

Close ties, great opportunities

Italian companies in Croatia: are we reaping all the benefits?

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*[...] we have excellent relations, two countries which are really friends [...]
(Sergio Mattarella, President of the Italian Republic, Zagreb 24/04/2015)*

Executive summary

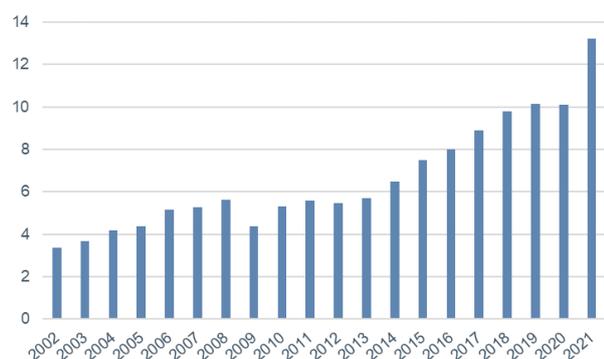
- ◆ Croatia has benefited from joining the EU: in 2019 the country's GDP per capita was up by 5 pp compared to the EU accession level in 2013. Over the next years economic convergence should experience an additional boost from joining the Euro Area and Schengen Area (possibly in 2023).
- ◆ The Croatian economy is deeply integrated in the single market, as more than half of foreign trade occurs with EU partners. Croatia is planning to adopt the euro next year (on January 1, 2023). An additional boost to goods' exports is expected from both the Euro Area and Schengen Area accession.
- ◆ Economic relations between Italy and Croatia have also benefited. Italian exports of goods almost doubled between 2012 and 2019, reaching EUR 3.8 billion.
- ◆ About 70% of Italy's exports to Croatia originates in four regions: Lombardy, Veneto, Sicily, and Emilia Romagna, the former two having exported around EUR 800 million each in 2021, the latter two around EUR 400 million each. By adding to these the quite significant export flows from Friuli-Venezia Giulia, Piedmont and Tuscany – which were above EUR 140 million each – almost 90% of Italian export towards Croatia is accounted for.
- ◆ Political risks in the country are limited, according to SACE's risk indicators. However, with some counterparts – small banks or private companies - caution may be needed: the credit risk profile is relatively higher than the political one.
- ◆ Croatia is one of the largest beneficiaries of the Recovery and Resilience Facility allocation of EUR 6.3 billion in grants (over 12% of GDP). In addition, financial envelope for Zagreb over the next decade also includes EU long-term budget in the amount of around EUR 14 billion.
- ◆ We see many opportunities for enhancing cooperation between Italian and Croatian economy: i) the National Recovery and Resilience Plan (NRRP) supports a new investment cycle that creates demand for imports of various machinery and equipment, as well as construction materials, ii) moreover, NRRP envisages speed up in privatisation of state-owned enterprises (SOEs) and iii) Mergers and Acquisitions.
- ◆ Italian companies will benefit on one hand from Croatia's greater integration in the European market and the thriving economy and, on the other hand, from the many initiatives that Zagreb is implementing, including privatizations of SOEs.

At the doorstep of the Euro Area

On July 1st 2013, Croatia joined the European Union (EU) becoming its twenty-eighth member. Zagreb has benefited economically since joining the EU: fiscal stabilization has been achieved, interest rates on all types of loans have declined and the country has gained access to the EU funds. Moreover, domestic companies have entered the single market and supply chains in other member states (Fig. 1). As a result the Croatian economy is now deeply integrated into the EU as more than half of foreign trade occurs with EU countries, among which the most important are Germany, Italy, Slovenia, Austria and Hungary. Although the Adriatic country is perceived as a service sector economy – given the utmost importance of tourism – manufacturing has significantly improved its performance over recent years, which is confirmed by stable growth in goods' exports.

Following a -8.1% contraction due to the pandemic, Croatia's economy rebounded quickly in 2021 by posting a 10.2% growth (Fig. 2). A strong V-shaped recovery was supported by both domestic and foreign demand. Private consumption and investments increased by 10.0% and 7.6%, respectively. At the same time the volume of exports of goods recorded strong double digit growth (+20%) confirming further their resilience, which already emerged in 2020 (+0.3%). Exports of services (namely tourism which accounts for around 70% of services exports) recovered swiftly by posting a 51.5% growth in 2021.

Fig. 1 – Croatian exports of goods to EU (27) countries (EUR billions)



Source: Eurostat

Fig. 2 – GDP growth (constant prices, annual change)



Source: Ameco, European Commission (Winter 2022)

In terms of economic convergence, Croatia has experienced relatively slow progress compared to other new Member states, especially due to the six-year recession initiated by the Global Financial Crisis: GDP experienced a 12% decline over 2009-2014. However, in the post-recession period the country's position improved and in pre-pandemic 2019 Croatia was at 66% of EU27 GDP per capita in PPP or up by 5 pp compared to the 2013 EU accession levels. Over the next years economic convergence should experience an additional boost from joining the Euro Area and Schengen Area (possibly in 2023). Broad Next Generation EU (NGEU) funding, including EUR 14bn of 2021-2027 Multiannual financial framework and EUR 6.3bn Recovery and Resilience Facility (RRF) allocations, will support both investments and reform progress leading to a more sustainable and diversified growth aligned with green transition goals.

Croatia is planning to switch from its national currency, the kuna, to the euro next year - joining the 19-member currency bloc eight years after Lithuania - and almost all political parties back the decision. A significant boost to goods' exports is expected from the Euro Area accession planned for January 1, 2023, but not only

international trade will benefit. Zagreb relies more than any other EU state on international tourism (≈20% of GDP) and the euro will eliminate all exchange rate effects and related costs. Furthermore, Croatia will gain access to the European Central Bank liquidity and the potential bailout financing from the European Stability Mechanism in case of crisis. To ease the access to the country, Croatia also aims at joining the Schengen zone, which removes barriers to travel around Europe. At the same time, Zagreb has a diversified economy (Tab. 1) and the country's geographical position, modern road infrastructure (with railways currently undergoing infrastructural investments) connecting seaports with Central European transport networks represent some of the significant facilitation to doing business in Croatia.

Tab. 1 – The Croatian Economy: diversified potential¹

<p>Primary sector and food industry</p> 	<ul style="list-style-type: none"> • The Gross Value Added (GVA) of primary activities, such as agriculture, forestry and fisheries, accounts for 3.9% of total Croatian GVA. In addition, food, beverages and tobacco products account for 3.5%. • The value of agricultural production is dominated by cereals, cattle, fodder crops, pigs, oilseeds, milk, wine, vegetables and herbs and flowers, which together account for 75% of the sector. • The value of agri-food exports in 2021 was EUR 2.9 billion (15.1% of total exports), while the imports' value was EUR 3.8 billion (13.3% of total imports). • Croatia is self-sufficient in the production of cereals and oilseeds, for which it has a trade surplus. • The most important exported agri-food products in 2020 were: corn, soybeans, cigarettes and wheat; while the main imported ones were: pork, animal feed, bakery products and live cattle for fattening.
<p>Secondary sector</p> 	<ul style="list-style-type: none"> • The GVA of manufacturing and construction accounts for 25% of total GVA. • Over 41% of the total value of all manufactured products is sold abroad, which in turn contributes positively to the country's balance of trade. • Workers are mainly employed in the following manufacturing activities: food products (18%), metal goods (13%) and wood products (except furniture; 7%). • Mechatronics, robotics, electronic and optical products are among those with the best prospects and are characterized by high growth potential (e.g. companies that develop solutions in advanced robotics such as Gideon Brothers, HSTec and H2O Robotics are becoming more and more prominent). • Development of the Croatian automotive industry is based on a long tradition in related sectors, such as metal processing, welding, glass and plastic production and engineering. Zagreb is also becoming a centre for electric cars production, such as Nevera by Rimac Automobili, presented in June 2021. • The pharmaceutical industry has a long tradition in terms of know-how and experience of the workforce. In addition, it is one of the sectors experiencing intensive investments in research and development.

¹ See the Annex for more details.

Service sector



- The service sector represents 55% of the GDP, employing 65.3% of the workforce.
- The tourism sector is among the key segments of the Croatian economy, accounting for almost a quarter of the GDP, by far the largest share in the EU. The sector was hit hard by the pandemic: international tourist arrivals decreased by 64.2% in 2020. Nevertheless, tourism successfully recovered in 2021: Croatia registered the best results in the Mediterranean with 13.7 million arrivals and 83.7 million overnight stays (+77% and 54%, respectively).
- Croatia is ranked 49th out of 160 countries according to the World Bank's Logistics Performance Index. Zagreb has excellent transport links with the rest of Europe and acts as a bridge connecting Western and Central Europe to the Black Sea and Eastern Europe and the Baltics to the Mediterranean thanks to three Pan-European corridors (Vb, Vc, X). Moreover, through the river port of Vukovar, which is part of the Pan-European Corridor VII, Croatia is linked to European countries also by river traffic routes. Furthermore, the Port of Rijeka is one of the most important ports in linking the Far East and Central Europe in terms of shortest transit and transport time.
- One of the fastest growing sectors is ICT. More than 50,000 people are employed across more than 10,000 companies. Numerous companies have seen rapid development and are regularly found on the Financial Times' list of Europe's fastest-growing companies, as well as Deloitte's list of the 50 fastest growing technology companies in Central Europe, such as Infobip, Infinum, Microblink, Infodom, Agrivi, and Q.

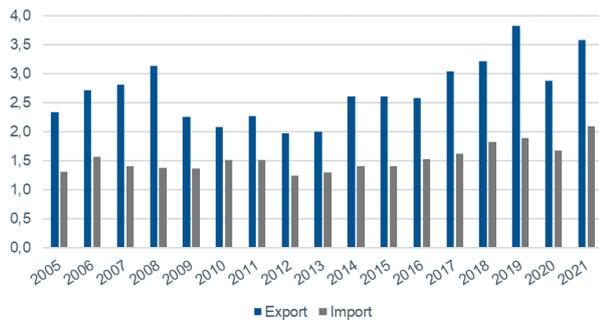
High affinity between Italy and Croatia

Economic relations between Italy and Croatia have also benefited: Italian exports of goods almost doubled between 2012 and 2019, reaching EUR 3.8 billion and exceeding pre-GFC values (Fig. 3), a faster growth compared to that of Italian exports towards the world, which increased by about 25% over the same time period. Croatian demand consisted mainly of refined products (23.7%), textiles and clothing, metals and mechanical engineering (Fig. 4). 2020 was a gloomy year for international trade and for the Italian goods exported to Zagreb as well (-24.6%, mainly due to the collapse of refined products), but bonds are strong and 2021 (+24.4%) has paved the way for a full recovery in 2022². Traditionally the two countries have shown close ties. In 2021, Italy was the second destination market for Croatian exports of goods after Slovenia, having received about 12.4% of all Croatian exports, and its second supplier after Germany. Analyzing the opportunities for Made in Italy's exports in the Adriatic country – considering, on one hand, the relevance of some sectors in the spectrum of Italian exports of goods and, on the other, the detailed structure of Croatian imports – the sectors showing more room for improvement are: mechanical engineering (for example automatic data-processing machines, magnetic or optical readers, machines for transcribing data onto data media in coded form and machines for processing such data), in which Italy already retains a relevant share in Croatian imports, transport equipment (especially, motor cars and other motor vehicles and parts and accessories) and pharmaceuticals.

Furthermore, about 340 Italian companies hold participations in Croatian firms, employing over 12.000 people. According to ICE-ITA's elaborations, Italy is one of the most involved country in Croatia and it ranks fifth after the Netherlands, Austria, Luxemburg and Germany for FDI stock since 1993 (with EUR 3.7 bn or 9.5% of total FDI's in 1993-2021). High affinity is also underlined by the fact that in 2021, 418 ths of Italian tourists visited Croatia (4% of total foreign arrivals) accounting for almost 2 mn of overnights (3.2% of total foreign overnights).

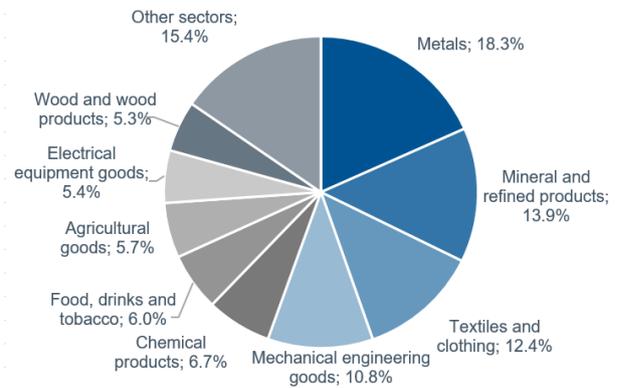
² Data for the first two months of 2022 (last period available at the time of writing) shows a +30.8% increase compared to January-February 2021.

Fig. 3 – Trade between Italy and Croatia 2005-2021 (EUR billions)



Source: Istat

Fig. 4 – Italian exports of goods by sector (2021)



Source: Istat

Political risks in the country are limited thanks to Croatia’s commitment to reach European standards in terms of rule of law, safeguarding of the business environment and property rights, fighting terrorism and protection of financial stability, as SACE’s risk indicators show³.



However, with some counterparts – small banks or private companies – caution may be needed: the credit risk profile is relatively higher than the political one, due to a private-sector debt that remains among the highest in Central and Eastern Europe and to a low market capitalization of listed companies.



³ Indicators range between 0 and 100, where 100 is the highest risk.

Italian regions towards Croatia: 4 accounting for 70%

After three years of uninterrupted growth (+14.1%, on average, from 2017 through 2019), 2020 was, as above mentioned, a setback for Italian exports of goods to Croatia. Despite the strong rebound experienced last year, Italian sales to the country have yet to exceed pre-pandemic levels (-6.2% 2021 vs. 2019). Although at first sight this performance does not seem particularly positive, the national-level data hide heterogeneous dynamics. In order to capture them, a regional and provincial analysis must be conducted.

About 70% of Italy's exports to Croatia originates in four regions: Lombardy, Veneto, Sicily, and Emilia Romagna, the former two having exported around EUR 800 mn each in 2021, the latter two around EUR 400 mn each (Fig. 5). By adding to these the quite significant export flows from Friuli-Venezia Giulia, Piedmont and Tuscany – which were above EUR 140 mn each – almost 90% of Italian export towards Croatia is accounted for.

All the main exporting-regions to Croatia have shown a substantial recovery in 2021, particularly Piedmont and Tuscany. Sicily represents an exception having seen its exports going from just above EUR 800 mn in 2019 to about EUR 430 mn last year due to an only very partial recovery of the refining sector. By excluding this region, the recovery of Made in Italy's goods is already complete (+4.3% 2021 vs. 2019).

Even within regions, the dynamics are diverse. Sicily's prominent position, for instance, is solely determined by Siracusa's exports of refined products, while the other regions' exports tend to be more evenly distributed among their provinces (Fig. 6).

Fig. 5 - Italian exports of goods to Croatia, by region (2021)

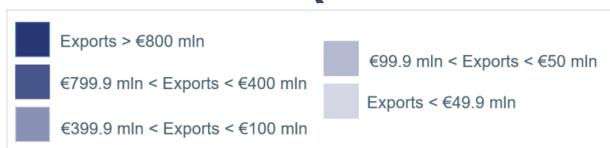
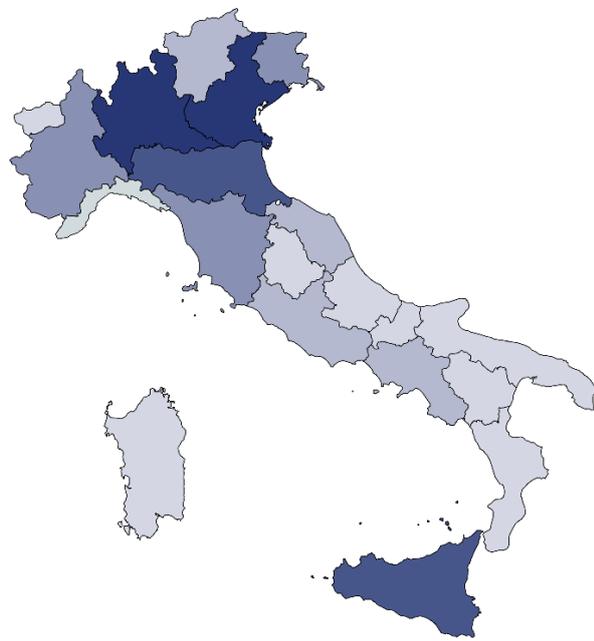
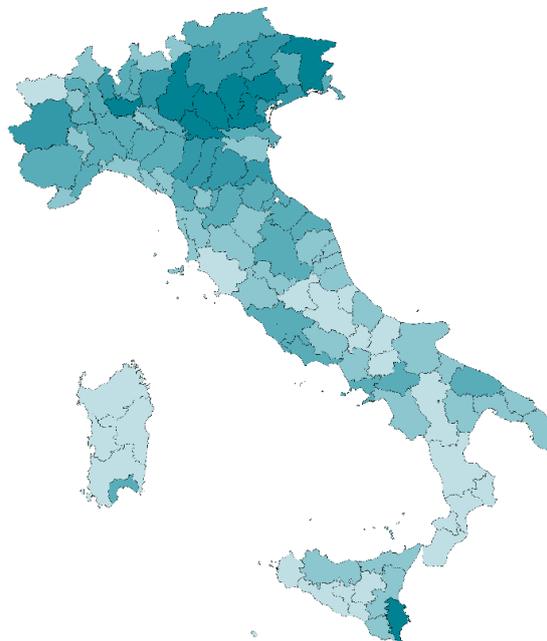


Fig. 6 - Italian exports of goods to Croatia, by province (2021)



Source: SACE's elaborations on Istat data. Figure created with MapChart

Lombardy's exports consist mainly of metals, particularly from the Brescia steel district⁴, textiles and clothing, thanks to Mantova's hosiery district as well as to Milan's exports of apparel, and mechanical engineering goods especially from Milan, Bergamo and Brescia. While metals have benefited from the surge in prices experienced in the second half of last year, the other two sectors still show an incomplete recovery.

Veneto's exports are somewhat similar, with the two main sectors being textiles and clothing – originating mainly in Verona and Treviso – and metals – from Padova and Vicenza. Sales of food and beverage are also quite relevant for the region, which exports mainly animal feed products and processed meat from Verona.

Lastly, Emilia-Romagna's exports to the country consist mainly of mechanical engineering goods, particularly from Bologna – which houses a packaging machinery district – Reggio Emilia, Modena and Parma, metals, especially from Ravenna, and rubber, plastic, and other non-metallic mineral products mainly from Sassuolo's tile district.

About 80% of Italy's exports to Croatia is directed to six regions: City of Zagreb (40%), County of Primorje-Gorski Kotar (10%), C. of Istria (9%), C. of Zagreb (8%) and Counties of Split-Dalmatia and Varaždin (each 6% or EUR 220 mn). Thus, broader Zagreb Region (City of Zagreb + County of Zagreb) accounted for almost 50% of Italian exports to Croatia or EUR 1.6 bn in 2021 (+53% compared to 2013). Italian exports to the geographically closest Counties of Primorje-Gorski kotar and Istria amounted to EUR 670 mn (+44% vs 2013).

Spotlight on opportunities

We see many opportunities for further enhancing cooperation between Italian and Croatian economies: i) the National Recovery and Resilience Plan (NRPP) supports a new investment cycle that creates demand for imports of various machinery and equipment, as well as construction materials, ii) moreover, the NRRP envisages a speed up in the privatisation of state-owned enterprises and iii) Mergers and Acquisitions (M&As).

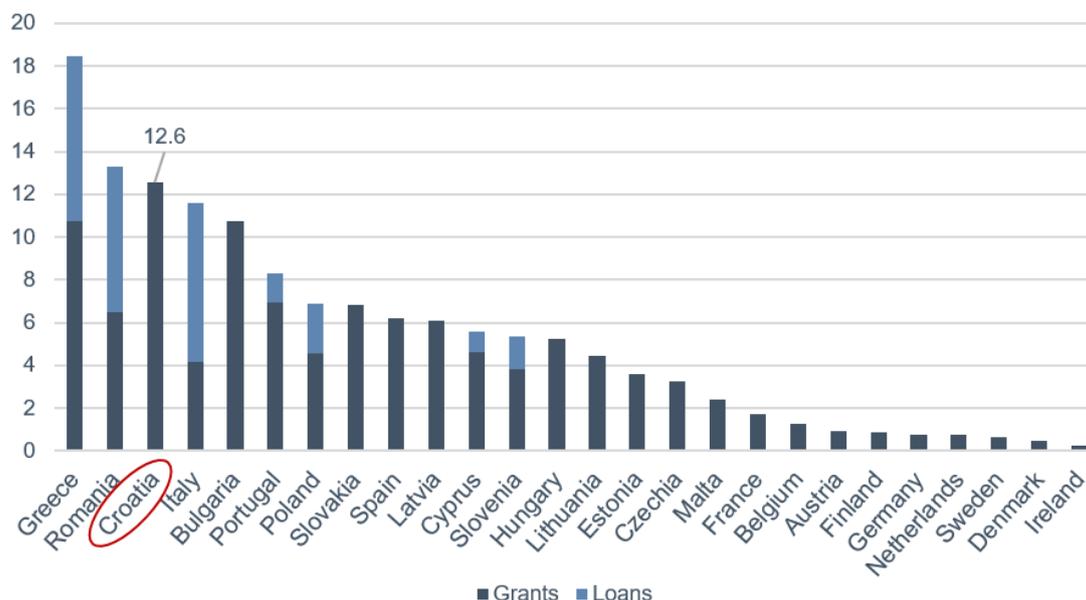
Next Generation EU – The Recovery and Resilience Facility

In 2020, the European Union provided an unprecedented response to the coronavirus crisis that hit Europe and the world. At its heart is a stimulus package worth EUR 2.018 trillion (in current prices) consisting of the EU's long-term budget for 2021-2027 (EUR 1.211 trillion), topped up by the EUR 806.9 billion worth Next Generation EU (NGEU), a temporary instrument to power the recovery. The centrepiece of NGEU is the Recovery and Resilience Facility (RRF) – an instrument providing grants and loans to support reforms and investments in the EU Member States at a total value of EUR 723.8 billion.

Croatia is one of the largest beneficiaries with the RRF allocation of EUR 6.3 billion in grants or over 12% of GDP. In addition to the RRF allocation, the financial envelope for Croatia over the next decade also includes EU long-term budget (Multiannual Financial Framework, MFF 2021-2027) in the amount of around EUR 14 billion.

⁴ As constantly monitored by Intesa San Paolo's "Monitor dei distretti".

Fig. 7 - Recovery and Resilience allocations (% of 2020 GDP)



Source: European Commission

After receiving a positive assessment from the EU on its NRRP, in September 2021 Croatia received a first pre-financing disbursement in the amount of EUR 818.4 million (13% of allocation)⁵, while in mid-March the country submitted a payment request for a disbursement of EUR 700 million, which was recently endorsed by the European Commission with payment due in June.

The European Commission's (EC) analyses suggest that NGEU investment can significantly boost GDP as for a fast NGEU scenario (four years) the level of real GDP in the EU can be around 1.5% higher than without NGEU investments. Member states with below-average GDP per capita will experience a significantly larger boost to GDP levels, as for example for Croatia the EC estimates 3.7% higher real GDP levels in 2024 compared to the counterfactual scenario.

Croatia's NRRP is based around 5 components (Economy; Public administration, judiciary, and state assets; Education, science, and research; Labour market and social protection; Public health) and 1 initiative (Renovation of buildings): 40% of the NRRP's total allocation for reforms and investments supports climate objectives (Energy efficiency and post-earthquake reconstruction of residential and public buildings; Sustainable mobility; Low-carbon energy transition; Support to business for green transition and energy efficiency), while 20% supports digital objectives (Digital transition of the public administration; Digital connectivity of rural areas; Digitalisation of higher education). Below are some of the key measures:

Economy

Goals for the economy are to reduce energy consumption and increase air quality in cities, improve and digitize energy infrastructure, improve waste management, protect water and biodiversity in order to reduce risk of climate change. Some of the major investments are:

- **Railway:** reconstruction and modernization of the existing and construction of new railways, only current transactions value in place (EUR ~230 mn)
- **Road:** electronic billing system for highways (EUR 71 mn),
- **Maritime:** purchase of passenger ships and modernization of ports (EUR ~140 mn), Zagrebacka obala Rijeka new container terminal,

⁵ To access EU funds, Croatia submitted its National Recovery and Resilience Plan on May 15th 2021 and received a positive assessment from the European Commission on July 8th.

- Public transportation: modernization of tram transportation and purchase of vehicles on alternative fuels (EUR 100 mn),
- Ecological transport: research, development and production of vehicles for “new mobility” and supporting infrastructure; co-financing purchase of vehicles on alternative fuels and development of supporting infrastructure (EUR 255 mn),
- Waste and water management (EUR 867 mn),
- Other: building logistics centres for agricultural products, strengthening sustainability and encouraging the green and digital transition of entrepreneurs in the tourism sector (EUR ~250 mn).

Public administration, judiciary, and state assets

- Digital transformation of society and public administration (EUR 382 mn),
- Modernisation of judiciary system (EUR 101 mn),
- Improving the efficiency of public administration (EUR 68 mn),
- Building capacity for the development and implementation of public policies and projects (EUR 23 mn).

Education, science and research

- Construction, extension, reconstruction and equipping of preschools, primary schools and secondary schools (EUR 596 mn),
- Raising research and innovation capacity (EUR 320 mn).

Labour market and social protection

- Labour market and social protection (EUR 276 mn).

Public health

- Construction and equipping of hospitals (EUR 189 mn).

Renovation of buildings

- Renovation of buildings, to support decarbonisation as well as to repair the damages made by earthquakes (EUR 767 mn).

Apart from the investments included in the NRRP, Croatia has further major investment projects planned in roads, railways and other infrastructure. Among others, the country launched a program specifically aimed at aiding various low-income areas in the North-East of Croatia and in the Sisak Moslavina region, which was hit by a strong earthquake at the end of 2020⁶. The Plan was approved last November by the European Commission, with subsidies planned for the period 2022-2027, and adds to the Croatian National Development Strategy 2030, which defines the national guidelines and priorities for medium-term uniform regional development. Some of the major planned investments are:

- Investments in modernization of railway, train stations and other rail infrastructure in period 2020-2030 worth EUR 4.5 bn will be mostly co-financed through European structural and investment funds and the Connecting Europe Facility
 - Most important project in the period is railway Rijeka-Zagreb-border with Hungary, which is part of the European network,
- Highway from Metković to Dubrovnik worth more than EUR 1.2 bn
- Investment in fifth generation mobile network planned to finish in 2027 worth EUR 750 mn,
- Completion of full highway profile of Istrian Y worth approximately EUR 200 mn,
- Investments in renewable energy by HEP (state-owned energy company), on average EUR ~130 mn per year until 2030.
- Completion of highway from Zagreb to Sisak worth EUR 40 mn,

⁶ Ministry of Foreign Affairs of Italy, Diplomazia Economica Italiana, n. 3/2022.

- Other investments in water supply and wastewater infrastructure, waste management, new bridge to island Krk, and so on.

Planned large scale investments under the RRF alongside usual MFF-funded and privately financed investments will strongly increase demand for capital goods especially machinery and equipment (just citing a few: mechanical engineering for the construction industry, as well as for the waste management, for agriculture or food transformation, for the automotive or for other means of transportation will find a thriving demand)⁷. According to Eurostat, over the past five-year period Croatia's imports of capital goods amounted on average to EUR 3.3 billion per year. Other Italian sectors may benefit from the Croatian NRRP, such as the supply chain of the green energy production or the one of energy efficient building materials, as well as parts and accessories of motor vehicles, transport and electronic equipment as reported also in the document recently published by the Italian Ministry of Foreign Affairs and International Cooperation⁸.

State owned enterprises privatisation

A significant part within the NRRP's component "Public administration, judiciary, and state assets" relates to the management of state-owned enterprises (SOEs). According to the Government's estimates, enterprises in majority state ownership account for around 5% of total value added and 4% of total employment. If enterprises owned by local government units are included, a total of around 7% of value added can be attributed to these companies, comparably higher than in other EU countries.

In line with the NRRP, at the end of last year the Government has adopted a list of 36 entities classified as of "special national interest" since they provide services related to areas of special importance for the implementation of economic policies. However, the comprehensive state portfolio includes more than 50 entities in majority ownership and over 300 entities in minority ownership.

Out of 305 entities currently managed by Centar za restrukturiranje i prodaju (CERP – Centre for Sale and Restructuring), **125 entities are readily available for privatisation**, 70 entities partially while 105 entities have unsolved property-legal issues and 5 ceased business activities.

The NRRP envisages that by the end -2023 around 150 entities will be tendered for privatisation (out of which 6 entities with majority state ownership) while additional 35 entities will be offered in 2024-2026⁹.

Mergers and Acquisitions opportunities in Croatia

Despite pandemic environment, the M&A activities in Croatia was quite dynamic especially in the ICT, the manufacturing and retail sector. The largest transaction that marked 2021 was the acquisition of Fortenova's Ledo (frozen food business) by Nomad Foods the Europe's leading frozen food company, with transaction value of EUR 615 mn. This was the largest transaction in 2021 as well as in recent years.

Private equity fund managed by Enterprise Investors that acquired the local retail chain Studenac in 2018, has continued with further consolidation. In early 2022 it acquired Pemo d.o.o., the local retail brand in the Dubrovnik region.

In recent years, Croatia experienced a bonanza of start-up/tech deals, including investments in Rimac Automobili by multiple large players in auto industry (Porsche, Kia, Hyundai, and so on.), investment in Infobip by One Equity Partners, acquisition of Nanobit by StillFront Group, Rimac Automobili's joint venture with Porsche with the consequent change of ownership of Bugatti".

⁷ Additional information about investments opportunities in Croatia available at <https://investcroatia.gov.hr/en/>.

⁸ MAECI, Diplomazia Economica Italiana, *I PNRR degli altri Paesi Ue. Opportunità per le imprese italiane*, April 2022

⁹ An updated list of entities in the CERP portfolio is available at <http://www.cerp.hr/portfelj-cerp-a/dionice-i-poslovnijedjeli/114q>

In 2021 one of the largest transactions was the acquisition by the **Slovenian energy group Petrol of the Croatian fuel retailer Crodux**, a transaction that has been supported by Privredna banka Zagreb d.d. Additionally, some high value deals in recent years include acquisition of Tele2 (renamed to Telemach) by United Group, acquisition of Optima Telekom by Telemach, acquisition of Emmezeta business in Croatia and Serbia by Polish Merkury Market.

The activity in the renewables sector has continued with increased interest by both financial and industrial investors wishing to add new green assets to their portfolio especially now in light of the Russian Ukrainian war, when Europe is intensifying its efforts to increase its energy security and diversify the energy resources. In January 2022 the acquisition of two windfarms (fully owned by Mirova and RP Global, with 78MW capacity) by (majority) Croatian pension-fund backed Professio Energia was announced. The transaction was supported by Privredna banka Zagreb, a member of Intesa Sanpaolo Group.

Going forward, sectors that represent potential for consolidation are:

- Renewable energy: Following acquisition activities in recent years, there is room for further consolidation in Croatian renewable energy sector; Moreover, fuelled by still favourable environment, it is expected that a strong refinancing trend will also continue, along with intensifying inflow of greenfield investments in the sector.
- Private health: Provectus Capital Partners' consolidation of private health industry started with the acquisition of Fortenova's Aviva Polyclinic and with later bolt-on acquisitions of Salona Dental Polyclinic, Dijagnostika 2000 and Uro-Centar Polyclinic. This will potentially spark further consolidation in the sector by other players in the industry.
- ICT: With the growing digitalisation agenda globally, the investors' interest in the sector will remain high, especially in the area of artificial intelligence and the cyber security.
- Grocery retail: Further consolidation is expected.

The strong expected V-shape recovery of the economy, together with the high liquidity still available in the market, can make the case for strong M&A activity. However, rising inflation is indicating that the monetary policy is to be realigned and some long term weights on M&A activity in Croatia, such as frequent change in tax regimes and a weak legal system, do represent a challenge for the years ahead.

Italian companies investing and exporting in Croatia will benefit, on one hand, from the greater integration of Croatia in the European market, favourable business climate and the thriving economy and, on the other hand, from the many initiatives that Zagreb is implementing following both its NRPP and the plan of privatizations of its SOEs. Nonetheless, approaching a new geography, even a developed one, might be difficult or risky: that's why PBZ and SACE are available to guide and support firms with an extended array of solutions.

Annex

Primary sector and food industry

The GVA of primary activities, such as agriculture, forestry and fisheries, amounted to HRK 13.5 billion (EUR 1.8 billion) in 2021, accounted for 3.9% of GVA of the Croatian economy and recorded a real growth of 5.5% compared to the previous year. In addition, GVA of food, beverages and tobacco products, amounting to EUR 1.5 billion (latest available data for 2020) accounts for 3.5% of total GVA.

According to the Croatian Bureau of Statistics (CBS) data, in 2020 the agricultural activity achieved a production value of HRK 18.3 billion (EUR 2.4 billion). Compared to 2019, the value of agricultural production increased by HRK 281.7 million (EUR 37.5 million), or 1.6%. The value of agricultural production is dominated by plant production, which, expressed in basic prices, accounts for 59.2% of the sector, livestock production accounts for 34.4%, service activities in agriculture for 3.9% and secondary activities for 2.5%.

Observed by products, the value of agricultural production in Croatia is dominated by cereals, cattle, fodder crops, pigs, oilseeds, milk, wine, vegetables and herbs and flowers, which together account for 75%.

The value of foreign trade in agri-food products in 2021 was EUR 6.6 billion or 14.0% of the value of total Croatian trade, while exports of agri-food products account for 15.1% of the value of total exports, and imports for 13.3% of the total (EUR 2.9 billion and EUR 3.8 billion, respectively). Comparing the average growth between 2015 and 2019 to that of the period 2010-2014, agri-food exports increased by 59.9% while imports increased by 47.6%.

According to the research conducted within the Agricultural Accounting Data System, market-oriented farmers use an average of 15.9 ha of agricultural land and keep 8.3 livestock units, thus achieving an average economic size of EUR 24,100. On average, these farmers earn less than half of the net value added of the average market-oriented farmer in the European Union. From year to year, Croatia records a significant increase in organic production. In 2020, a total of 5,937 entities in organic agriculture were registered in Croatia. Organic production accounts for 7.2% of the total utilized agricultural area.

Croatia is self-sufficient in the production of cereals and oilseeds, for which it has a trade surplus. The production of other agricultural products does not meet the needs of domestic consumption (fruits and vegetables, sugar beet, milk, beef, pork, poultry, eggs) and there is a trade deficit in these sectors. The most important exported agri-food products in 2020 were: corn, soybeans, cigarettes and wheat, while the main imported ones were: pork, animal feed, bakery products and live cattle for fattening.

According to the CBS, in 2020, 1,506,205 ha of agricultural land were used in the Republic of Croatia. According to the method of use, the most represented are arable land and gardens with 888,928 ha (59% of the total used agricultural land), followed by permanent grasslands with 536,683 ha (share of 35.6%). There were 36,046 ha of orchards (2.4% share), 21,454 ha of vineyards (1.4% share) and 20,282 ha of olive groves (1.3% share). The least represented are vegetable gardens, with an area of 1,777 ha (0.1% share), nurseries, with an area of 576 ha, and basket willow with an area of 459 ha.

In particular, it should be noted that in 2023 a moratorium on the sale of state and private agricultural land to foreign nationals and legal entities will expire. According to Eurostat data, the average price of purchasing one hectare of arable land in Croatia in 2020 amounted to EUR 3,440 – the cheapest in the EU. Compared to 2019, the average price increased by 1.3%, while compared to 2015 it increased by 26% on average. As the price varies by region, the highest average price per hectare was in the Adriatic Region (EUR 4,462), followed by Pannonian Croatia (EUR 3,504) and North Croatia (EUR 2,987). Croatia is also among the cheapest EU member states in terms of agricultural land rent prices, with average price of EUR 105 per hectare per year in 2020.

Secondary sector

The GVA of industry (manufacturing and other) and construction amounts to HRK 88.8 billion (EUR 11.8 billion) and accounts for 25% of total GVA. Croatia's manufacturing industry plays an important role in the development and growth of the country's economy. Over 41.5% of the total value of all manufactured products is sold abroad, which in turn contributes positively to the country's balance of trade. As the largest industry sector in Croatia by total value of products sold on domestic and foreign markets, manufacturing accounted for 80% of all industrial activity in 2020. Manufacturing of mechatronics, robotics, and electronic and optical products are among the sectors with the best prospects in Croatia and are characterized by high growth potential. Businesses operating in these sectors focus on introducing new technologies, professional development of human capital, manufacturing high-quality products and environmentally friendly manufacturing processes. The diversity of production lines, innovation, the educated and trained human capital, along with a commitment to success, means that mechatronics, robotics and electronic and optical products are business opportunities with good prospects in Croatia. Around 230,000 persons are employed in the manufacturing sector. The largest portions of workers are employed in the following manufacturing activities: food production (18%), fabricated metal production (13%), and wood production (except furniture, 7%).

Manufacturing sectors with high growth potential:

- ✓ **The manufacturing of machinery and equipment** is one of the most important industries in the Republic of Croatia. Business entities in this industry are focused on exports, the introduction of new technologies, ongoing professional staff training, quality systems certification, environmentally friendly production, and linkages to domestic and foreign manufacturers. The production spectrum of this industry in Croatia is exceptionally diverse and can satisfy all the needs of potential customers and partners. In recent times, companies that develop solutions in advanced robotics such as Gideon Brothers, HSTec and H2O Robotics are becoming more and more prominent.
- ✓ Development of the Croatian **automotive industry** is based on a long tradition in related sectors, such as metal processing, welding, glass and plastic production and engineering. Croatian entrepreneurs engaged in the production of automotive parts have a tradition in high-precision manufacturing with zero failure tolerance, and their main competitive advantage is their excellent product quality. Croatia is also a producer of electric cars production, such as Nevera by Rimac Automobili, presented in June 2021. Besides a highly educated workforce, other advantages that the companies in the automotive industry can expect doing business in the Republic of Croatia are excellent infrastructure, as well as close proximity to markets and car production facilities in countries located in Western and Central Europe.

The **pharmaceutical industry** in the Republic of Croatia has a long tradition. The know-how and experience of the workforce promises successful future development of the industry and related sectors. In addition, the pharmaceutical industry is one of the sectors of the Croatian economy experiencing intensive investments in research and development.

Service sector

The service sector represents 55% of the country's GDP, employing 65.3% of the workforce. The **tourism sector**, in particular, is among the key segments of the Croatian economy, accounting for almost a quarter of GDP, by far the largest share in the EU. However, the tertiary sector was hit hard by the economic crisis following the covid-19 pandemic. Tourism, in particular, saw the number of tourists arrivals decrease by 64.2% in 2020. Nevertheless, the sector successfully recovered in 2021: Croatia generated the best tourism results in the Mediterranean with 13.7 million arrivals and 83.7 million overnight stays in 2021 (+77% and 54%, respectively).

Croatia has excellent **transport** links with Eastern and Central Europe, as well as the rest of Europe by air, road, railway and sea routes, and acts as a bridge in connecting Western and Central Europe to the Black Sea

and Eastern Europe and the Baltics to the Mediterranean. The three Pan-European corridors (Vb, Vc, X) pass through Croatia. The Port of Rijeka is one of the most important ports in linking the Far East and Central Europe in terms of shortest transit and transport time. Through the river port of Vukovar, which is part of the Pan-European Corridor VII, Croatia is linked to European countries also by river traffic routes. Users of the transport infrastructure can also count on state-of-the-art communication and mobile infrastructure along with integrated software solutions across all regions of the Republic of Croatia. Croatia's excellent geostrategic position, EU membership, modern infrastructure and good transport links to European countries provides numerous opportunities in developing and implementing investment projects in the **logistics sector**, especially in the area of constructing logistics and distribution centres. Croatia is ranked 49th out of 160 countries according to the World Bank's Logistics Performance Index.

One of the fastest growing sectors in Croatia is **ICT sector**. The sector is expanding and employs more than 50,000 people across more than 10,000 companies. Investments in ICT have been the most dynamic component of investments in recent years in Croatia. One of the main characteristics of the sector is a skilled and well-educated labour force for meeting the demanding requirements of investment projects. The quality of Croatian engineers, developers and ICT employees in general is well known. Numerous internationally recognized Croatian companies have seen rapid development, and are regularly found on the Financial Times' list of Europe's fastest-growing companies, as well as Deloitte's list of the 50 fastest growing technology companies in Central Europe, such as Infobip, Infinum, Microblink, Infodom, Agrivi, and Q.

Energy Sector

According to available data, gross primary energy consumption in Croatia in 2020 was 7.76 million tons of oil equivalent (TOE), while final energy consumption in 2019 amounted to 6.47 million TOE. Renewable energies account for approximately 31% of Croatia's energy mix, out of which 53.82% are employed in electricity generation; 6.59% in transport and 36.93% in heating and cooling.

In February 2020, the Croatian government adopted a new Energy Strategy for the period until 2030, with an outlook through 2050¹⁰. The Strategy includes a wide range of energy policy initiatives that will improve energy security, increase energy efficiency, lower dependence on fossil fuels, increase local production and increase renewable resources. The Strategy predicts that renewable energy resources as a share of total energy consumption will grow to 36.7% by 2030, and to 65.6% by 2050.

Currently Croatia imports about half of the total energy consumed annually: around 80% of its oil and gas needs and around 30-40% of its electricity. The country has great potential to decrease energy imports by increasing the use of renewable resources. There is a lot of emphasis on the fast-developing wind and solar energy, while also reducing the cost of technology, making projects increasingly cost-effective. Accordingly, the new Energy strategy foresees a large number of wind and solar projects. However, Croatia also has potential regarding geothermal energy (especially in continental Croatia), and it is becoming increasingly interesting to explore offshore potentials related to the northern Adriatic (especially offshore wind) which could be a good complement for the production of electricity from renewable energy sources on land. The bio economy also shows great potential, especially the development of power plants and high-efficiency biomass cogeneration, as well as the use of biogas for electricity generation. The added value of electricity generation from bio economics is cross-sectoral connectivity. All these systems, which are geographically dispersed, must be effectively connected in such a way that energy is efficiently transferred to the final customer. Although part of the system will be located close to the place of consumption, the difference in the use of certain technologies (constant production of renewable energy using geothermal potential and bio-economy versus variable producers such as power plants using wind and solar energy), but also the difference in the places of energy production and consumption in Croatia (in the south there is a great potential of production, and in the north

¹⁰ <https://mingor.gov.hr/o-ministarstvu-1065/djelokrug-4925/energetika/energetska-politika-i-planiranje/strategije-planovi-i-programi-2009/2009>

of consumption) require the strengthening of the electricity system, which must not become a bottleneck to transfer energy to final consumers.

According to the Strategy, overall, 2020-2050 planned investments in energy sector amount to EUR 17.8 billion¹¹, out of which around 75% relates to electricity system. Investments in grid alone are planned in the amount of EUR 2.4 billion. Thus, total investments including energy efficiency of buildings are foreseen to reach around 2.3% of GDP cumulatively in the period 2020-2050. Should Croatia proceed gradually with the implementation of what the EU has set out in the energy sector, then by 2030 wind energy is expected to account for 21.3% of power generation, solar energy for 6.1% (overall wind and solar energy share will increase from 11% to 27.4%), geothermal energy for 0.8%, while hydroelectricity's share will be around 44% (a decline from current 46%).

The green transition is also a cornerstone of the National Recovery and Resilience Plan¹², as Croatia aims to connect 1.5 GW from renewable energy sources to the grid by the end of 2024, while more than 2.5 GW of new renewable power plants will be connected to the grid by 2030.

¹¹

[https://mingor.gov.hr/UserDocsImages/UPRAVA%20ZA%20ENERGETIKU/Strategije,%20planovi%20i%20programi/Analiza%20i%20podloga%20za%20izradu%20Strategije%20energetskog%20razvoja%20Republike%20Hrvatske%20-ZELENA%20KNJIGA%20_kona%C4%8Dna%20verzija%20\(002\).pdf](https://mingor.gov.hr/UserDocsImages/UPRAVA%20ZA%20ENERGETIKU/Strategije,%20planovi%20i%20programi/Analiza%20i%20podloga%20za%20izradu%20Strategije%20energetskog%20razvoja%20Republike%20Hrvatske%20-ZELENA%20KNJIGA%20_kona%C4%8Dna%20verzija%20(002).pdf)

¹² https://ec.europa.eu/info/business-economy-euro/recovery-coronavirus/recovery-and-resilience-facility/croatias-recovery-and-resilience-plan_en#croatias-recovery-and-resilience-plan

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This report is part of a collaboration between PBZ and SACE, which aims at providing information on business opportunities in Croatia to Italian companies. Historical data and information come from official and reliable sources and refer to what is available as of May 17, 2022.