



# Weekly Briefing

**Croatia Economy briefing:**  
**Standard & Poor's upgrades Croatia's credit rating outlook**  
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## **Standard & Poor's upgrades Croatia's credit rating outlook**

*After long time of recession and recovery of economic crisis, credit rating agencies recognized Croatia's success. For the first time after 2004, when the rating was investment (BBB), Standard & Poor's upgraded Croatia's outlook from stable to positive, and with grade BB+, it is only one step below the 2004 investment grade.*

### **Croatia's outlook upgraded from stable to positive**

Credit-rating agency Standard & Poor's (S&P) has affirmed its long-term credit rating (BB+) for Croatia and upgraded its outlook from stable to positive thanks to expectations that the economy will continue to grow while fiscal indicators will continue to improve. According to Standard & Poor's, the best rating Croatia had was in 2004 when the grade was investment (BBB) and outlook positive. Since then, there was a negative trend in Croatia's credit rating until March 2018 when rating was upgraded from BB to BB+. The lower credit rating was due to a slow recovery from consequences of the economic crisis, low GDP growth rates, high unemployment rates and high government debt.

The global economic crisis hit the Croatian economy in 2009 when the GDP fell for almost 7% and the GDP growth rate was negative until 2014 when growth rate began to rise slowly. Decline in the GDP was followed by a decline in final consumption, including government and household consumption; growth of government debt in relation to the GDP, reaching an all-time high of 84 percent in 2014; and growth in unemployment rate, including youth unemployment rate. All those negative trends in Croatia in the period 2009-2014 were followed by lower ratings and outlooks.

The period of recovery of the Croatian economy begins in 2015, which is reflected in more favorable economic indicators, including the GDP,

unemployment rate, government debt share in the GDP and other indicators. A more favorable economic situation has affected Croatia's credit rating in both Standard & Poor's and other credit-rating agencies. According to the latest S&P's report, the Croatian economy is only one step below the investment rating with positive long-term outlook.

Positive outlook reflects the expectation that the Croatian economy will continue to grow, while government debt will be reduced. Risks associated with the largest Croatian food company Agrokor are expected to gradually diminish after a deal was reached with most creditors. S&P estimates are that in 2018 the Croatian GDP will grow by 2.8%, with the same expectations for 2019 thanks to strong domestic consumption and good overall export performance driven by another strong tourist season.

Moreover, the government's debt ratio has fallen below (still high) 80% and it is predicted that the ratio could drop another 10 percentage points by 2021. This will be below 70% in line with S&P's fiscal and growth forecasts.

In 2017, Croatia achieved its first ever general government surplus of 0.6% of the GDP, supporting the downward trend in the government debt ratio. It is expected that Croatia will continue increasing small deficits averaging 0.8% of the GDP over a period of 2019-2021, as accelerated pick-up of EU structural and cohesion funds should drive up capital expenditures.

The upgrade reflects Croatia's improved external position which benefits from current account receipts driven by strong tourism-related inflows, continued external deleveraging of the economy, and rapid growth of foreign currency reserves.

Also, the ratings remain constrained by Croatia's improved fiscal picture, benefiting in part from the ongoing economic recovery, but also from structural reform efforts. Croatia's National Reform Programme spells out several reforms that the government wants to implement, though the progress is still merely gradual. In addition, the Croatian government has already implemented structural reforms to the VAT and income tax that took effect in 2017. Moreover, parafiscal

charges, fees and taxes not directly payable to the government, were reduced by 30% in 2017 and the restructuring of the highway and motorways companies, including their debts, is progressing.

Although growth in investment is depressed, mainly due to reduced public investment and lower Agrokora's capital spending, Standard and Poor's expects growth in investment to accelerate at the end of 2018 and in 2019. This will be the result of an increased withdrawal of EU funds, and increased public infrastructure investments, such as construction of the Pelješac bridge.

The S&P's Report also points out that the restructuring of the Agrokora has progressed considerably, where thanks to the settlement of most of the company's creditors, the overall economic and political risks were reduced. S&P's considers that the further tax cuts in 2019 and a high level of retained corporate profits will support households and investment spending. However, tax changes will only partially offset the adverse effect of labor shortages against prospects of economic growth.

The unemployment rate fell below 10 percent, partly due to emigration, but also because of employment growth. The labor shortage in many sectors, such as tourism and construction, is a key challenge according to S&P's analysts. Since the beginning of this year, all three of the world's leading credit-rating agencies have upgraded their rating or outlook for Croatia's rating. S&P and Fitch hold the Croatian rating one level below the investment rating and Moody's two levels below, with S&P and Fitch holding outlook positive and Moody's stable.

Croatian economists predict that in 2019 the Croatian GDP will grow at a rate of three percent, thanks to an increase in consumption, exports and investment. In addition, an accelerated fall in government debt and a reduction of the risk of restructuring Agrokora, Croatia's credit rating would again, after five years, be able to return to the investment level. According to economists' expectations, Croatia could expect an improvement of 1-level credit within a 3-6 months horizon.

## **Croatian companies credit ratings**

Hrvatska elektroprivreda (HEP Group) is the national energy company which has been dealing with generation, distribution and supply of electricity. Few days after upgrading Croatia's credit rating outlook, Standard & Poor's affirmed its long-term credit rating of HEP (BB) and upgraded its outlook from stable to positive.

In its report published on 26 September, Standard & Poor's stated that HEP was showing solid credit parameters and relatively stable cash flows in the last several years. It also stated that, according to the current assessment, HEP's credit rating would probably be upgraded following the upgrade of Croatia's sovereign rating.

Except from HEP, the Croatian Development Bank (HBOR) also had credit rating outlook revised from stable to positive. S&P equalized ratings on HBOR with their ratings on Croatia based on expectation of an almost certain likelihood of extraordinary government support for HBOR if needed.

Zagrebačka banka, the biggest Croatian bank, kept the same credit rating and credit rating outlook from March 2018, BB+ with positive outlook, while Zagrebački holding, public utility services provider in Zagreb, the capital of Croatia, holds speculative rating B+ with a stable outlook.

## **Conclusion**

The financial crisis that hit Europe in 2009 affected Croatian economy deeply and the recovery was long. As a small open country, with high government's debt ratio, Croatia was struggling for years to reach pre-crisis level of the GDP, lower the unemployment rate and improve other economic indicators. The openness of the Croatian economy and an encouraging environment led to positive changes and current favorable economic indicators. This is also result of implementing reforms. Croatia recovered from the recession few years ago and this positive period has continued with a rise of the credit rating. The upgrade of outlook that happened recently was expected, and according to economists, a

further increase in the credit rating to the investment level, both for Croatia and Croatian companies, is expected very soon.