Summary for non-specialists
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Macroeconomic Imbalances

Croatia 2014

On 13 November 2013, the European Commission presented its third Alert Mechanism Report (AMR) in accordance with the Regulation (EU) No. 1176/2011 on the prevention and correction of macroeconomic imbalances. The AMR serves as an initial screening device to identify Member States that warrant further in depth analysis into whether imbalances exist or risk emerging. According to Article 5 of Regulation No. 1176/2011, these country-specific "in-depth reviews" should examine the nature, origin and severity of macroeconomic developments in the Member State concerned, which constitute, or could lead to, imbalances. On the basis of this analysis, presented on 5 March 2014, the Commission will conclude whether it considers that an imbalance exists or not, and if so whether it is excessive or not, and what type of follow-up it will recommend to the Council to address to the Member State.

The 2014 in-depth reviews (for Belgium, Bulgaria, Germany, Denmark, Ireland, Spain, France, Croatia, Italy, Luxembourg, Hungary, Malta, Netherlands, Slovenia, Sweden, Finland and the United Kingdom) were published on 5 March 2014 together with a Commission communication summarising the results. On the basis of the analysis in the In-depth review the Commission concluded that:

Croatia is experiencing *excessive macroeconomic imbalances, which require specific monitoring and strong policy action.* In particular, policy action is required in view of the vulnerabilities arising from sizeable external liabilities, declining export performance, highly leveraged firms and fast-increasing general government debt, all within a context of low growth and poor adjustment capacity. The Commission will put in motion a specific monitoring of policy implementation, and will regularly report to the Council.

More specifically, after an expansionary phase, in which imbalances accumulated, Croatia is now experiencing a prolonged bust, in which a range of external and internal risks have come to the fore. External rebalancing is beset by important risks pending the reduction of Croatia's foreign liabilities to safer levels and is conditioned on improved competitiveness and broadening exports beyond tourism to support growth. The deleveraging of non-financial corporates is still at an early stage and non-performing loan developments in this segment need monitoring. State-owned enterprises, which in some sectors still play a dominant role and which are often un-restructured, are overall highly indebted and weakly profitable. Croatia has the lowest activity and employment rates in the EU, which is partly related to underlying institutions and policy settings. Better labour market functioning will be crucial to support the growth and adjustment needed in view of external and internal vulnerabilities. On nearly a range of standard indicators, Croatia's business environment ranks significantly below the average for central and eastern European Member States. These factors combine to lower potential growth, which hinders private sector balance sheet repair and increases the required fiscal consolidation effort. There is a need for significant additional fiscal consolidation efforts to curtail the deficit and prevent debt from rising unsustainably. Croatia is in EDP and needs to take effective action to address the excessive deficit by 30 April 2014. On current trends, in the absence of additional measures, Croatia risks missing its targets by a large margin in 2014.