

David Smith



THE SUNDAY TIMES

The Economic and Business Outlook

**Croatia and the Global
Economy**

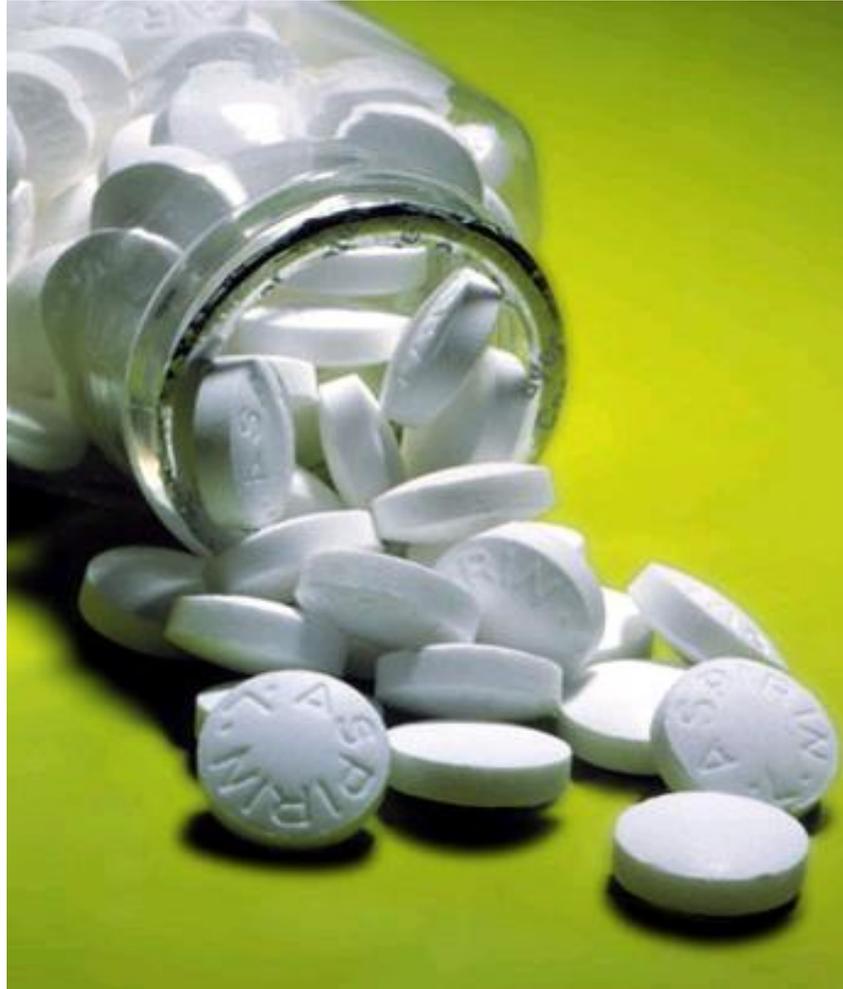
Seven years after the worst storm in a century



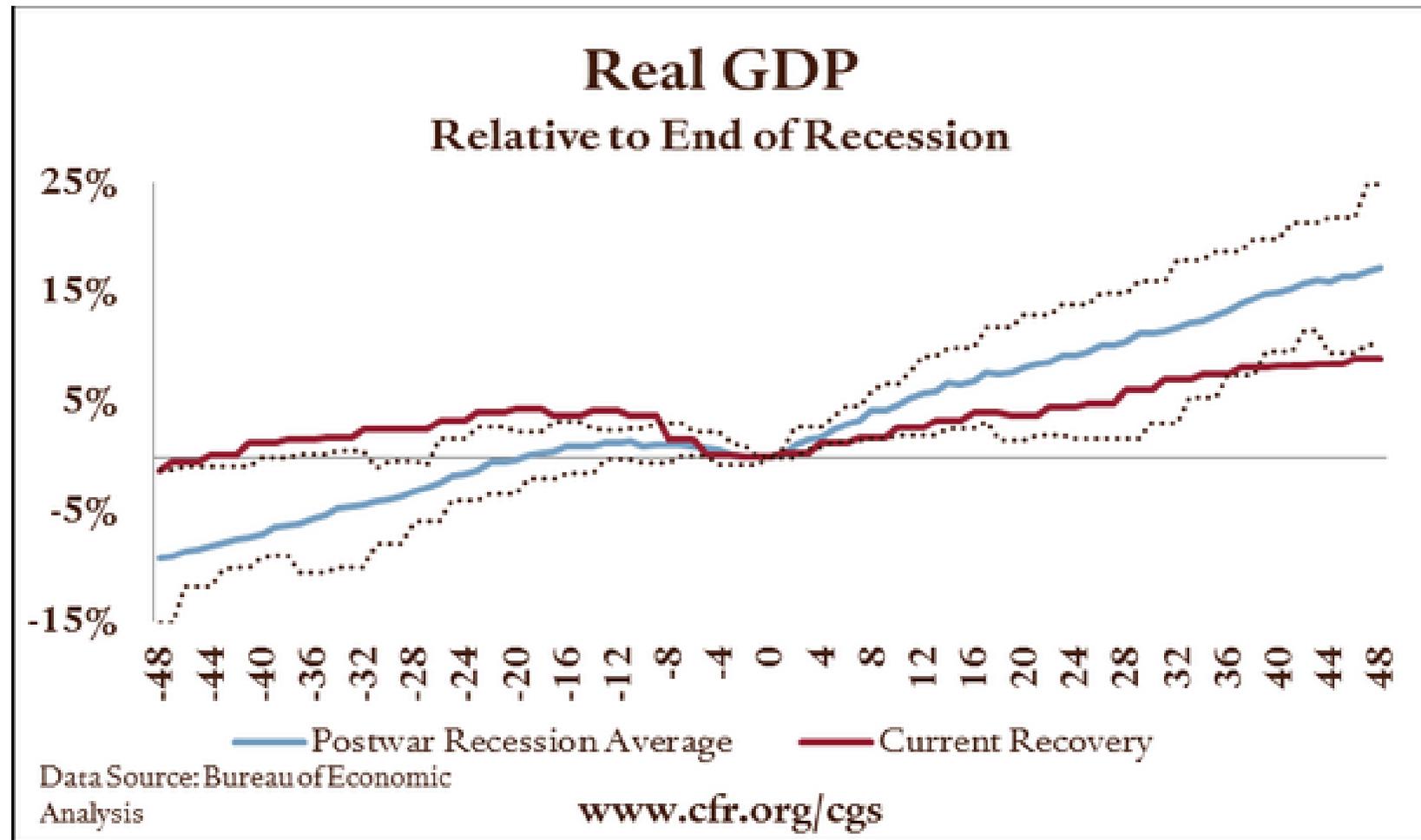
Are we still in an age of instability?



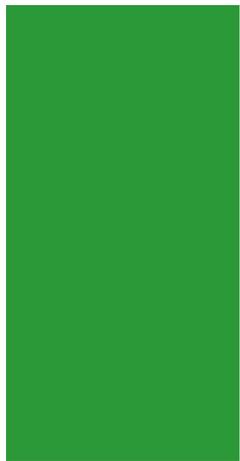
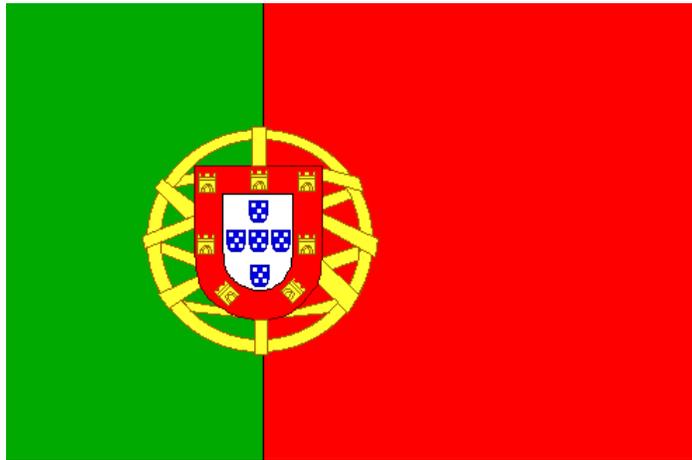
It's taken a long time to get over it



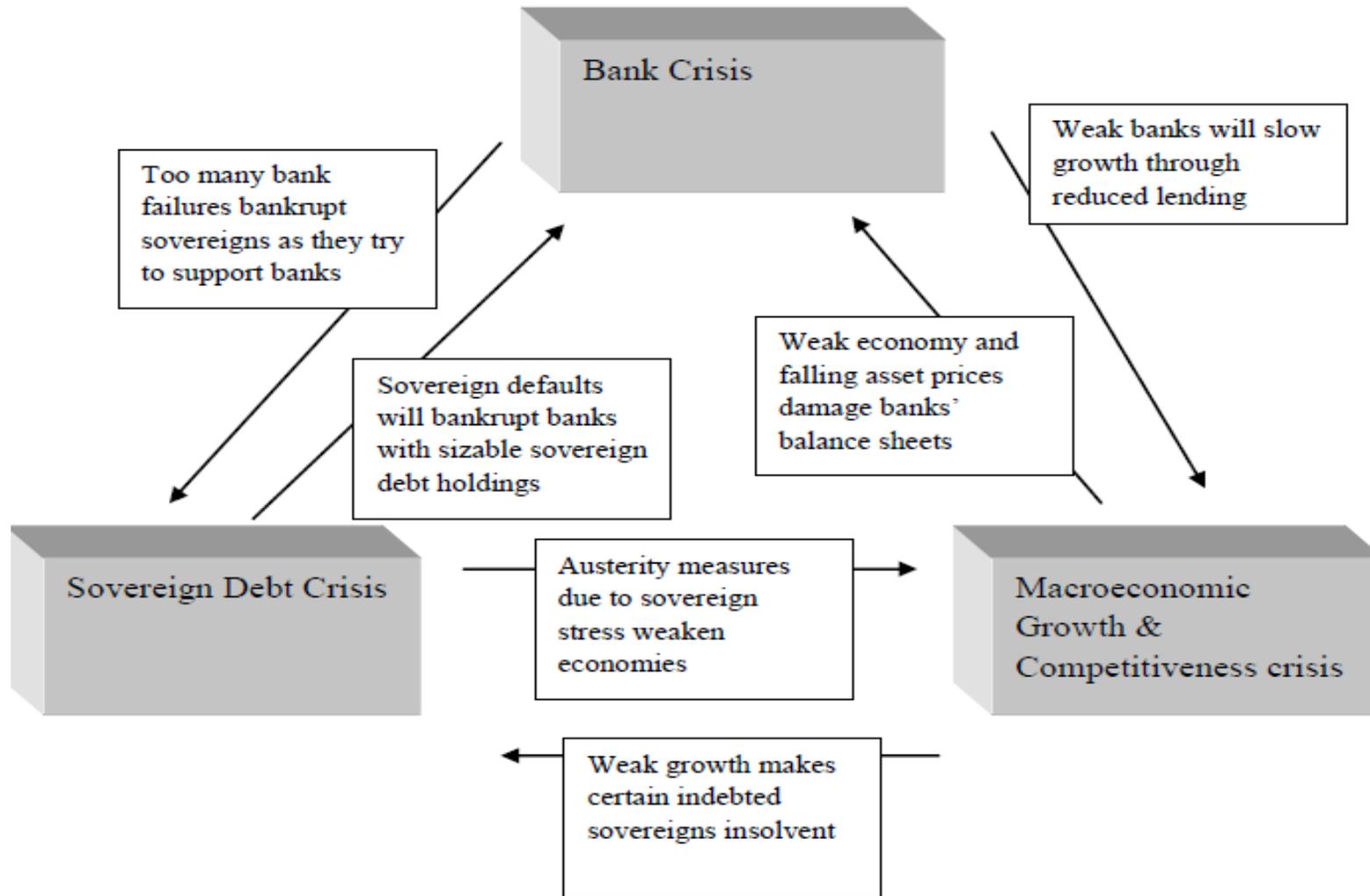
In America ...



And even more so in the eurozone



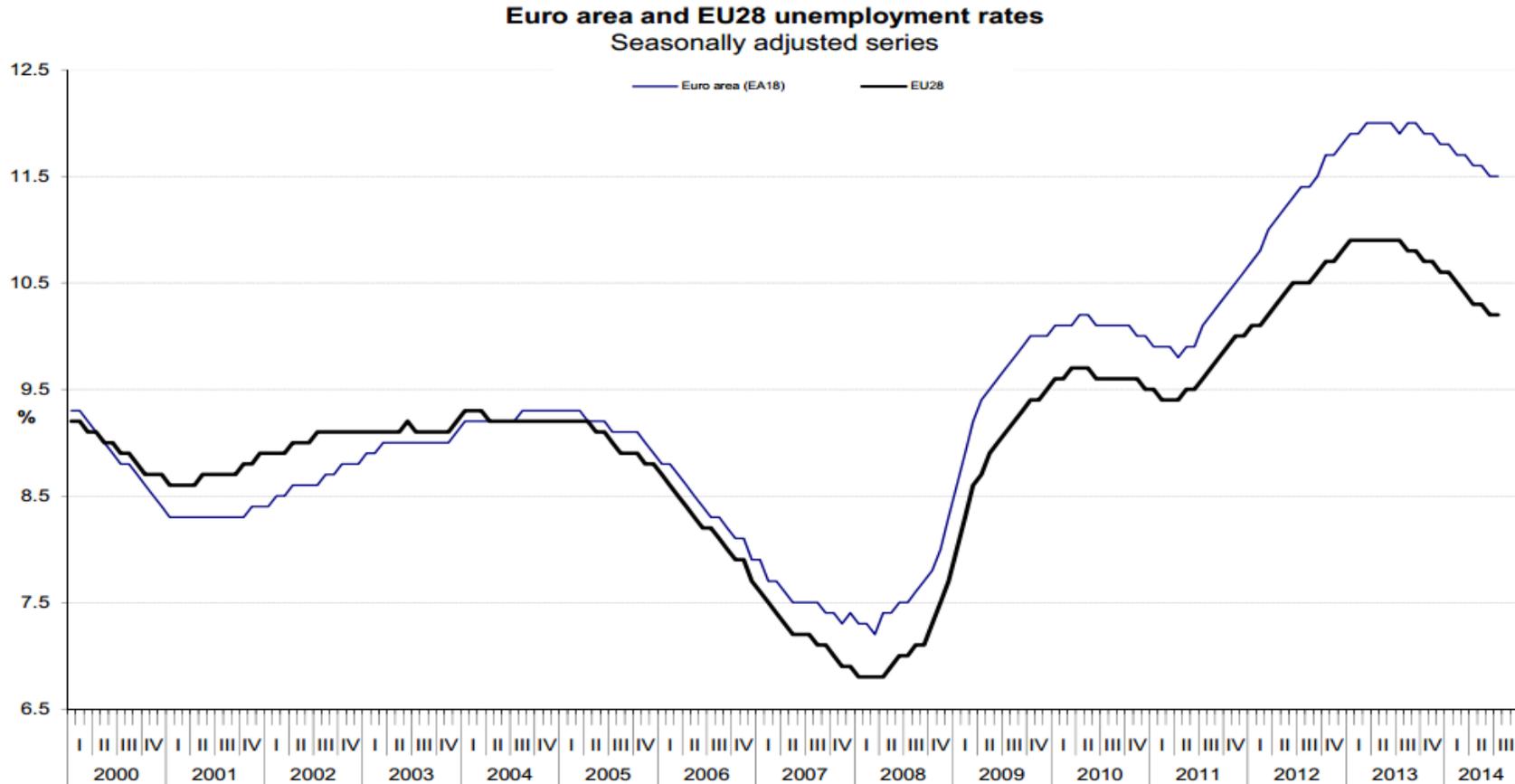
Three euro crises in one



Recession, recession, slow recovery



And very high unemployment

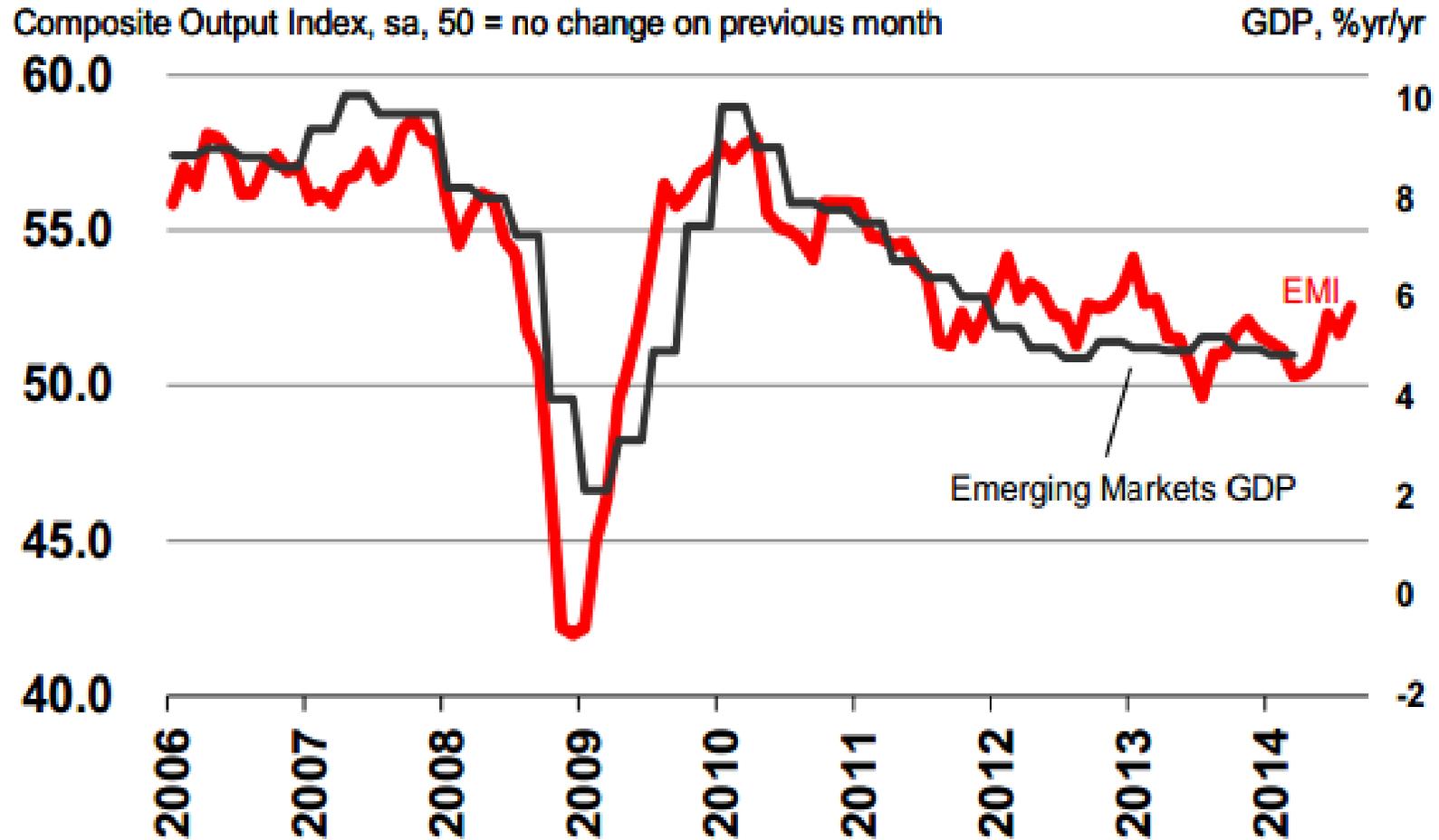


Even China's growth has slowed



SOURCE: WWW.TRADINGECONOMICS.COM | NATIONAL BUREAU OF STATISTICS OF CHINA

As did emerging economies generally

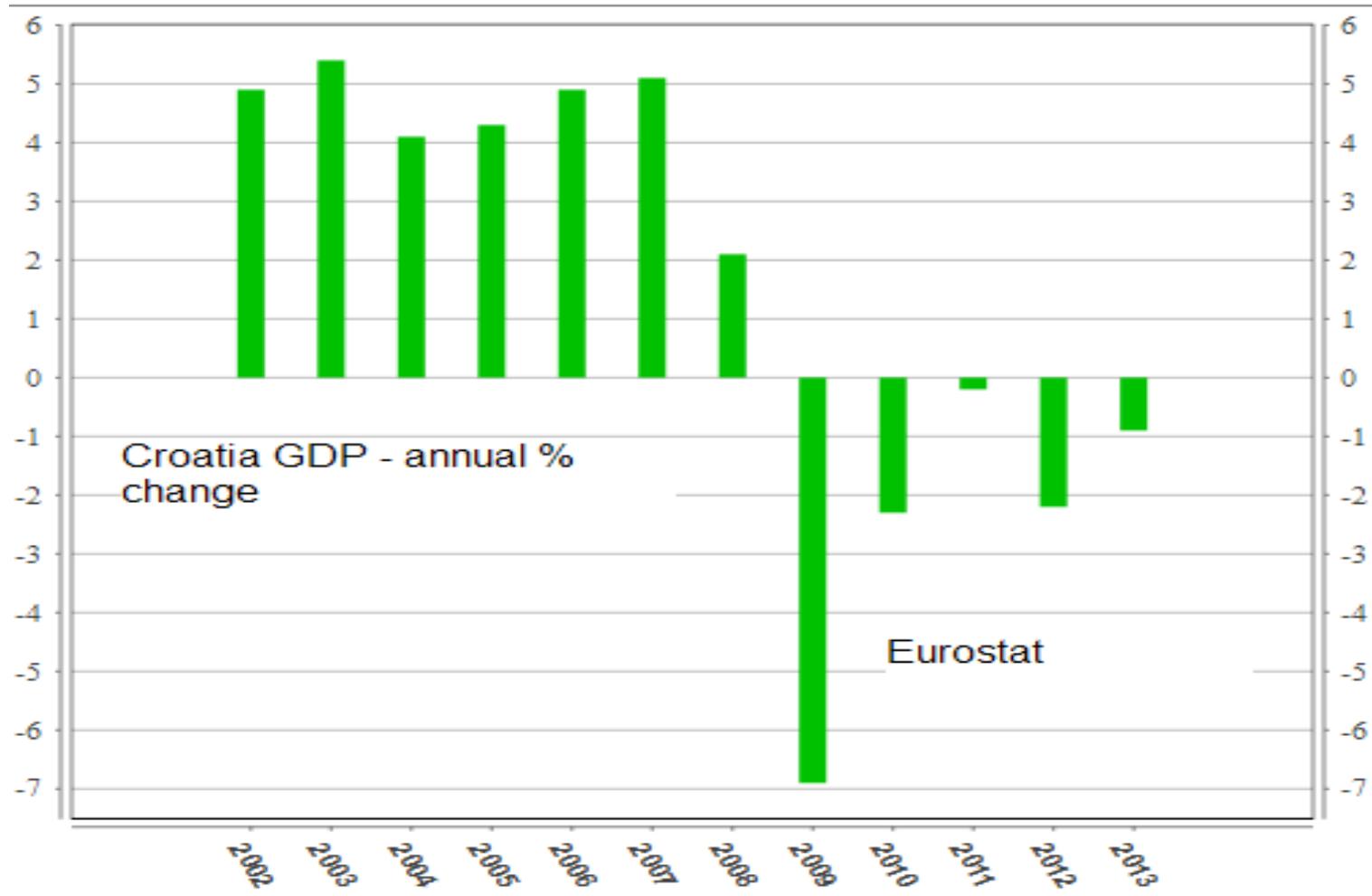


Sources: HSBC, Markit.

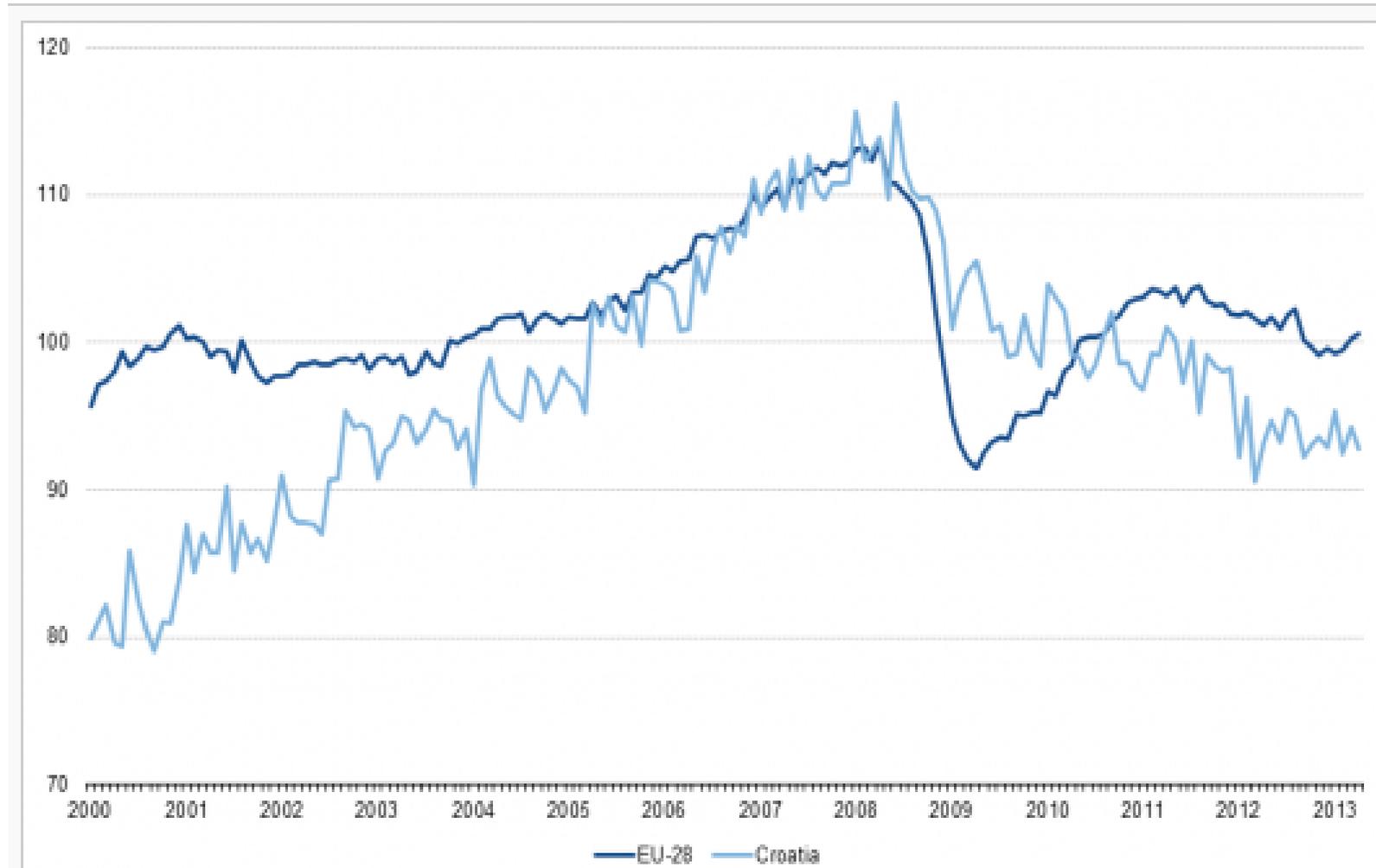
Croatia has struggled



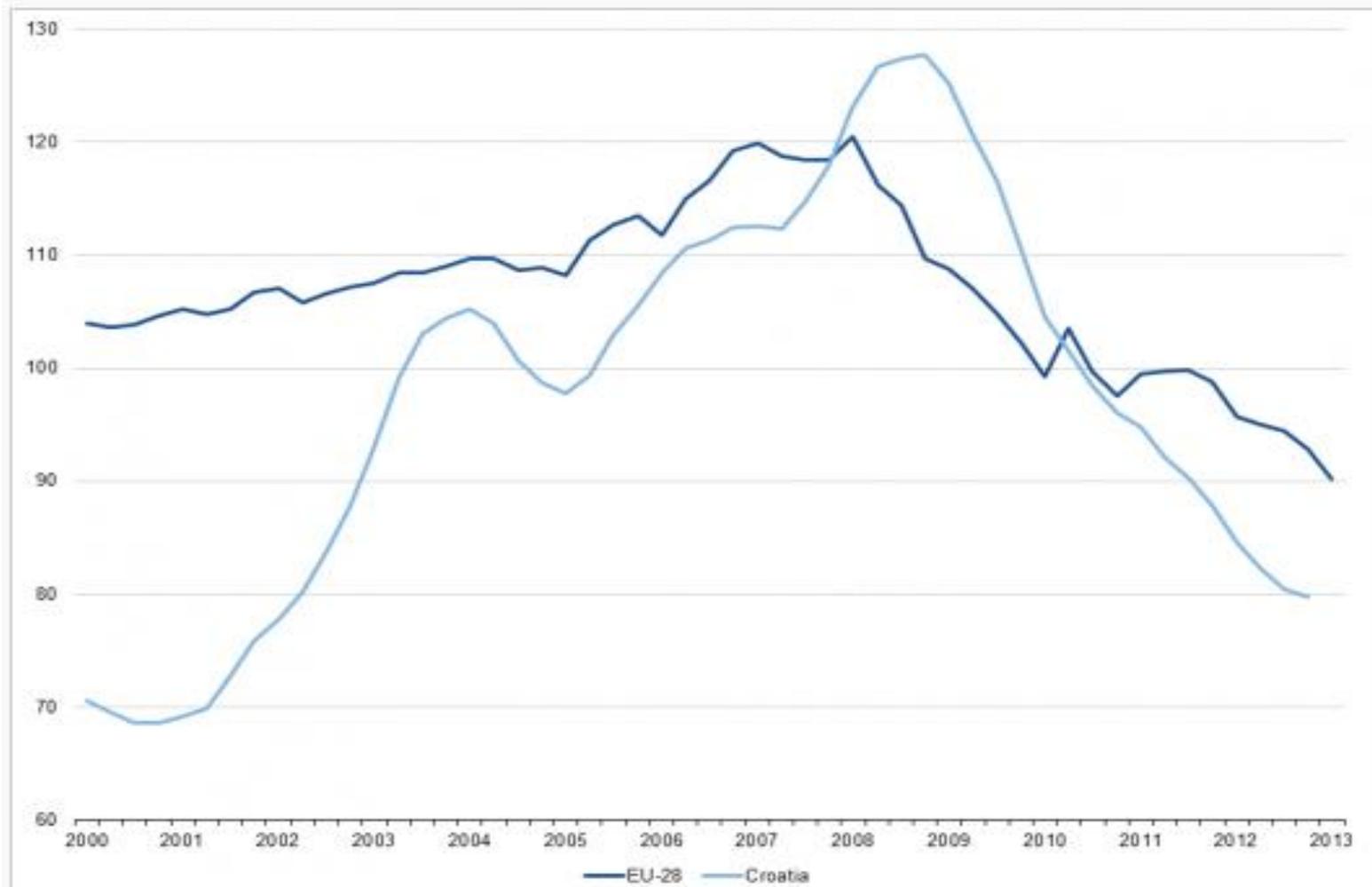
With a long recession



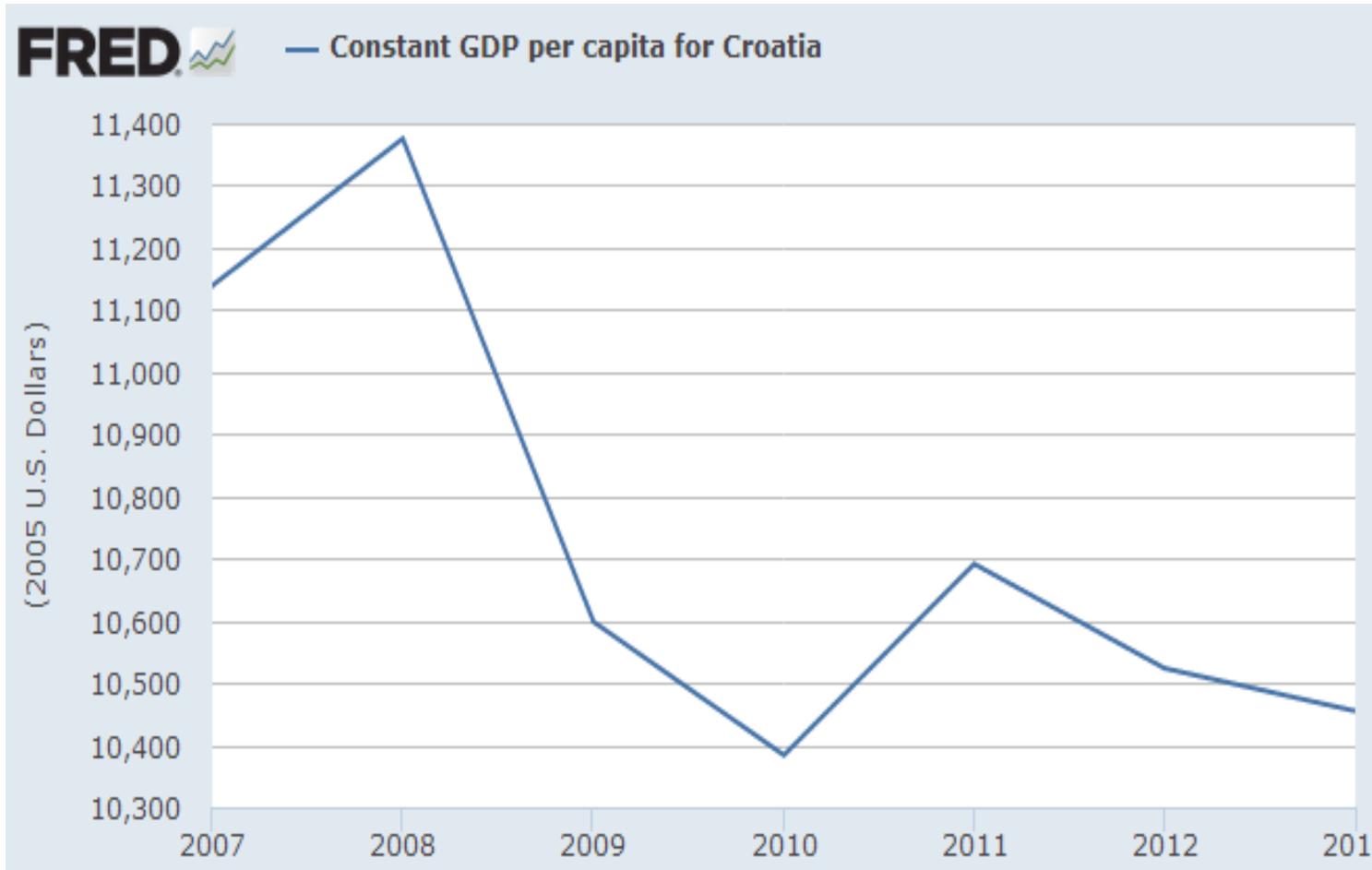
Weak industrial production



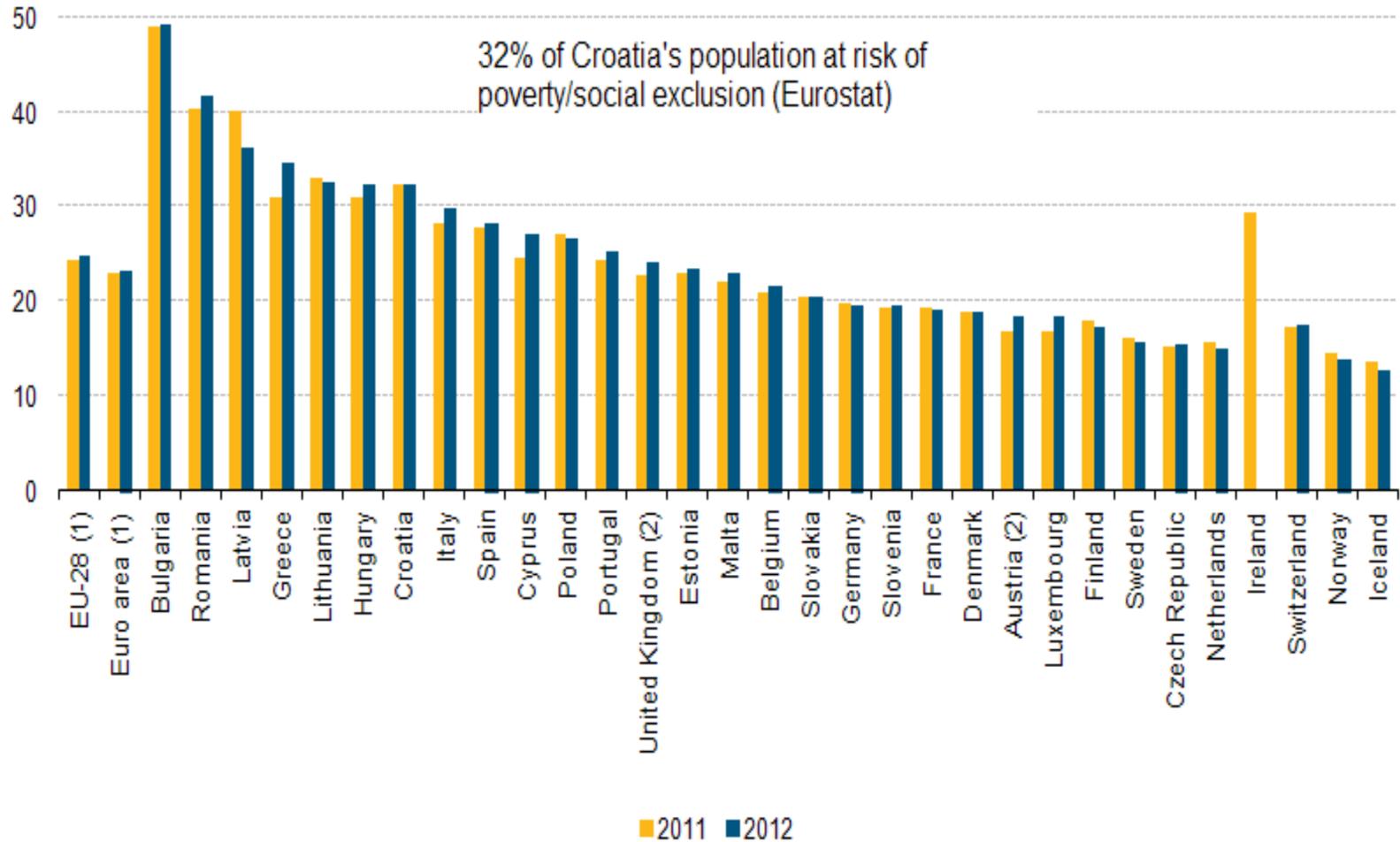
And weak construction



Falling living standards



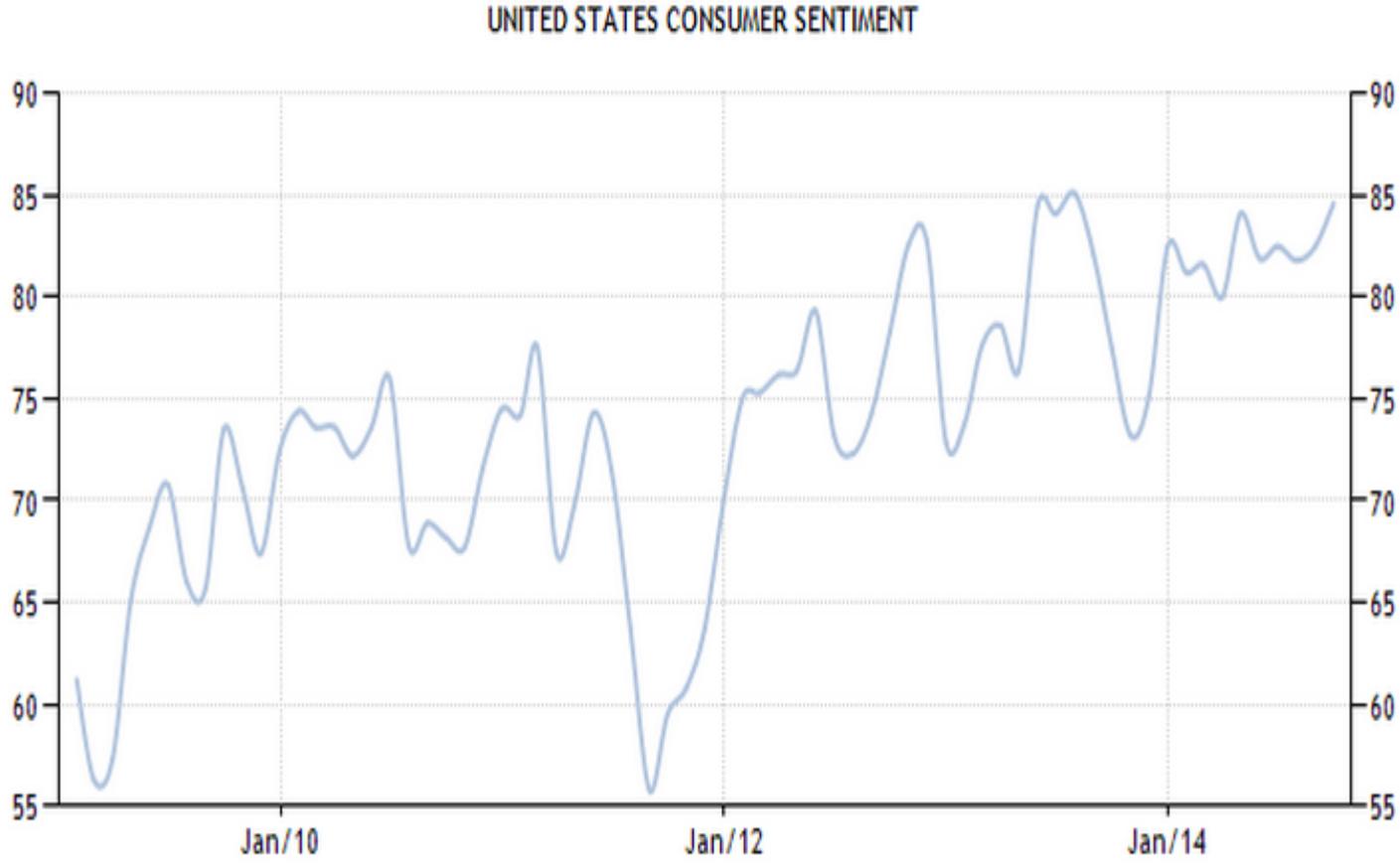
An increased risk of poverty



A brighter future?



US consumer confidence has recovered



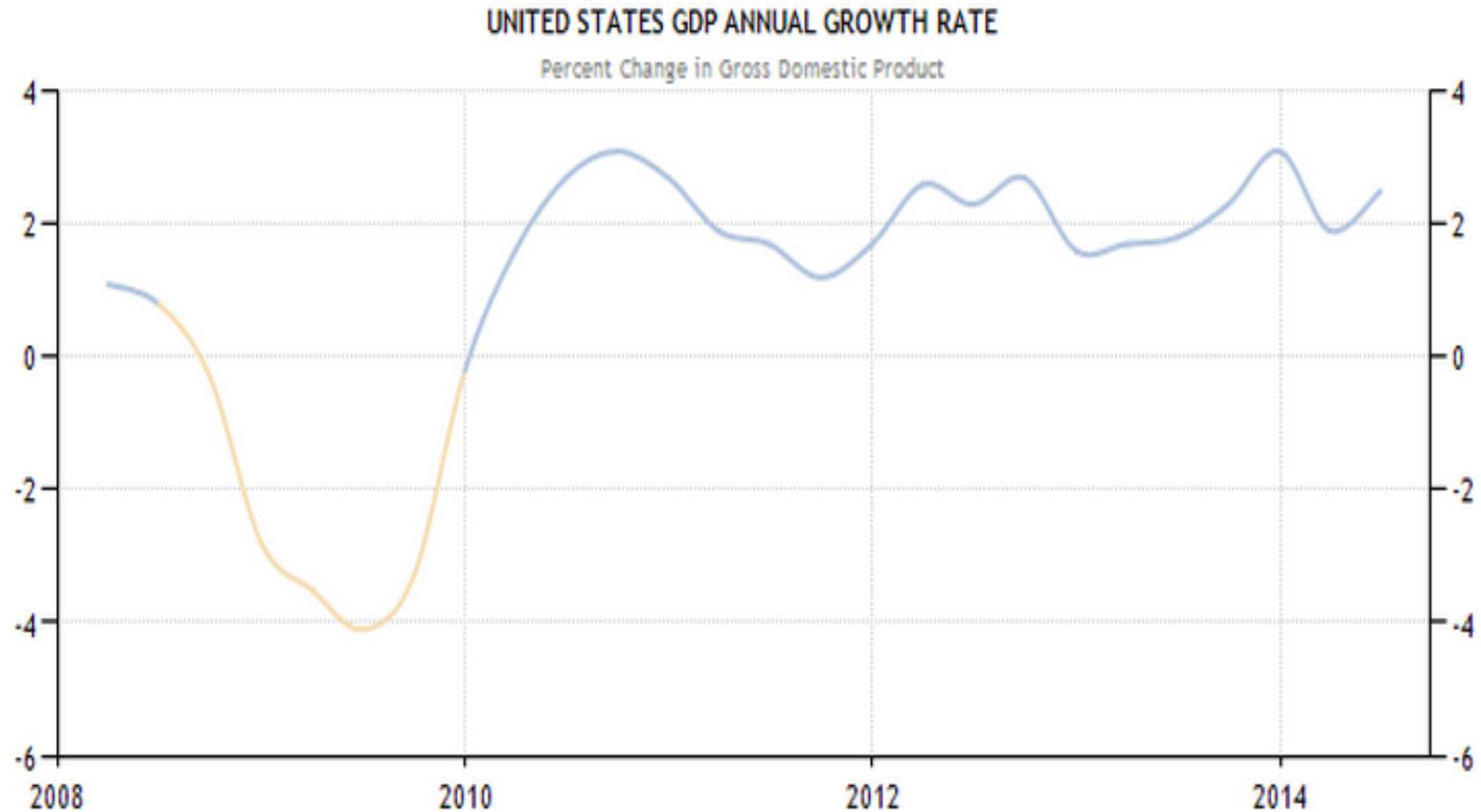
SOURCE: WWW.TRADINGECONOMICS.COM | THOMSON REUTERS/UNIVERSITY OF MICHIGAN

Confidence above long-run average in Europe



source: European Commission services

US recovery now well established



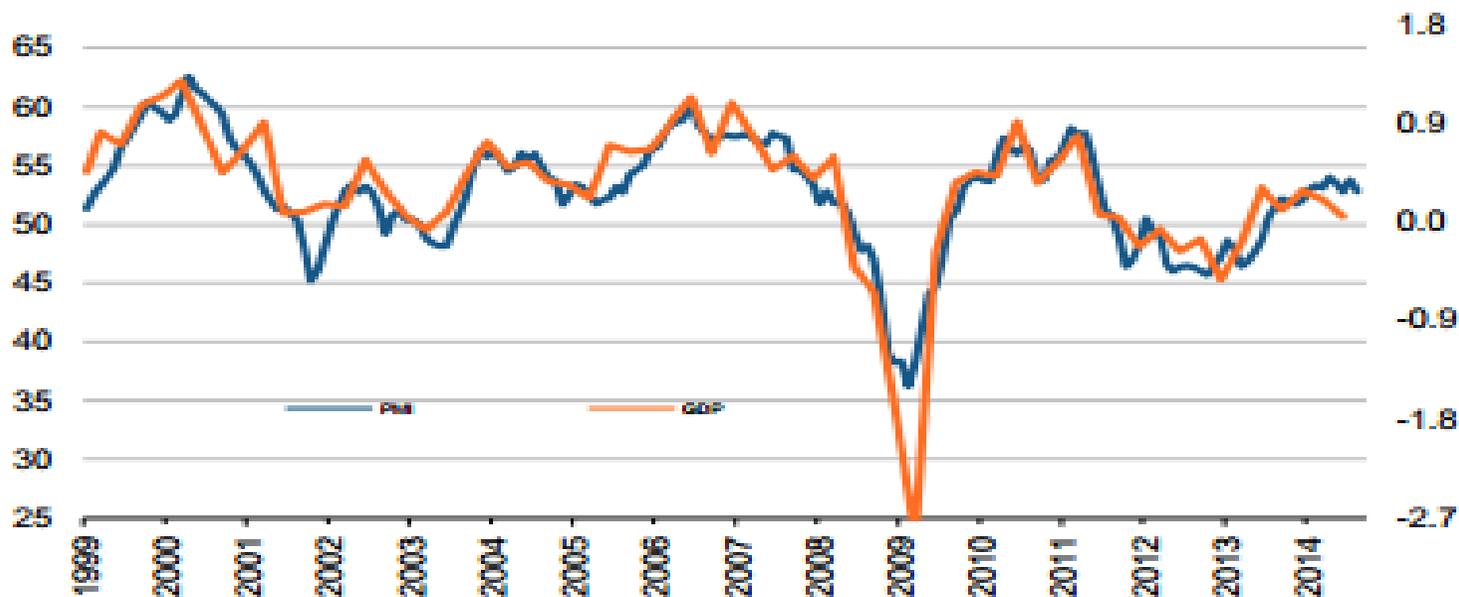
SOURCE: WWW.TRADINGECONOMICS.COM | U.S. BUREAU OF ECONOMIC ANALYSIS

And Europe is growing again (just)

Markit Eurozone PMI and GDP

Markit Composite PMI Output Index
sa, 50 = no change

Eurostat Eurozone GDP
Quarterly % change



Source: Markit, Eurostat. GDP = gross domestic product

Britain is growing very well



SOURCE: WWW.TRADINGECONOMICS.COM | OFFICE FOR NATIONAL STATISTICS

What's the outlook?



Five questions

1. Is the euro crisis over?
2. Is Croatia's economy set for recovery?
3. Are global interest rates going up?
4. Are emerging economies still a growth story?
5. What are the risks?

1. The good news for Europe

- Nobody is seriously talking about the end of the euro any more.
- The European Central Bank is aggressively acting to head off deflation & stagnation.
- The most severely-hit countries in Europe appear to be coming through the worst.
- Growth, albeit slow growth, is back and unemployment is falling.

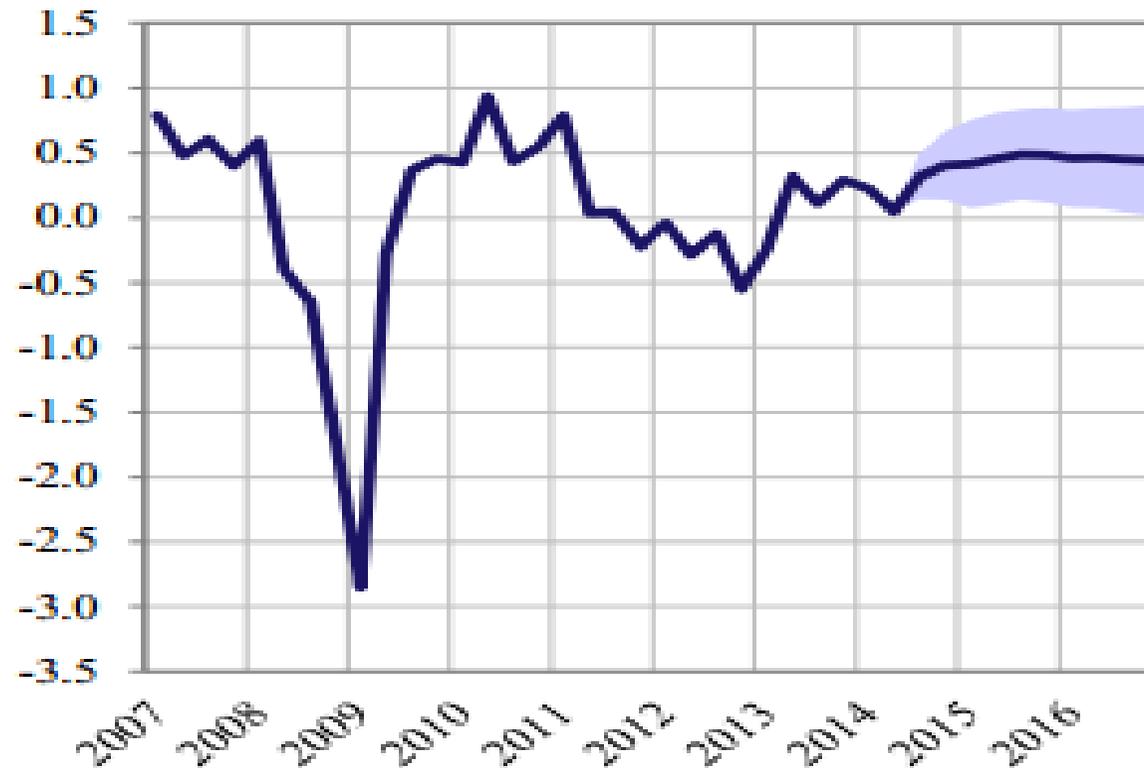
The bad news for Europe

- Though growth is back, it is very weak, perhaps 1% to 1.5% a year. Ultra low interest rates tell their own story.
- Two of its big economies – France and Italy – look particularly weak, even as ‘peripheral’ economies recover.
- Political discontent, driven by slow growth and high unemployment, persists.

Europe should continue to recover slowly

Euro area real GDP

(quarter-on-quarter percentage changes)



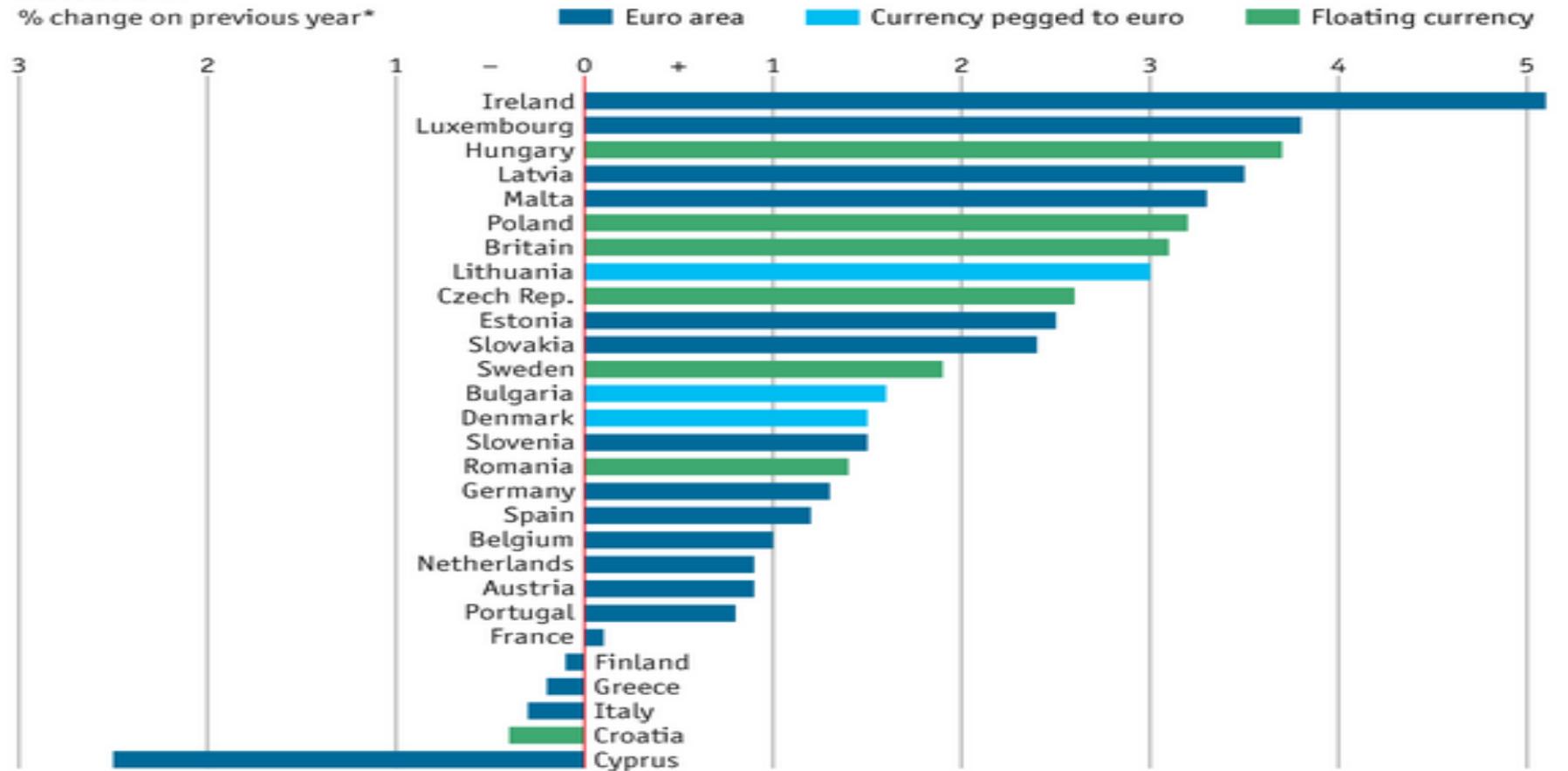
But with very wide variations

- Strongest growth now in Ireland, Spain, Portugal, UK, Sweden, Netherlands, together with Poland, Slovenia, Slovakia, Latvia, Lithuania, Estonia, Hungary. Greece gradually returning to growth
- Weakest growth in Italy – in its third recession in six years – France, Germany, Denmark, Cyprus, Belgium.

The good and the bad in Europe

Latest GDP

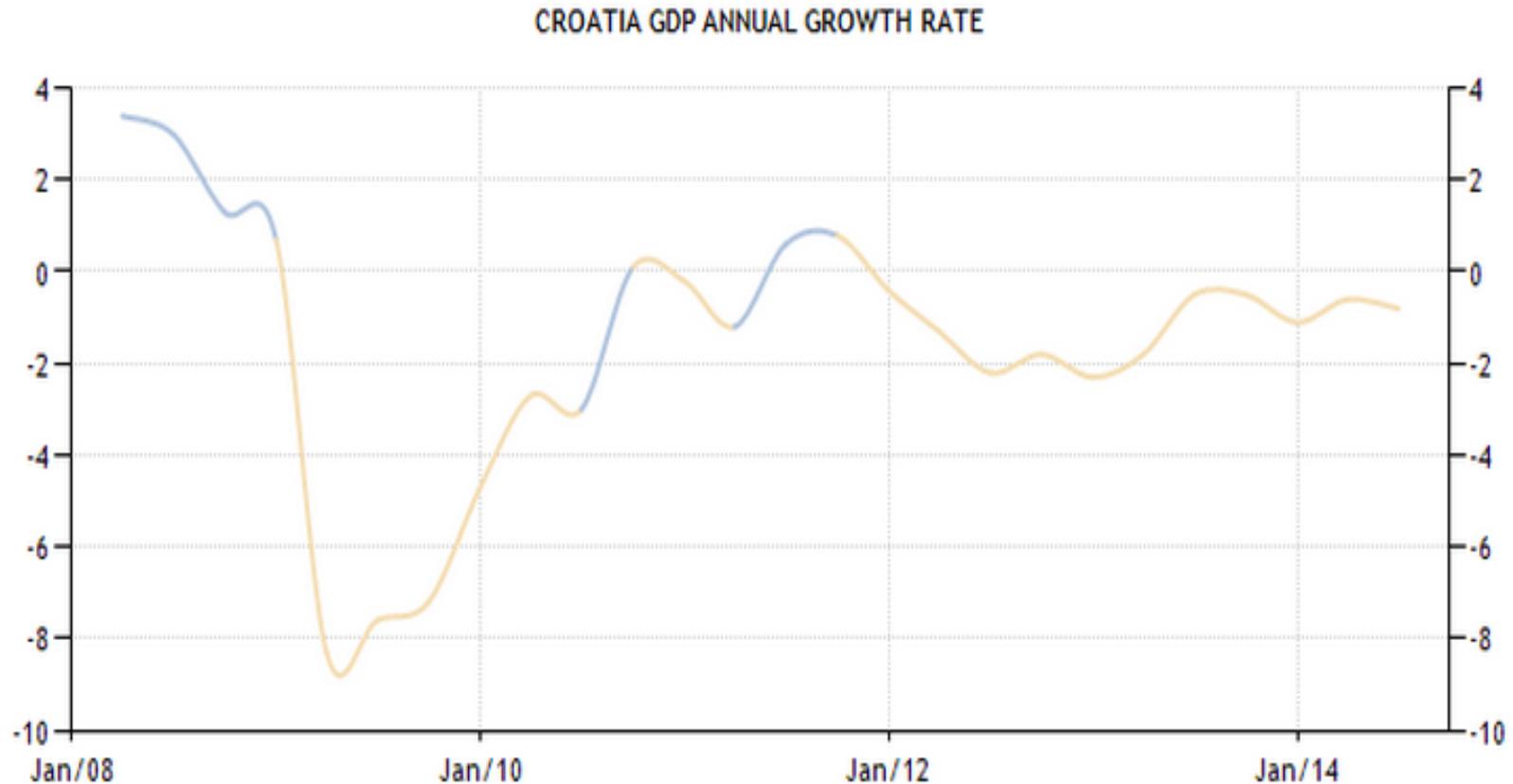
% change on previous year*



Source: Eurostat

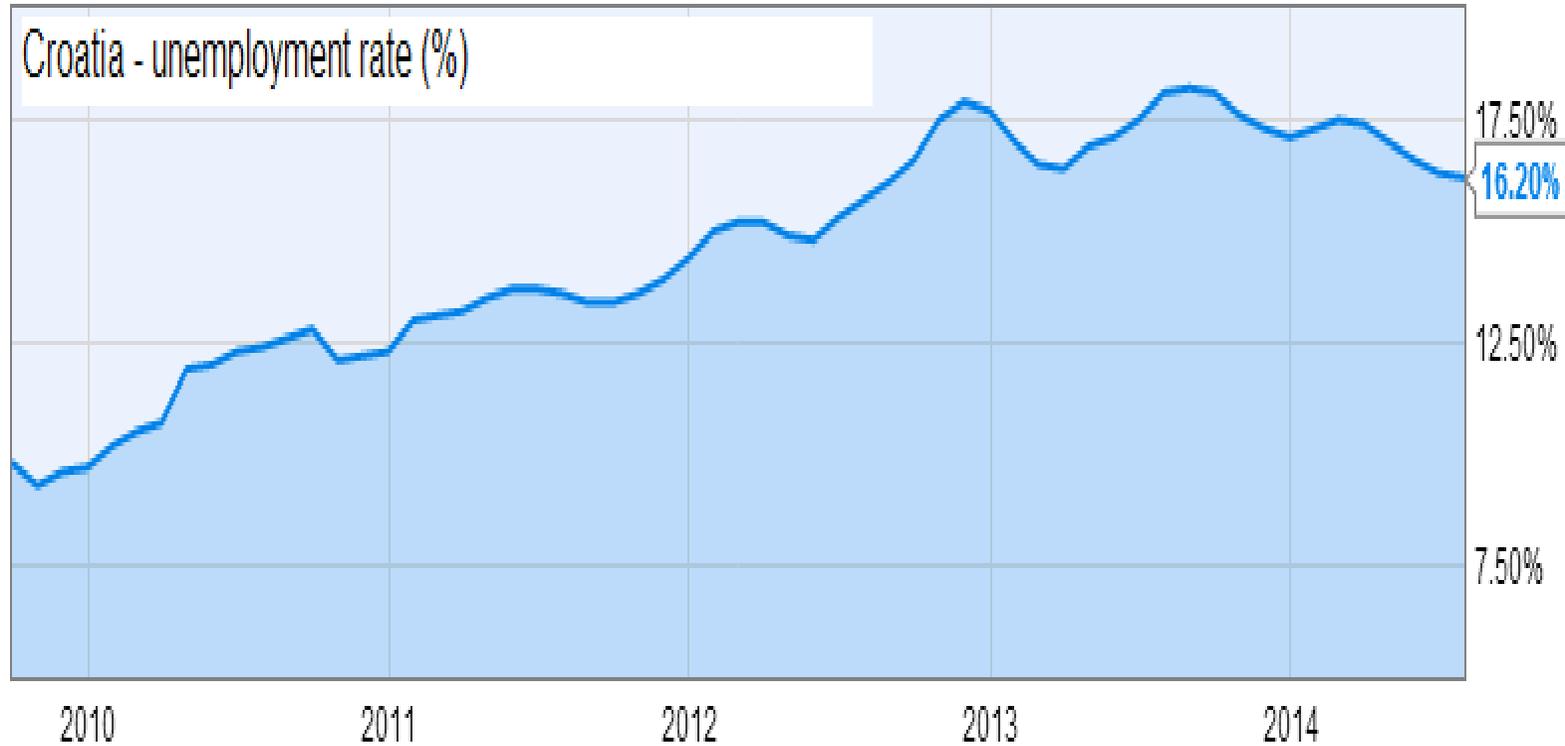
*Q2 2014 or latest

2. A revival for Croatia?

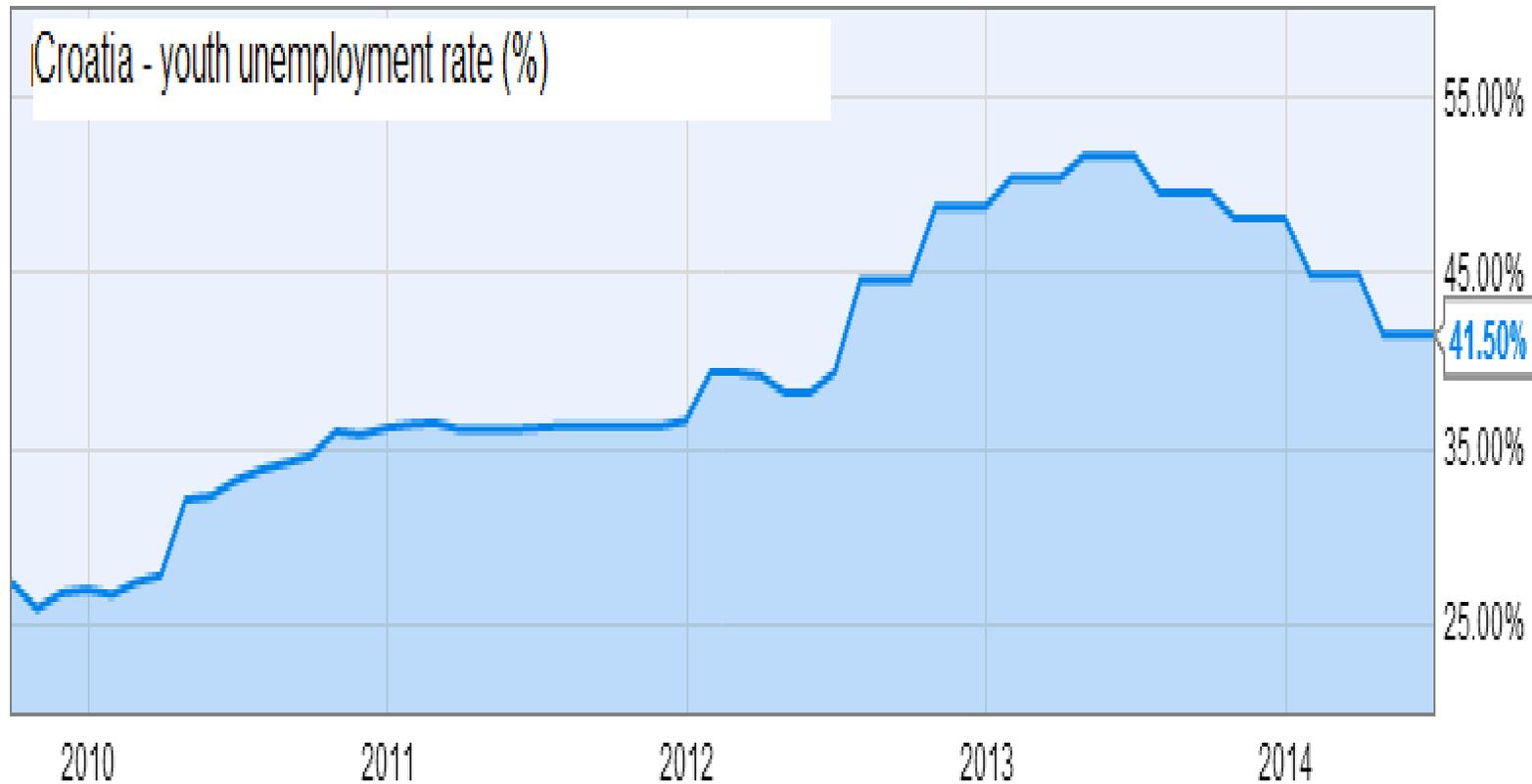


SOURCE: WWW.TRADINGECONOMICS.COM | CROATIAN BUREAU OF STATISTICS

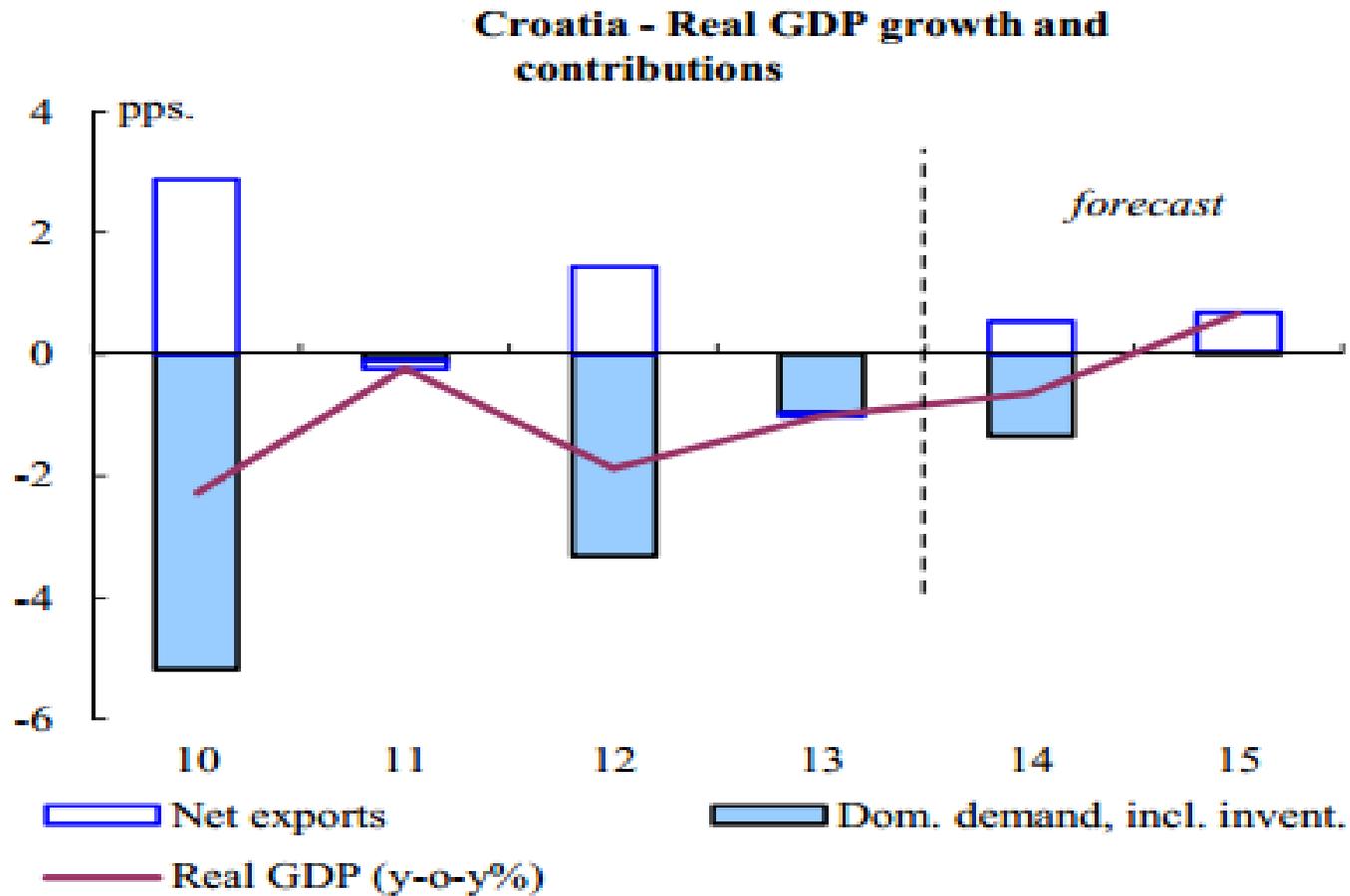
Unemployment edging lower



Including youth unemployment



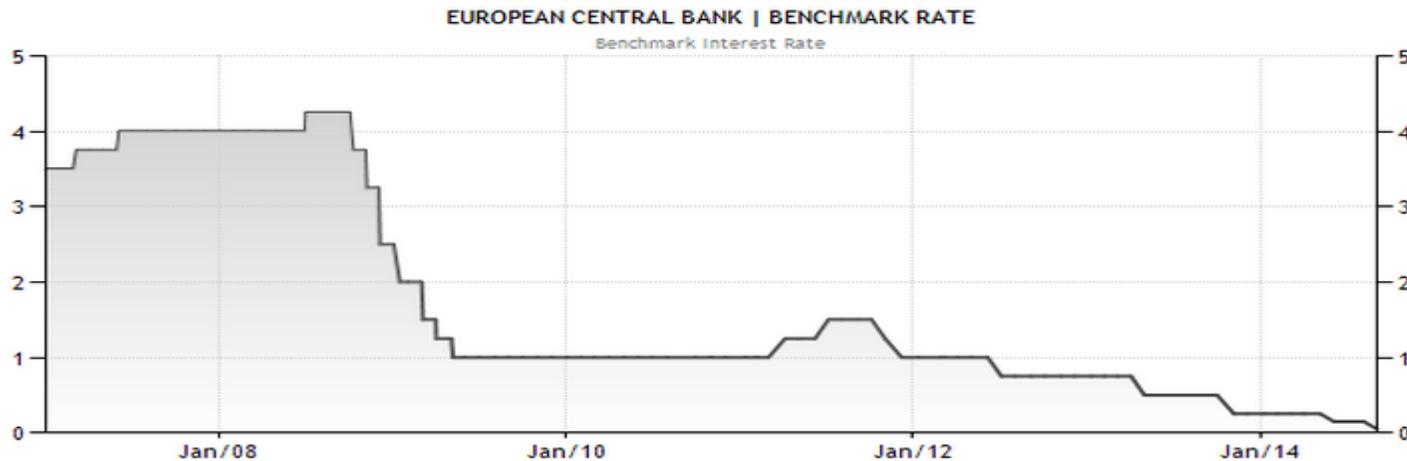
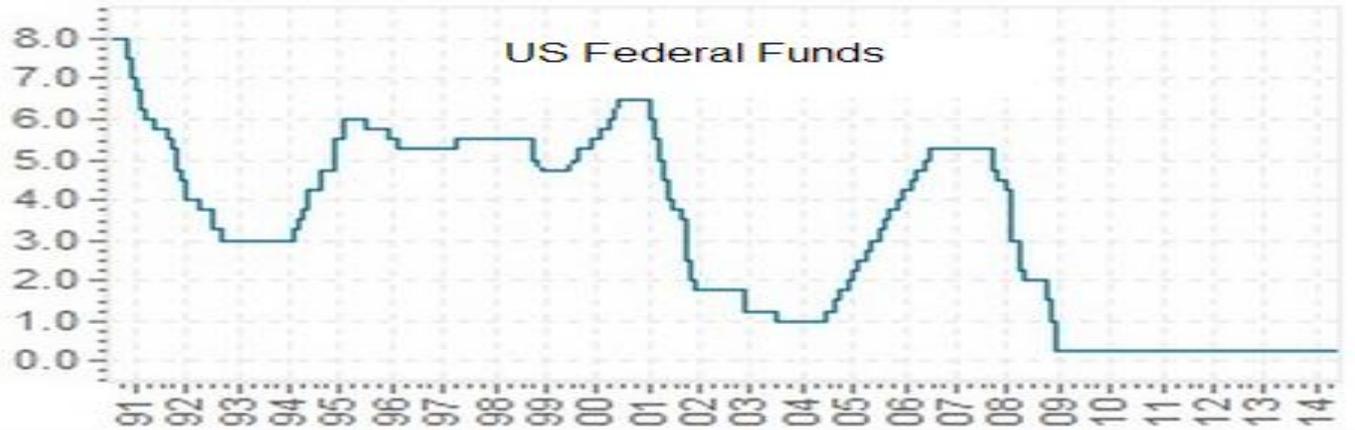
Modest growth likely in 2015



But a long way to go

- Growth risks remain tilted to the downside
- Deficit reduction/high private sector debt will weigh down on growth
- Further labour market reforms needed to boost low employment
- Supply-side changes needed to boost investment and private enterprise

3. A time of record low interest rates



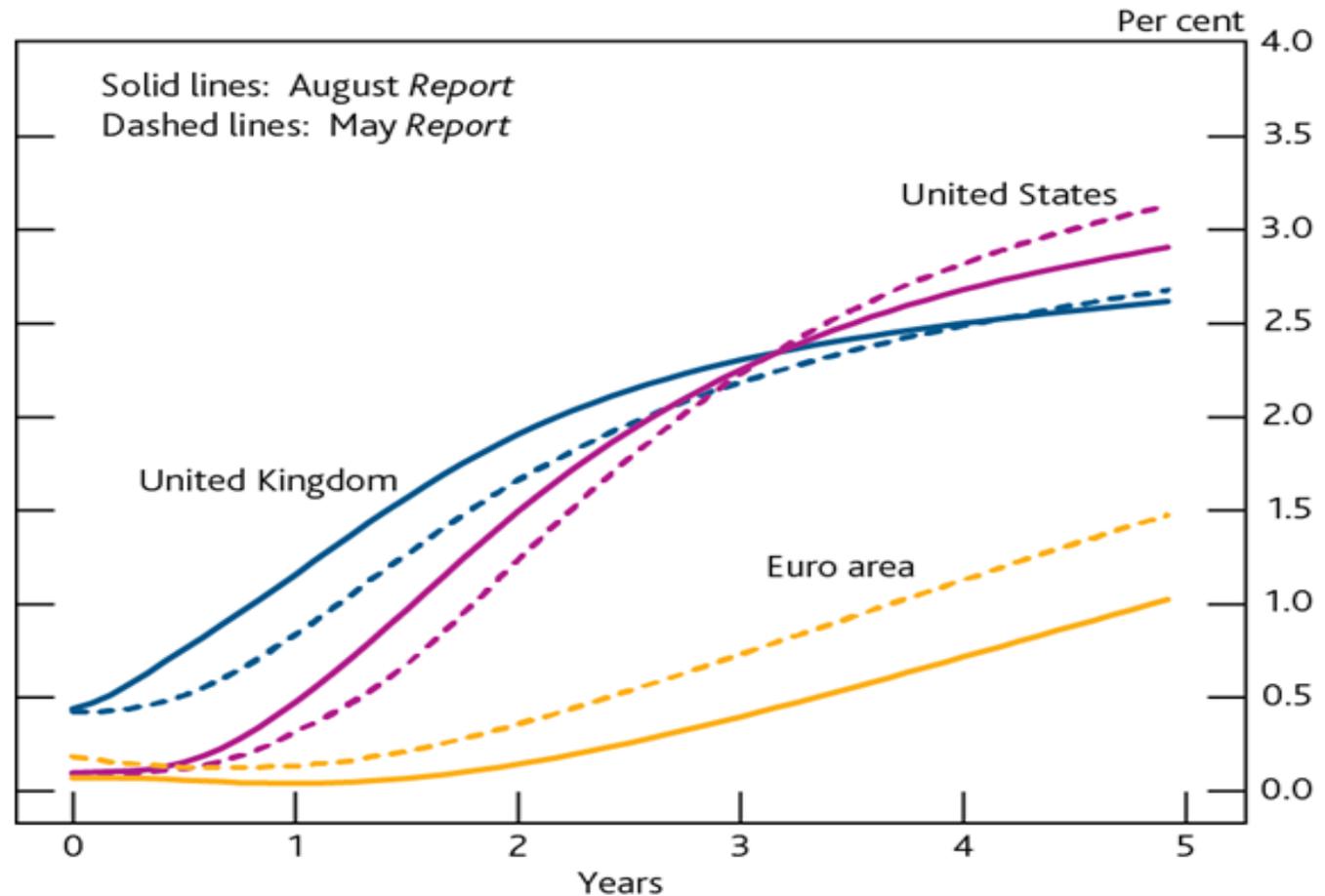
SOURCE: WWW.TRADINGECONOMICS.COM | EUROPEAN CENTRAL BANK

For a very long time

- Federal Reserve began to cut rates in 2007
- Last UK rate rise was more than seven years ago
- European Central Bank has only just cut rates again
- Longest period of unchanged rates for 60 years.

Rate rises are on the horizon

International forward interest rates



Though not everywhere

- Bank of England set to hike first, in the first half of 2015
- Federal Reserve should start later in 2015
- But any rate rise by the European Central Bank very distant
- Japan stuck with zero interest rates

And not by too much

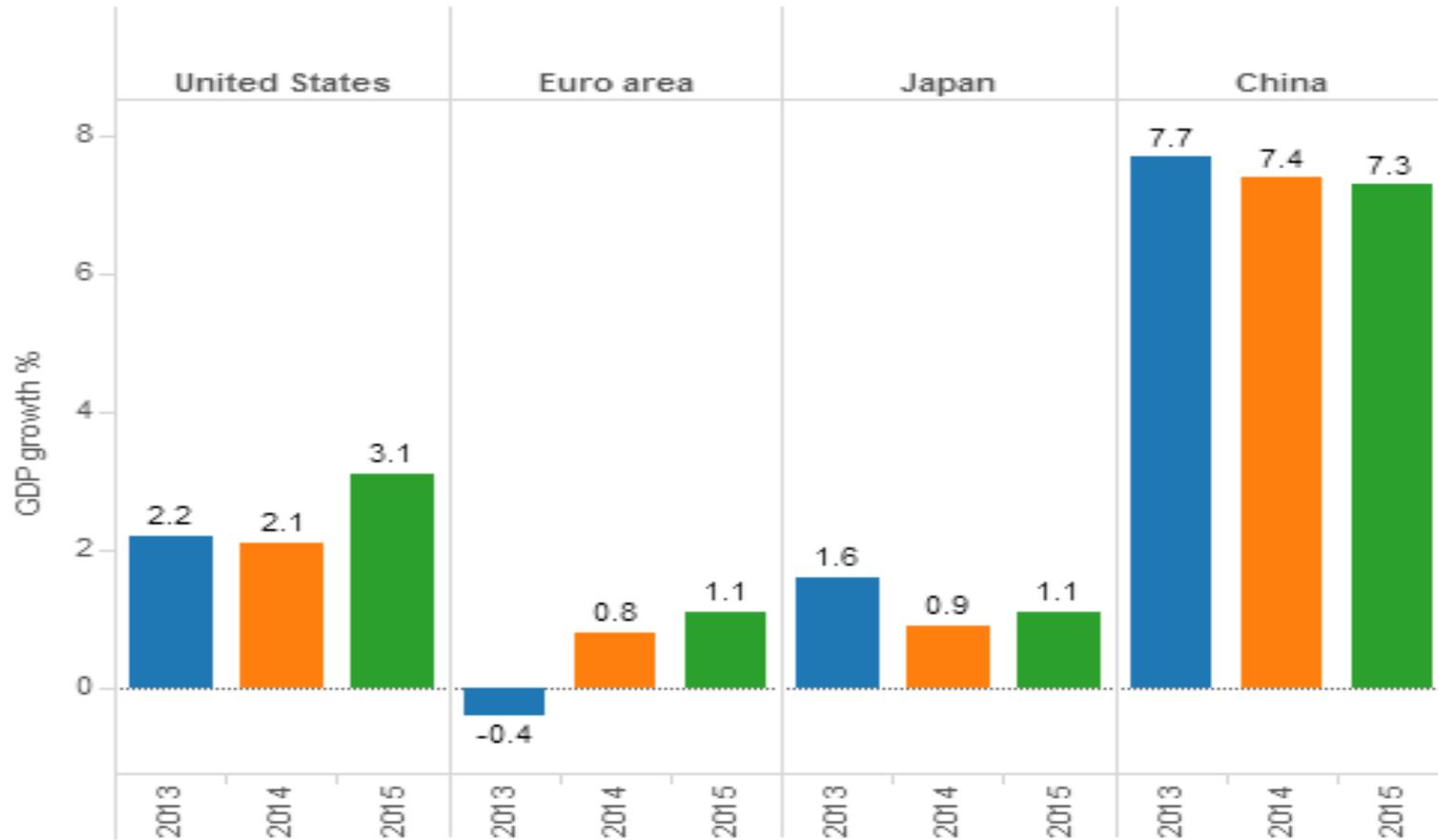
- Central banks are emphasising a 'new normal' for interest rates.
- When rates rise they will do so gradually and to a much lower level than in the past.
- So 2.5% or 3% rates could be the new norm.

4. The global economy's shifting sands



A gradual global upturn

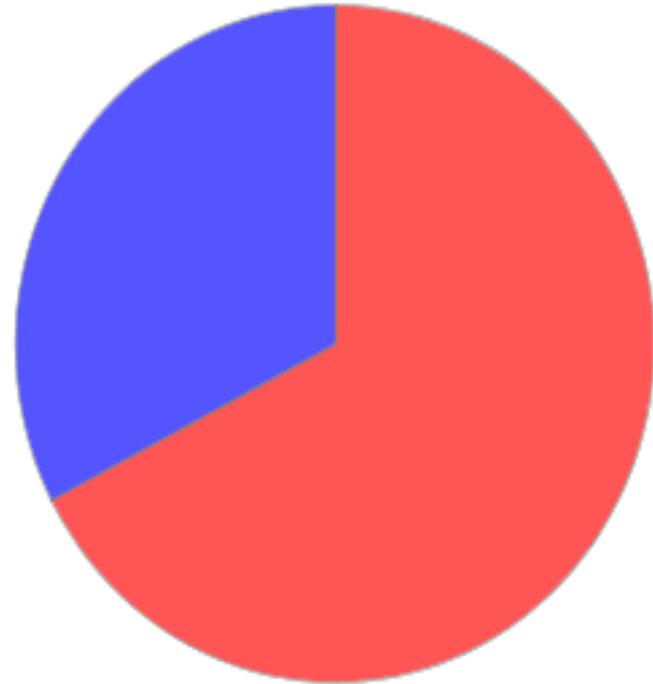
GDP growth



Source: OECD interim forecasts

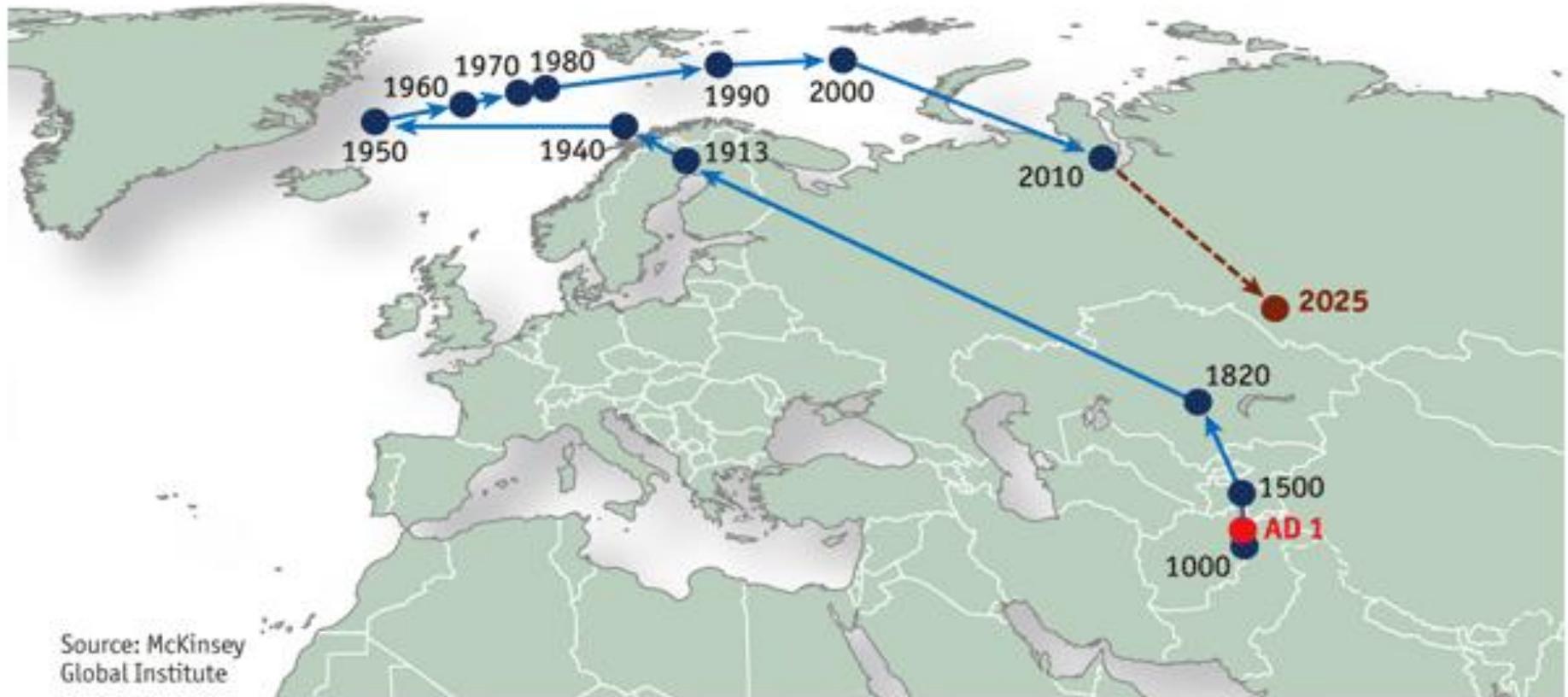
The 2/3 -1/3 rule

- 1990s: Two-thirds of global growth from advanced economies, one-third from emerging countries.
- 2010s: Two-thirds of global growth from the emerging world, one-third from advanced.



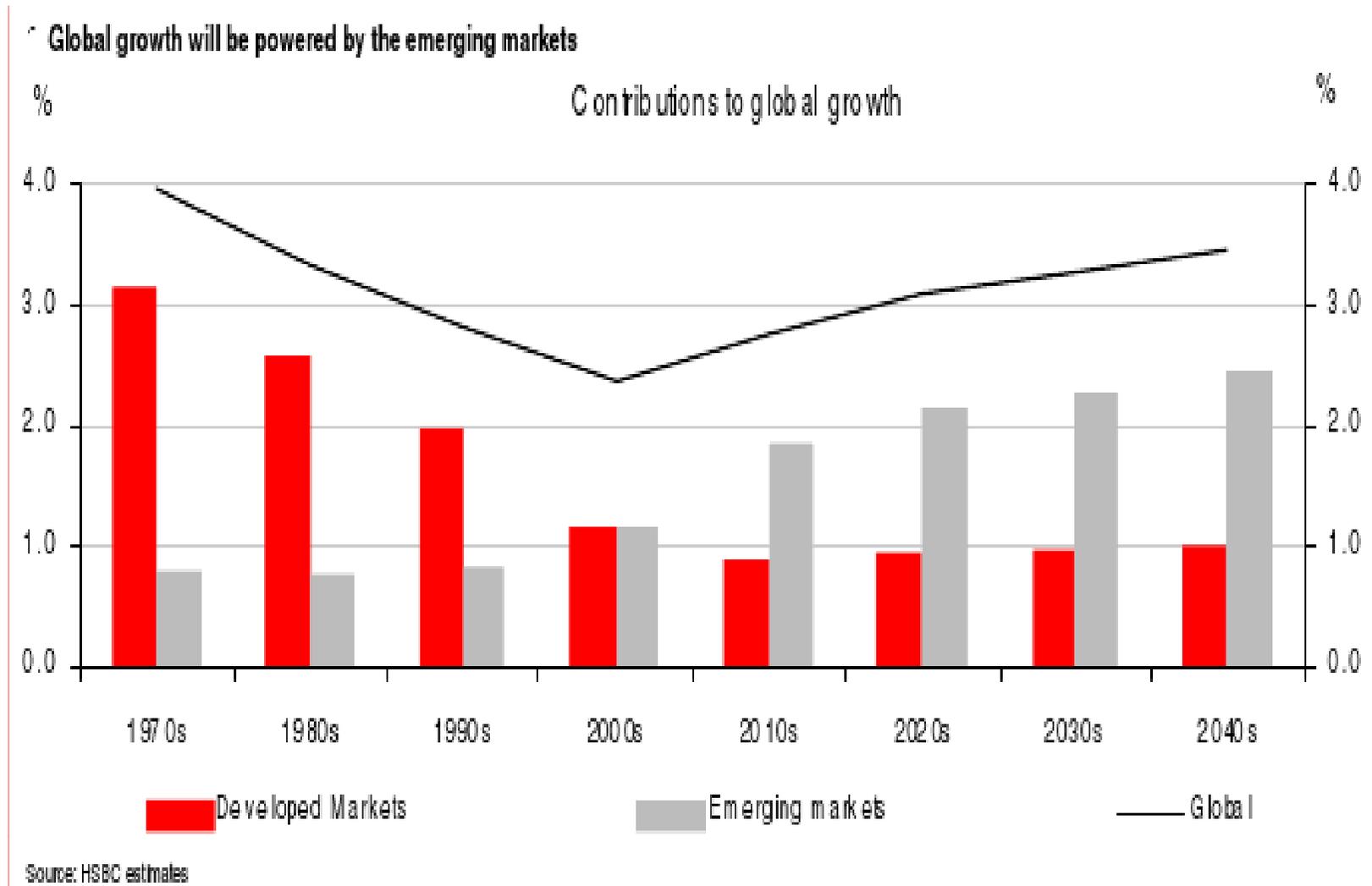
The world's centre of gravity shifts

Evolution of the earth's economic centre of gravity
AD 1 to 2025



Source: McKinsey
Global Institute

And there's plenty of growth to come



Though maybe at a slightly slower pace

Evolution of growth in emerging markets

Favorable external conditions are waning, stimulus policies are being rolled back, and productivity gains are leveling off, resulting in lower potential growth.

(simple average, percent)

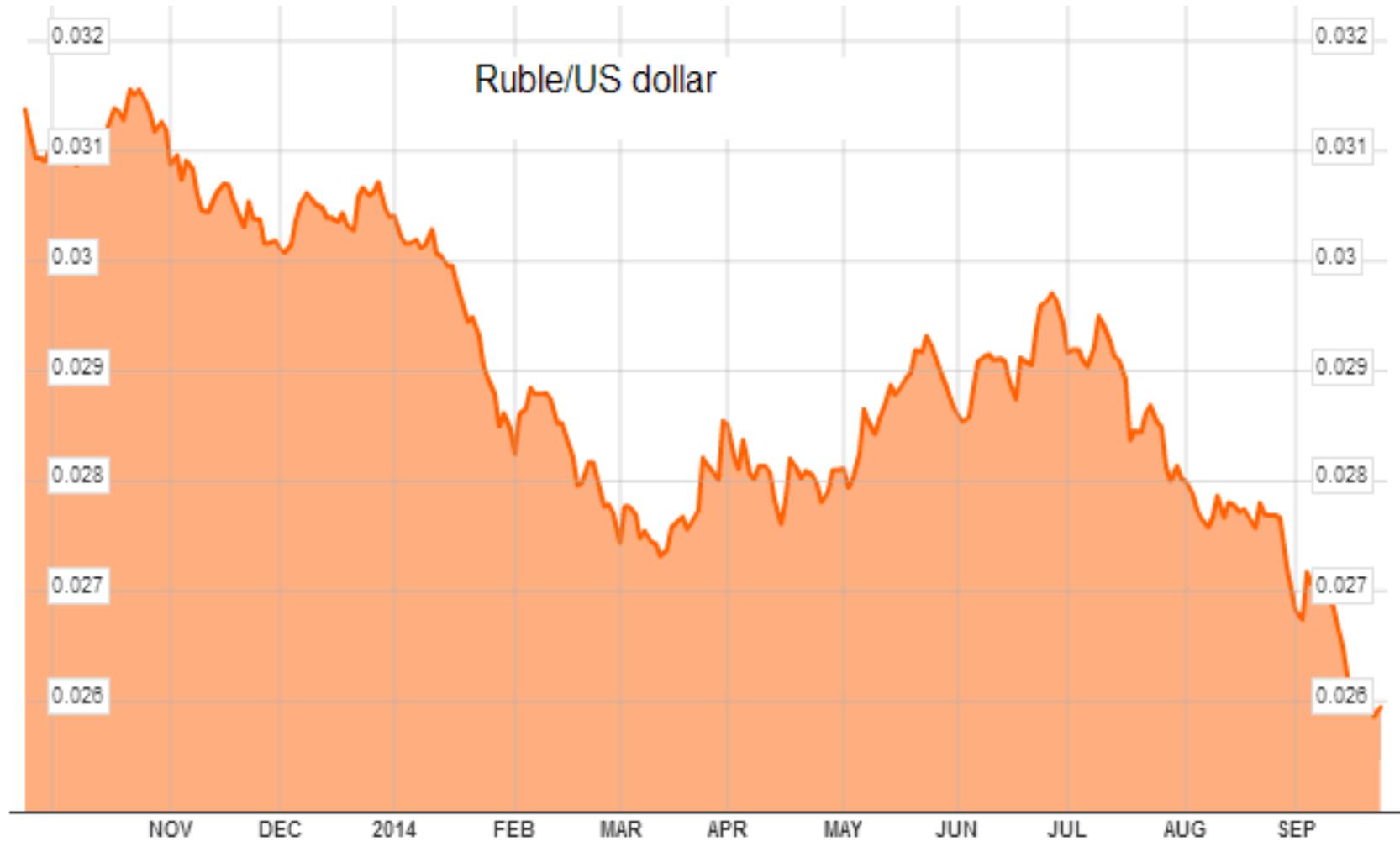


Source: IMF staff estimates.

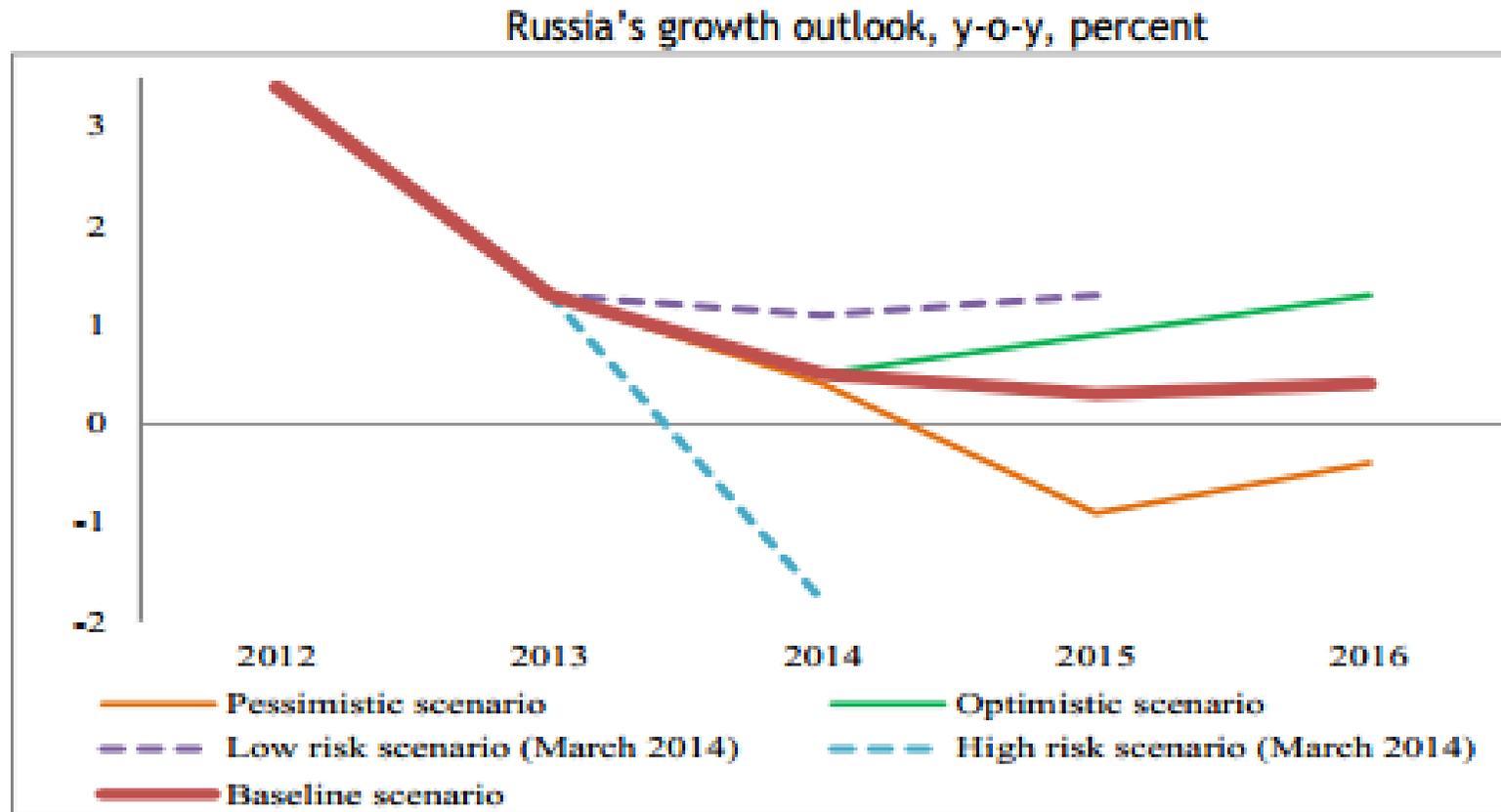
5. What are the risks?

- Russia/Ukraine
- Middle East instability – the rise of Islamic State and other militant groups
- Another round of the eurozone crisis/further EU banking difficulties
- Slower growth in China
- Protectionism
- The unknown unknowns

Russia-Ukraine crisis has hit the ruble

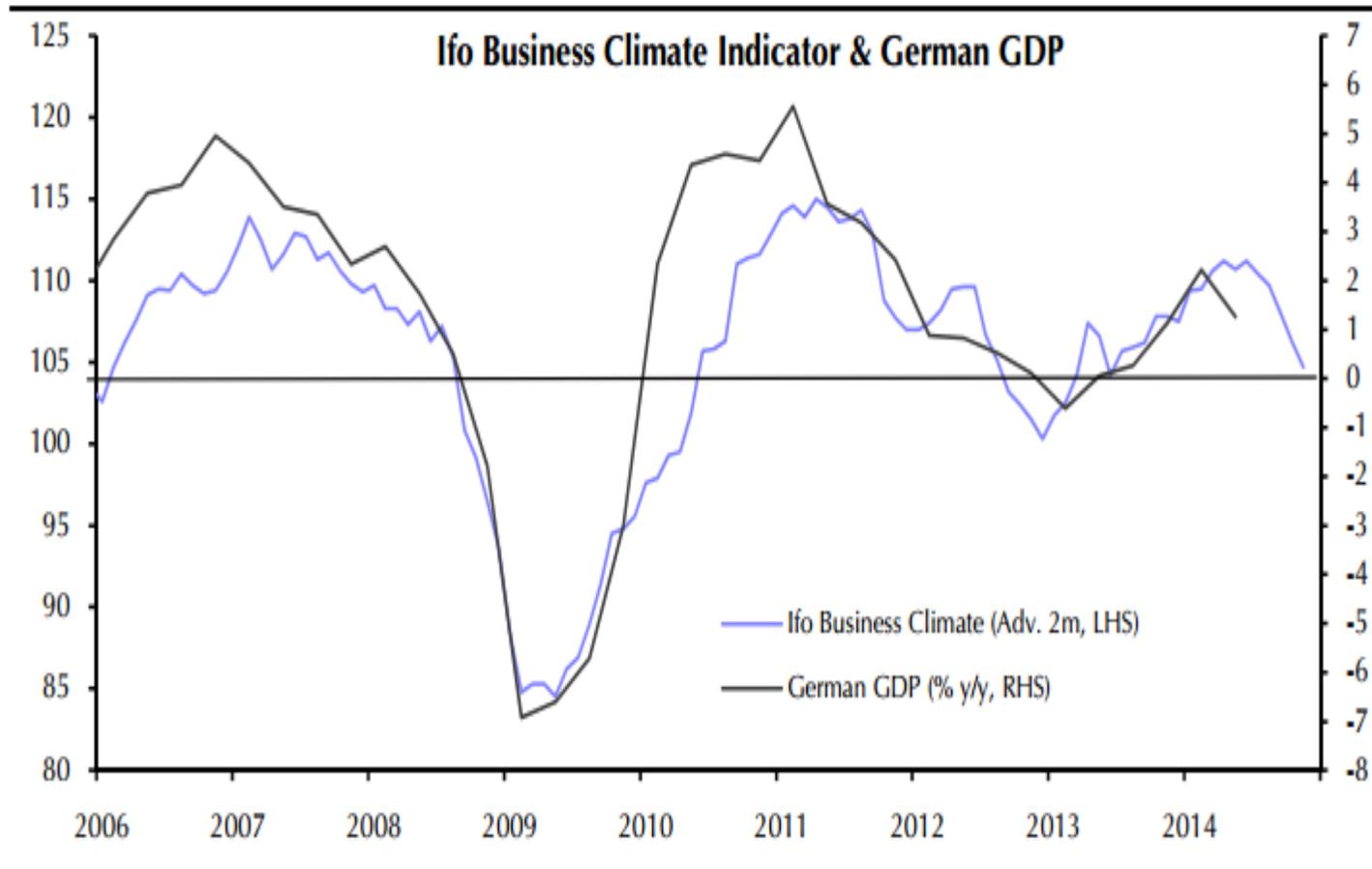


A Russian economic slowdown



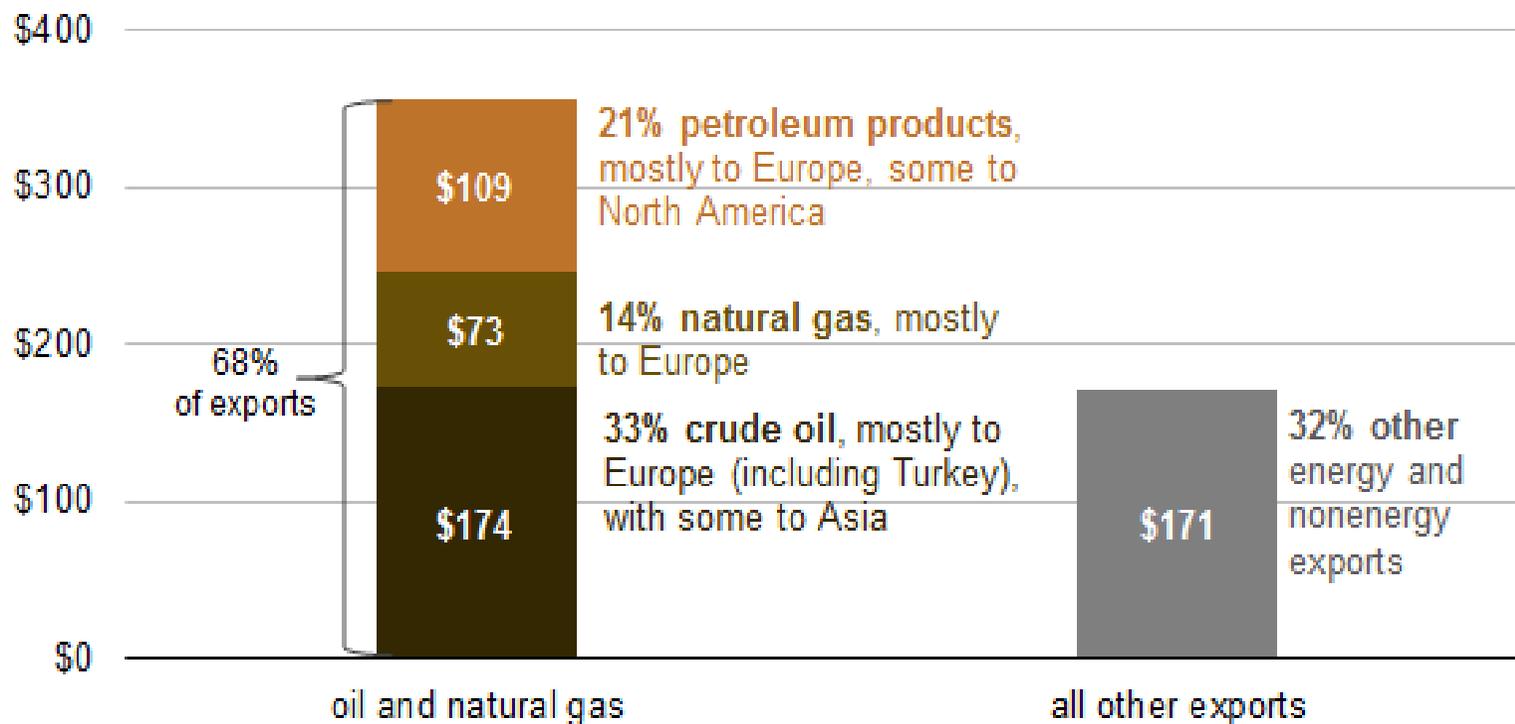
Source: World Bank staff estimates.

And a hit to business confidence in Germany



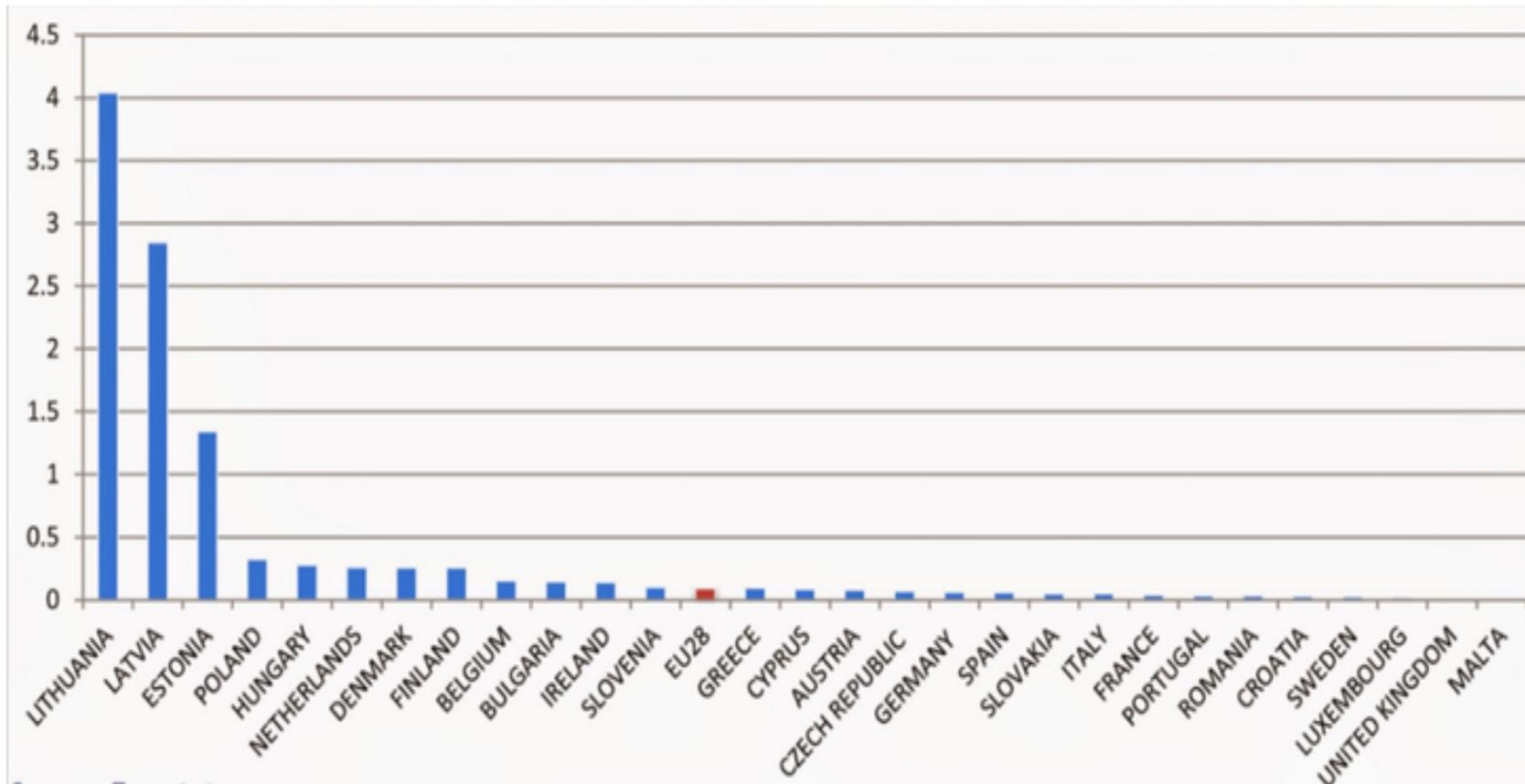
Sanctions will hit some Russian exports

Russia gross export sales, 2013, USD bn



And some exporters to Russia

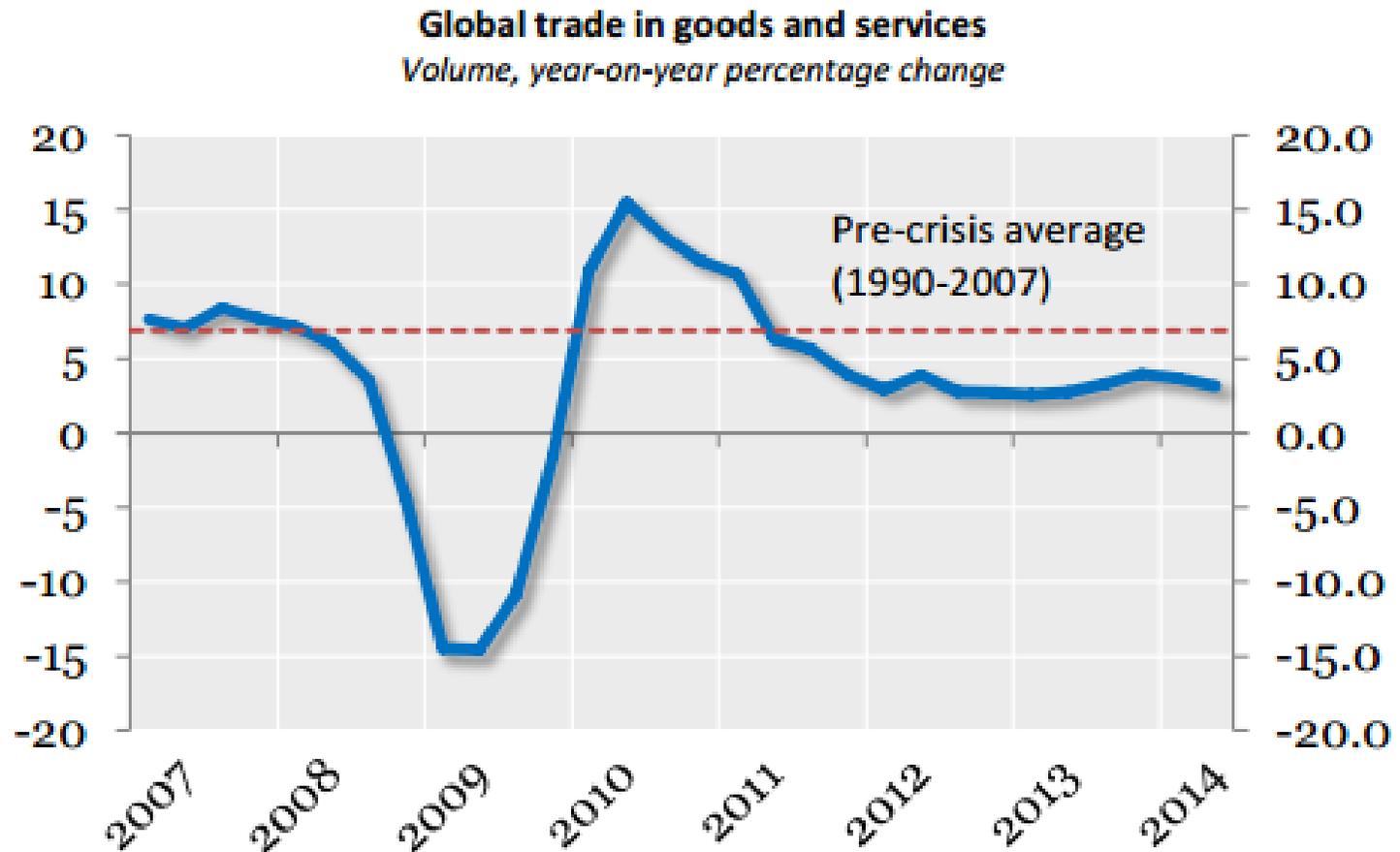
Shares of agricultural trade with Russia as percent of annual GDP, 2013



Middle East crisis yet to hit oil market

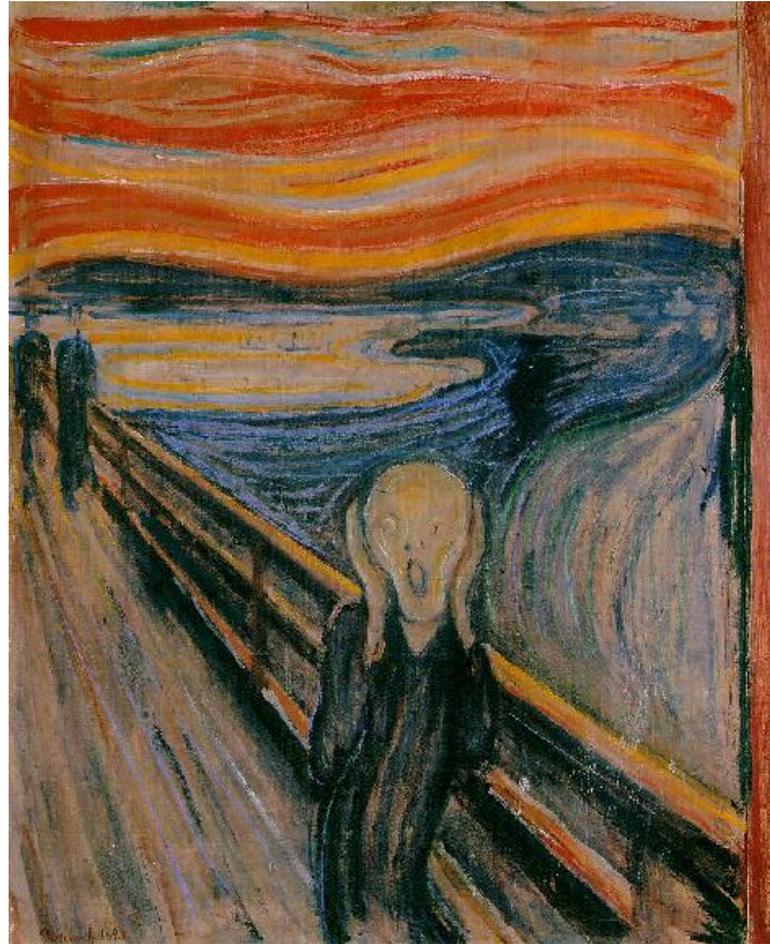


But world trade weaker than it should be



Source: OECD National Accounts database.

So should we still be worried?



Or look forward with optimism?



Summing up

- Growth prospects slightly better in Europe but remain subdued.
- Interest rates in some advanced economies will rise, but only gradually.
- Eurozone crisis not gone away, but danger of break-up less than it was.
- Croatia set for modest growth but work to do.
- Emerging market story still intact.