

Supervision

The method of supervision as a whole is determined, in particular the rules for the compliance with compulsory dual display and correct conversion, including the powers of the competent supervisory bodies, as well as the obligation to apply the principle of opportunity. Therefore, no proceedings will be initiated or fines will be charged in cases of established violation for the first time, if a legal or a natural person eliminates irregularities and deficiencies identified during the inspection supervision within the set deadline. Only if that is not the case, the procedure for imposing a misdemeanour sanction will be initiated. There are fines envisaged in the kuna, which will be in force until the day of the introduction of the euro, and fines in in the euro, which will be in force from the day of the introduction of the euro.

7.3. Development of Structural Macroeconomic Model of the Croatian Economy

The project for the development of the structural macroeconomic model of the Croatian economy began in September 2021, and is being implemented in cooperation with experts from the World Bank. The project is funded under the EU TSI (Technical Support Instrument) and will develop a macroeconomic model of the Croatian economy suitable for making medium-term macroeconomic forecasts, simulating the effects of economic policies and shocks, in accordance with the needs of the Ministry of Finance.

Medium-term forecasts of macroeconomic and fiscal aggregates are contained in a number of strategic documents published by the Government, whereby the Ministry of Finance, as the state administration body responsible for drafting forecasts of macroeconomic and budgetary aggregates, actively participates in the policy formulation and preparation of such documents. Reliable macroeconomic and fiscal forecasts are also extremely important in the context of the European Semester and are published under the Convergence Programme, and play an important role in the calculation of indicators under the Stability and Growth Pact.

Furthermore, within the process of Croatia's accession to the euro area, high-quality draft budget plans are becoming even more relevant in the context of the Fiscal Agreement. In addition, the Republic of Croatia will implement a number of structural reforms in the next period, as a result of which the need for a model that can simulate the effects of such reforms is growing. Finally, during the implementation phase of the National Recovery and Resilience Plan, it will be extremely important to ensure adequate monitoring of investments and assessment of their macroeconomic and fiscal effects.

Consequently, it is necessary to develop a macroeconomic model that would include all key macroeconomic variables of the domestic economy and which could be used to assess the impact of individual proposed economic policy measures and/or external shocks on the trends in them. The development of the structural macroeconomic model of the Croatian economy will improve the process of making macroeconomic forecasts, which will then strengthen the capacity to produce quality budget forecasts. In addition to the appropriate tools for forecasting and simulating the effects, this also requires good analytical capacity of employees, who will be educated through customized workshops.

In the second half of 2022, the development of a final model adapted to the Croatian economy and its testing by employees of the Ministry of Finance is planned. The planned project thus follows the CSR, as it will support the strengthening of the budget framework since the results of the model will be used to prepare budget documents, thus improving the quality of medium-term budget forecasts and the sustainability of public finances.

ANNEXES

Annex 1a. Macroeconomic Outlook

	ESA Code	2021 (level)	2021 (rate of change)	2022 (rate of change)	2023 (rate of change)	2024 (rate of change)	2025 (rate of change)
1. Real GDP	B1*g	417,076	10.2	3.0	4.4	2.7	2.5
2. Nominal GDP	B1*g	430,621	13.8	9.5	8.8	5.5	5.0
Components of real GDP							
3. Private consumption expenditure[1]	P.3	245,032	10.0	1.4	3.2	2.4	2.3
4. Government consumption expenditure	P.3	93,434	3.1	3.3	1.9	2.0	2.1
5. Gross fixed capital formation	P.51	90,812	7.6	5.8	6.1	3.9	3.6
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	-12,449	-3.0	-1.7	0.7	1.0	0.9
7. Exports of goods and services	P.6	211,958	33.3	6.9	6.0	4.2	3.8
- of which goods	*P.61*	110,074	20.0	4.8	5.4	4.6	4.1
- of which services	*P.62*	101,884	51.5	9.2	6.7	3.7	3.4
8. Imports of goods and services	P.7	211,712	14.7	6.1	6.9	4.2	3.6
- of which goods	*P.71*	180,491	14.8	5.6	6.5	4.0	3.5
- of which services	*P.72*	31,221	13.9	9.1	9.5	5.1	4.2
Contribution to real GDP growth							
9. Final domestic demand	P.3 + P.51	429,278	8.3	2.8	3.6	2.7	2.6
10. Changes in inventories and net acquisition of valuables	P.52 + P.53	-12,449	-4.9	-0.2	1.5	0.2	0.0
11. External balance of goods and services	B.11	246	6.8	0.3	-0.7	-0.1	0.0

Note: GDP and its components expressed in real terms are in constant prices, previous year prices, in HRK million

[1] Including the spending of non-profit institutions that serve households.

Note: Data for 2021 are preliminary

Source: CBS, MF

Annex 1b. Price Developments

	2021 (level)	2021 (rate of change)	2022 (rate of change)	2023 (rate of change)	2024 (rate of change)	2025 (rate of change)
1. GDP deflator	108.4	3.2	6.2	4.1	2.7	2.4
2. Private consumption deflator[1]	105.4	2.7	7.8	3.7	2.5	2.2
3. CPI[2]	105.0	2.6	7.8	3.7	2.5	2.2
4. Public consumption deflator	113.6	3.7	5.4	4.0	2.6	2.3
5. Investment deflator	114.1	2.4	5.3	3.9	2.5	2.2
6. Export price deflator (goods and services)	107.8	4.6	8.5	3.5	2.5	2.4
- of which goods	101.8	6.9	11.8	3.3	2.4	2.2
- of which services	114.5	2.1	4.9	3.7	2.7	2.5
7. Import price deflator (goods and services)	108.3	6.7	11.0	3.3	2.2	2.0
- of which goods	108.6	7.4	12.1	3.3	2.2	2.0
- of which services	106.5	2.9	4.5	3.5	2.4	2.3

[1] Including the spending of non-profit institutions that serve households.

[2] Inflation is measured by the consumer price index.

Note: Levels are expressed as index 2015=100.

Source: CBS, MF

Annex 1c. Labour Market Developments

	ESA Code	2021 (level)	2021 (rate of change)	2022 (rate of change)	2023 (rate of change)	2024 (rate of change)	2025 (rate of change)
1. Employment, persons[1]		1,696	1.2	2.8	1.5	1.1	0.9
- of which, employees		1,466	0.4	2.7	1.4	0.9	0.8
- of which, self-employed		229	6.4	3.7	2.1	1.7	1.2
2. Employment, hours worked		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
3. Unemployment rate (%)[2]		138.2	7.6	6.3	5.6	5.2	5.0
4. Labour productivity, persons[3]		n.a.	8.9	0.2	2.9	1.7	1.6
5. Labour productivity, hours worked		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
6. Unit labour cost		n.a.	-3.6	7.5	2.1	2.3	2.1
7. Compensation of employees[4]	D.1	198,760	5.5	10.6	6.5	5.1	4.6
8. Compensation per employee[5]		11,296	5.0	7.6	5.0	4.1	3.8

1 *According to the national accounts definition*
2 *According to the ILO methodology.*
3 *Real GDP in constant prices, previous year prices, per person employed.*
4 *Data for 2021 level is in HRK million.*
5 *Data for 2021 level is an average monthly compensation of employee per head in HRK*
Note: Data for 2021 are preliminary
Source: CBS, Eurostat, MF

Annex 2a. General Government Budget

	ESA Code	2021 (level, HRK billion)	2021 (% of GDP)	2022 (% of GDP)	2023 (% of GDP)	2024 (% of GDP)	2025 (% of GDP)
Net lending (EDP B.9) by sub-sector							
1. General government	S.13	-12.4	-2.9	-2.8	-1.6	-1.6	-1.2
2. Central government	S.1311	-12.9	-3.0	-2.6	-1.2	-1.1	-0.6
3. State government	S.1312	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
4. Local government	S.1313	-1.1	-0.3	-0.2	-0.3	-0.4	-0.4
5. Social security funds	S.1314	1.6	0.4	0.0	-0.1	-0.1	-0.2
General government (S13)							
6. Total revenue	TR	199.6	46.4	46.9	46.5	45.8	45.5
7. Total expenditure	TE	212.1	49.2	49.8	48.1	47.4	46.7
8. Net lending/borrowing	EDP B.9	-12.4	-2.9	-2.8	-1.6	-1.6	-1.2
9. Interest expenditure	EDP D.41	6.7	1.6	1.4	1.2	1.1	1.0
10. Primary balance		-5.7	-1.3	-1.4	-0.3	-0.5	-0.2
11. One-off and other temporary measures[1]		0.0	0.0	-0.3	-0.1	0.0	0.0
Selected components of revenue							
12. Total taxes (12=12a+12b+12c)		106.4	24.7	24.6	24.3	24.2	24.2
12a. Taxes on production and imports	D.2	83.1	19.3	19.3	19.1	19.0	18.9
12b. Current taxes on income, wealth, etc	D.5	23.3	5.4	5.3	5.3	5.3	5.3
12c. Capital taxes	D.91	0.0	0.0	0.0	0.0	0.0	0.0
13. Social contributions	D.61	48.9	11.3	11.4	11.2	11.2	11.2
14. Property income	D.4	3.8	0.9	0.8	0.7	0.7	0.7
15. Other		40.6	9.4	10.1	10.2	9.6	9.5
16=6. Total revenue	TR	199.6	46.4	46.9	46.5	45.8	45.5
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)		155.3	36.1	36.0	35.6	35.4	35.3
Selected components of expenditure							
17. Compensation of employees + intermediate consumption	D.1+P.2	89.4	20.8	20.8	20.2	19.9	19.7
17a. Compensation of employees	D.1	53.9	12.5	12.1	11.8	11.6	11.5
17b. Intermediate consumption	P.2	35.5	8.3	8.7	8.4	8.3	8.3
18. Social payments (18=18a+18b)		66.9	15.5	15.1	14.7	14.7	14.7
***of which* Unemployment benefits**		0.8	0.2	0.2	0.2	0.2	0.2
18a. Social transfers in kind supplied via market producers	D632	10.0	2.3	2.3	2.2	2.3	2.4
18b. Social transfers other than in kind	D.62	56.9	13.2	12.8	12.5	12.4	12.3
19=9. Interest expenditure	EDP D.41	6.7	1.6	1.4	1.2	1.1	1.0
20. Subsidies	D.3	11.6	2.7	2.0	1.8	1.8	1.7
21. Gross fixed capital formation	P.51	20.6	4.8	5.7	6.3	6.2	6.0
22. Capital transfers	D.9	6.6	1.5	1.7	1.6	1.6	1.6
23. Other		10.4	2.4	3.2	2.2	2.1	2.0
24=7. Total expenditure	TE	212.1	49.2	49.8	48.1	47.4	46.7
p.m.: Government consumption (nominal)	P.3	96.9	22.5	22.4	21.8	21.6	21.5

[1] *plus sign means a deficit-reducing one-off measure.*

Source: CBS, MF

Annex 2b. Amounts to be excluded from the Expenditure Benchmark

	2021 (level, HRK billion)	2021 (% of GDP)	2022 (% of GDP)	2023 (% of GDP)	2024 (% of GDP)	2025 (% of GDP)
1. Expenditure on EU programmes fully matched by EU funds revenue	11.9	2.8	3.6	4.0	3.6	3.6
1.a Of which investment expenditure fully matched by EU funds revenue	1.6	0.4	1.0	1.5	1.4	1.5
2. Cyclical unemployment benefit expenditure	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
3. Effect of discretionary revenue measures	-0.7	-0.2	0.0	0.0	0.0	0.0
4. Revenue increases mandated by law	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Source: CBS, MF

Annex 3. General Government Debt

	ESA Code	2021 (% of GDP)	2022 (% of GDP)	2023 (% of GDP)	2024 (% of GDP)	2025 (% of GDP)
1. Gross debt		79.8	76.2	71.7	68.9	66.9
2. Change in gross debt ratio		-7.5	-3.6	-4.6	-2.7	-2.0
Contributions to changes in gross debt						
3. Primary balance		-1.3	-1.4	-0.3	-0.5	-0.2
4. Interest expenditure	EDP D.41	1.6	1.4	1.2	1.1	1.0
5. Stock-flow adjustment		0.2	0.5	0.0	-0.6	0.0
of which:						
- Differences between cash and accruals						
- Net accumulation of financial assets		0.0	0.0	0.0	0.0	0.0
of which:						
- privatisation proceeds						
- Valuation effects and other						
p.m.: Implicit interest rate on debt		2.0	2.0	1.8	1.7	1.6
Other relevant variables						
6. Liquid financial assets						
7. Net financial debt (7=1-6)		79.8	76.2	71.7	68.9	66.9
8. Debt amortization (existing bonds) since the end of the previous year		3.8	5.0	4.2	4.8	3.9
9. Percentage of debt denominated in foreign currency		70.7	-	-	-	-
10. Average maturity		-	-	-	-	-

Source: HNB, CBS, MF

Annex 4. Cyclical trends

	ESA Code	2021 (% of GDP)	2022 (% of GDP)	2023 (% of GDP)	2024 (% of GDP)	2025 (% of GDP)
1. Real GDP Growth (%)		10.2	3.0	4.4	2.7	2.5
2. Net Lending of general government	EDP B.9	-2.9	-2.8	-1.6	-1.6	-1.2
3. Interest expenditure	EDP D.41	1.6	1.4	1.2	1.1	1.0
4. One-off and other temporary measures[1]		0.0	-0.3	-0.1	0.0	0.0
Of which:						
On the revenue side: general government		0.0	0.0	0.0	0.0	0.0
On the expenditure side: general government		0.0	-0.3	-0.1	0.0	0.0
5. Potential GDP growth (%)		2.9	3.3	3.2	2.7	2.2
contributions:						
- labour		1.2	1.5	1.2	0.7	0.3
- capital		0.7	0.8	0.9	1.0	1.0
- total factor productivity		1.0	0.9	1.0	1.0	1.0
6. Output gap		1.0	0.7	2.0	2.0	2.3
7. Cyclical budgetary component		0.5	0.3	0.9	0.9	1.1
8. Cyclically-adjusted balance (2 - 7)		-3.4	-3.2	-2.5	-2.5	-2.3
9. Cyclically-adjusted primary balance (8 + 3)		-1.8	-1.8	-1.2	-1.4	-1.3
10. Structural balance (8 - 4)		-3.4	-2.9	-2.4	-2.5	-2.3

Note: The EC production function methodology was used to calculate the gross domestic product gap

Source: CBS, MF

Annex 5. Long-Term Sustainability of Public Finance

	2020 (% of GDP)	2030 (% of GDP)	2040 (% of GDP)	2050 (% of GDP)	2060 (% of GDP)	2070 (% of GDP)
Total expenditure						
Of which: **age-related expenditures**						
Pension expenditure	11.4	11.0	10.4	9.9	9.7	9.5
Social security pension						
Old-age and early pensions	7.5	7.9	7.7	7.5	7.5	7.4
Other pensions (disability, survivors)	3.9	3.1	2.7	2.4	2.2	2.1
Occupational pensions (if in general government)						
Health care	6.5	6.1	6.4	6.5	6.6	6.6
Long-term care (*this was earlier included in the health care*)	0.5	0.5	0.5	0.6	0.6	0.6
Education expenditure	4.9	4.6	4.4	4.4	4.5	4.6
Other age-related expenditures						
Interest expenditure						
Total revenue						
Of which: property income						
Of which: from pensions contributions (or social contributions if appropriate)	6.0	7.1	7.2	7.1	7.1	7.1
Pension reserve fund assets						
Of which: consolidated public pension fund assets (assets other than government liabilities)						
Systemic pension reforms[1]						
Social contributions diverted to mandatory private scheme[2]	1.9	1.7	1.7	1.8	1.8	1.8
Pension expenditure paid by mandatory private scheme[3]	0.0	0.2	0.3	0.3	0.3	0.4
Assumptions						
Labour productivity growth	0.7	1.4	2.3	2.2	1.9	1.5
Real GDP growth	-8.1	0.7	1.5	1.2	1.0	0.9
Participation rate males (aged 20-64)	77.1	78.2	78.4	78.4	78.1	78.3
Participation rates females (aged 20-64)	66.7	69.4	70.2	70.6	70.5	70.6
Total participation rates (aged 20-64)	72.0	73.9	74.5	74.6	74.4	74.6
Unemployment rate (aged 20-64)	9.7	7.7	7.2	6.7	6.7	6.7
Population aged 65+ over total population	21.3	25.3	27.8	30.3	31.7	32.7

[1] The reform of the pension system refers to the introduction of three pillars that include a mandatory private pillar.

[2] Social contributions or other revenues from the mandatory private pillar, which cover the liabilities arising from the reform of the system.

[3] Expenditures for pensions or other social benefits paid from the mandatory private pillar related to the reform of the pension system.

Source: Ministry of Labour and Pension System, Croatian Health Insurance Fund, AWG

Annex 6. Contingent Liabilities

	2020 (% of GDP)	2021 (% of GDP)	2022 (% of GDP)
Public guarantees	1.7	1.9	n.a.
Of which: linked to the financial sector	n.a.	n.a.	n.a.

Source: HNB, MF

Annex 7. Basic assumptions

	2021	2022	2023	2024	2025
Short-term interest rate (annual average)	n.a	n.a	n.a	n.a	n.a
Long-term interest rate (annual average)	n.a	n.a	n.a	n.a	n.a
USD/€ exchange rate (annual average) (euro area and ERM II countries)	1.18	1.10	1.10	1.10	1.10
Nominal effective exchange rate, % change	-0.7	2.4	0.0	0.0	0.0
(for countries not in euro area or ERM II) exchange rate vis-vis the € (annual average)	n/a	n/a	n/a	n/a	n/a
World, GDP growth	6.1	3.6	3.6	3.4	3.4
EU GDP growth	5.4	2.9	2.5	2.1	1.9
Growth of relevant foreign markets[1]	11.6	4.5	5.3	4.7	4.3
World import volumes	10.3	5.3	4.6	3.9	3.8
Oil prices (USD/barrel)[2]	70.4	110.8	96.1	87.2	81.4

[1] Refers to goods

[2] Brent.

Source: Eurostat, EC, ECB, IM, HNB, MF

Annex 8. Comparison with the latest available EC projection

	Commission's latest forecast			Ministry of Finance's latest forecast		
	2021	**2022**	**2023**	**2021**	**2022**	**2023**
GDP, change, %[1]	10.5	4.8	3.0	10.2	3.0	4.4
Consumer Price Index, change %[1]	2.7	3.5	1.6	2.6	7.8	3.7
Unemployment rate, %[2]	6.7	6.2	5.8	7.6	6.3	5.6
Employment, change, %[2]	1.6	1.3	1.2	1.2	2.8	1.5
General Government Balance, % GDP[2]	-4.1	-2.9	-2.1	-2.9	-2.8	-1.6
General Government Debt, % GDP[2]	82.3	79.2	77.9	79.8	76.2	71.7

[1] Winter projections EC, February 2022

[2] Autumn projections EC, November 2021

Source: EC, MF

Annex 7. Impact of the Recovery and Resistance Facility

Revenue from RRF grants (% of GDP)							
	2020	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**
RRF GRANTS as included in the revenue projections	-	*0.0*	*0.9*	*1.3*	*1.8*	*2.2*	*1.1*
Cash disbursements of RRF GRANTS from EU		*1.4*	*2.2*	*0.8*	*1.2*	*1.1*	*0.8*

Expenditure financed by RRF grants (% of GDP)							
	2020	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**
TOTAL CURRENT EXPENDITURE	**-**	***0.0***	***0.3***	***0.4***	***0.5***	***0.5***	***0.0***
Gross fixed capital formation P.51g	-	*0.0*	*0.3*	*0.5*	*1.0*	*1.2*	*0.7*
Capital transfers D.9	**-**	*0.0*	*0.2*	*0.4*	*0.4*	*0.4*	*0.4*
TOTAL CAPITAL EXPENDITURE	**-**	***0.0***	***0.6***	***0.9***	***1.3***	***1.7***	***1.1***

Other costs financed by RRF grants (% of GDP)[1]							
	2020	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**
Reduction in tax revenue	-	-	-	-	-	-	-
Other costs with impact on revenue	-	-	-	-	-	-	-
Financial transactions	-	*0.0*	*0.0*	*0.2*	*0.1*	*0.1*	*0.0*

[1] It refers to the costs that are not recorded in national accounts as expenditures

Source: MF