HNB

Semi-annual Information

Semi-annual Information on the Financial Condition, the Degree of Price Stability Achieved and the Implementation of Monetary Policy in the Second Half of 2019

Zagreb, May 2020

HRVATSKA NARODNA BANKA • CROATIAN NATIONAL BANK

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SEMI-ANNUAL INFORMATION 2019

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in the Second Half of 2019

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1 Contents

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1 Summary

Real GDP was 2.7% higher in the second half of 2019 than in the same period of the preceding year, but economic activity grew more slowly than in the first half of 2019. The real growth was mostly attributable to the rise in total exports, with increases seen in both exports of goods and exports of services. The growth in imports of goods and services decelerated sharply, so that net foreign demand made a positive contribution to real GDP growth in the second half of 2019. All domestic demand components also gave a boost to overall economic growth, with the largest contribution being made by personal consumption, which reflected the steady favourable trends in the labour market, the rise in household loans and a record high level of consumer optimism. Investment activity also continued to pick up on an annual basis, albeit at a slightly slower speed than in the first six months of 2019, while government consumption grew at a rate similar to that seen in the first half of the year.

Favourable developments in the labour market continued. In the second half of 2019, employment growth kept the same pace as in the first half of the year and was broadly based, with the sharpest increases being observed in construction, information activities and business services, and tourism-related service-activities. Unemployment continued to decrease and the seasonally adjusted registered unemployment rate stood at 7.4% of the labour force in the second half of 2019. The dynamics of wage growth remained the same so that the average nominal gross wage was 3.8% higher in the second half of 2019 than in the same period of 2018. Purchasing power increased by 2.9%.

In the second half of 2019, consumer price inflation accelerated from 0.6% in June to 1.4% in December. This was mainly a result of the rise in the annual rate of change in the prices of unprocessed food and energy. The pick-up in inflation was particularly notable in December owing to the increase in the annual growth rate of the prices of meat and refined petroleum products, which was partly due to the positive base effect and partly due to the December 2019 increase in these prices. Core inflation edged up from 1.1% in June to 1.2% in December 2019, largely driven by the prices of meat, non-durable household goods, and hairdressing and beauty salon services.

The surplus in the current and capital account widened sharply from the second half of 2018 to the second half of 2019, mostly driven by the steady rise in net exports of services. In addition, the sum of the balances in the secondary income account and in the account of capital transactions improved, while the deficit in the primary income account narrowed slightly. By contrast, the goods trade deficit widened. The financial account of the balance of payments was again marked by net capital outflows resulting from a decrease in net foreign debt liabilities. Accordingly, relative indicators of external debt and the international investment position continued to improve.

In the second half of 2019, the CNB continued to pursue an expansionary monetary policy, supporting the high levels of monetary system liquidity and maintaining a stable nominal exchange rate of the kuna against the euro. In such conditions, banks had no interest in the short-term kuna funds offered at regular weekly auctions. High liquidity also continued to support the several-year trend of improved financing conditions of domestic sectors. The annual increase in placements to non-financial corporations slackened in 2019 due to several one-off effects, while household placements grew faster on account of the pick-up in housing loans spurred by the continued implementation of the government subsidy programme. By contrast, growth in general-purpose cash loans slowed down on an annual level owing also to the Recommendation on actions in granting non-housing consumer loans, which the CNB issued to credit institutions in late February 2019.

The general government ran a surplus of HRK 2.7bn in the second half of 2019. This outstripped the surplus of HRK 1.1bn made in the second half of 2018, reflecting a faster increase in total revenues (7.3%) than in total expenditures (5.7%). Overall, the budget surplus reached almost HRK 1.5bn (0.4% of GDP) in 2019 as a whole, up from HRK 849m (0.2% of GDP) in 2018. The public debt-to-GDP ratio stood at 73.2% at the end of December 2019, which was 1 percentage point less than in June 2019.

The CNB's total international reserves increased by 6.4% from the end of 2018 to the end of 2019, and net international reserves grew by 9.8% in the same period. The increase in international reserves in 2019 was predominantly a consequence of the purchase of foreign exchange from banks aimed at countering appreciation pressures. Although a half of government securities of euro area member states had negative yields, the rate of return on the entire euro portfolio was 0.07% in 2019, while the rate of return on the dollar portfolio totalled 2.10%. The main objective was thus successfully achieved, i.e. liquidity and safety in international reserves management.

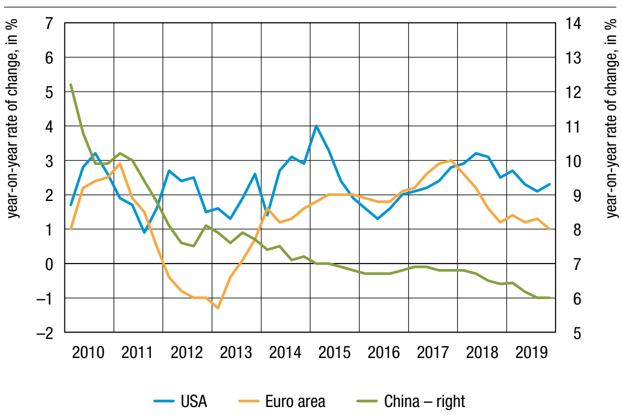
Assets and profitability grew in 2019 and the quality of credit risk exposure improved. High system capitalisation and liquidity continued to ensure stable bank operations. The 4.2% increase in total assets was predominantly a result of lending to households (largely through general-purpose cash loans) and a rise of investments in bonds of central governments. The 2019 operating profit was the highest ever recorded. The increase was generated predominantly thanks to higher non-interest income and lower expenses on impairments despite the noticeable growth of provisions for the several-times increased number of litigations against banks resulting from a class action connected to CHF loans. Indicators of return, ROAA and ROAE went up to 1.6% and 9.9% respectively. The quality of exposure to credit risk continued to improve, so the non-performing loans ratio totalled 5.5% at the end of 2019. Despite increased exposure to risks, total capital ratio stood at a high 23.2%.

The profitability of housing savings banks improved, although it is noticeably lower than bank profitability. The good quality of the exposures and high capitalisation of the system were maintained. However, the assets of the system continued to dwindle. In 2019, they went down 3.4% as a result of one housing savings bank ceasing its operations. They currently account for only 1.2% of total assets of credit institutions.

2 Global developments

Principally contributing to the global economic slowdown, which continued into the second half of 2019, were emerging markets, such as India, the Republic of South Africa and Mexico, and the ongoing sluggish growth in China. After stagnation in the first half of 2019, global trade deteriorated further amid growing trade tensions, and its volume had shrunk by the year-end. At the same time, growth in developed countries slowed down slightly. Unfavourable developments were largely the outcome of the slower US economic growth, in spite of the sharp pick-up in the first half of the year. By contrast, though the euro area economy was burdened by the uncertainty surrounding the Brexit process and problems in the manufacturing industry, particularly in Italy and Germany, euro area growth held steady throughout most of the second half of 2019 thanks to positive trends in the service sector, slowing down noticeably only towards the year-end. Global financing conditions remained relatively favourable, particularly after the Fed reduced the target range of its benchmark interest rate on several occasions and the ECB resumed its quantitative easing programme in response to the slowdown signs in the US and the euro area.

Figure 2.1 Economic growth in selected markets



Sources: Eurostat, BEA and NBS.

The sluggish economic growth in the USA, which has been almost uninterrupted since mid-2018, continued into the second half of 2019 (Figure 2.1). Annual growth was 2.2% in the second half of 2019, largely due to personal consumption driven by exceptionally favourable movements in the labour market with record-low unemployment rates. The growth was also spurred by government consumption. By contrast, following several quarters of sharp growth, the contribution of investments and net exports of goods and services turned negative. Against this background, domestic inflationary pressures eased slightly, so that inflation was below the Fed's target through most of the period under review.

As regards the euro area, real GDP grew by 1.3% in the first half of 2019, but edged down to 1.2% in the second half of the year, with the slowdown seen across the member states. Ever since mid-2018, the euro area economy has been strongly influenced by external factors, particularly the mentioned decrease in global trade volume and the slower increase in foreign demand. This mostly affected member states with large export-oriented manufacturing sectors, such as Germany and Italy. On the other hand, unfavourable developments in manufacturing did not spill over much to the service sector for the most part of the year. Nevertheless, data for the last quarter of 2019 indicate that growth slowed down perceptibly even in the member states that are traditionally more oriented towards domestic demand and the service sector, such as France.

2.1 Croatia's main trading partners

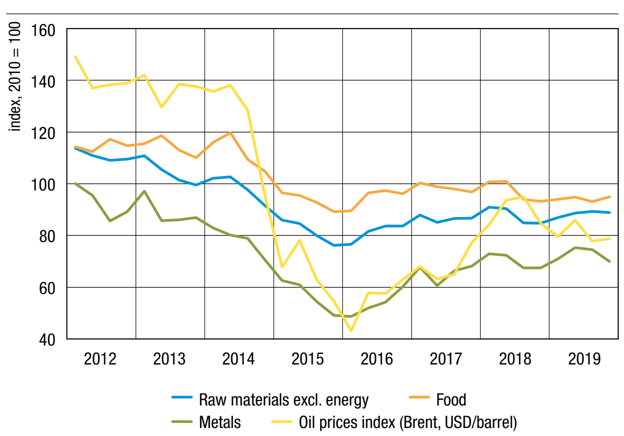
Most of Croatia's major trading partners, particularly those in the euro area, saw slower growth in the second half of 2019. This was especially noted in Germany, Slovenia and Austria, while growth in Italy held steady from the first half of 2019, but was well below the average for the rest of the euro area. A marked slowdown was also seen in most partners in Central and Eastern Europe, that is, non-euro area member states, such as Hungary, the Czech Republic, Poland, Bulgaria and Romania.

With regard to Croatia's trading partners in Southeastern Europe, economic growth picked up sharply in Serbia and slowed down in Bosnia and Herzegovina in the second half of the year.

2.2 Prices, exchange rates and financing conditions

Raw material prices excluding energy edged up in the second half of 2019. Broken down by components, the rise was seen in prices of alcoholic beverages and, to a lesser extent, food products, while the prices of agricultural raw materials and metals declined, mostly on the back of expectations of a global growth slowdown. Similarly, the price of a barrel of crude oil dropped from USD 64 at end-June to USD 58 in early September due to heightened concerns about global economic growth and the trade tensions between the USA and China. The mild downward trend in prices was interrupted in mid-September after the attacks on oil facilities in Saudi Arabia and the spike in prices to USD 68. The rise was of short duration and prices stabilised at USD 60 by the end of the month. Thanks to the progress in trade negotiations between the USA and China and expectations regarding further cuts in oil production by OPEC countries and other major global oil producers, the crude oil price per barrel had risen to USD 66 by the end of the year, which is a quarter above the end-2018 price.

Figure 2.2 Raw material prices in the world market in US dollars

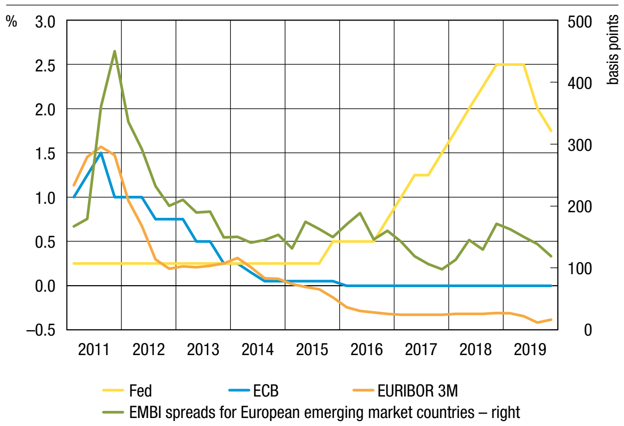


Sources: IMF and Bloomberg.

In response to unfavourable economic trends, major central banks strengthened their expansionary monetary policy even more. The Fed narrowed the target range of its benchmark interest rate on several occasions in the second half of 2019 (Figure 2.3), whereas the ECB reintroduced the quantitative easing programme, i.e. the monthly purchase of EUR 20bn worth of bonds, in early November.

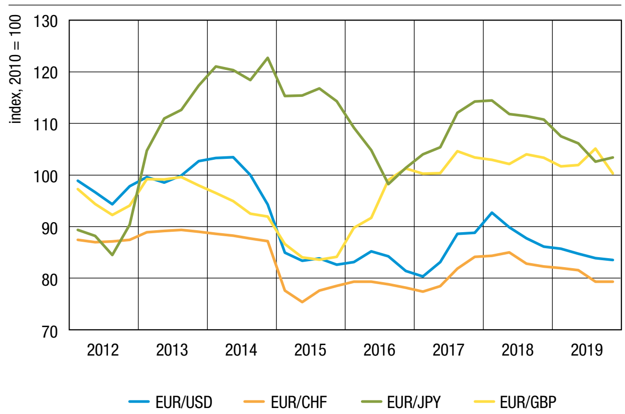
Financing conditions for European

Figure 2.3 Benchmark interest rates and the average yield spread on bonds of European emerging market countries
end of quarter



Source: Blomberg.

Figure 2.4 Exchange rate movements of individual currencies against the euro



Note: A growth in the index indicates a depreciation of a currency against the euro.
Source: Eurostat.

emerging markets improved further in the second half of 2019. The EMBI index for European emerging markets decreased by about 30 basis points from the end of the previous year. Uncertainty was reduced thanks to the good performance of these economies, especially the stabilisation of economic conditions in Turkey.

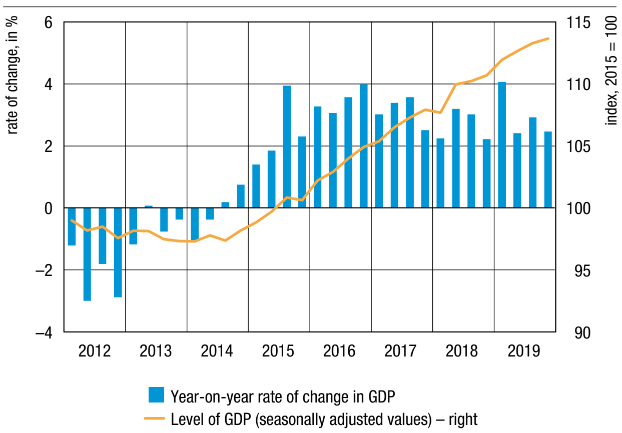
On the global foreign exchange market the euro weakened against all major global currencies in the second half of 2019. The US dollar/euro exchange rate was EUR/USD 1.1 at the end of 2019, which is a decrease of 1.5% from the end of June 2019, while the exchange rate of the Swiss franc against the euro stood at EUR/CHF 1.10, down by 2.7%. The depreciation of the euro in the second half of 2019 was largely associated with heightened uncertainty surrounding the UK's exit from the EU, i.e. the risk of a disorderly Brexit, which was present at that time. Additional pressure was made by the sluggish growth in Germany, driven by problems in the manufacturing sector, particularly the car industry.

3 Aggregate supply and demand

The annual growth rate of real GDP was 2.7% in the second half of 2019, down from 3.2% in the preceding six months. When compared with the same period of the previous year, economic growth in the second half of 2019 was mostly driven by goods and services exports, with increases seen in both exports of goods and exports of services. All domestic demand components also made a positive contribution to real economic activity, with the largest boost to GDP growth again coming from household consumption. The annual increase in total imports decelerated sharply in the same period, so that the contribution of net foreign demand to total economic growth turned positive in the second half of 2019. The contribution of the change in inventories was large and negative, and was probably one of the reasons behind the sluggish growth in imports.

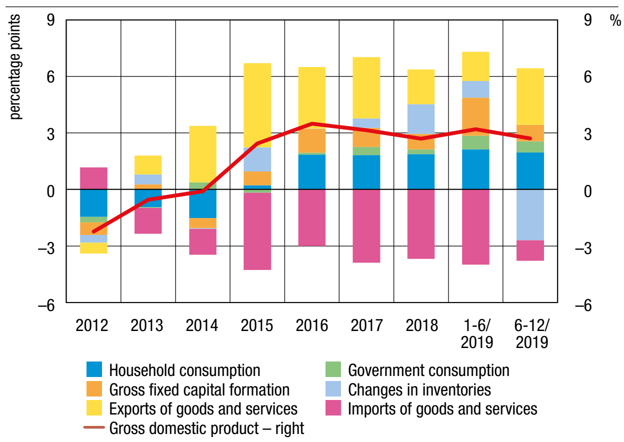
GDP by the production approach showed that in the second half of 2019 gross value added moved at a pace similar to that in the first half of the year, rising at an annual rate of 2.6%. All activities except manufacturing recorded growth, with the annual growth being especially high in construction. GVA growth was only slightly lower than GDP growth, so that the share of net taxes in GDP continued to increase, albeit at a much slower pace than in the preceding half of the year.

Figure 3.1 Gross domestic product
real values



Source: CBS (seasonally adjusted by the CNB).

Figure 3.2 GDP rate of change
contributions by components



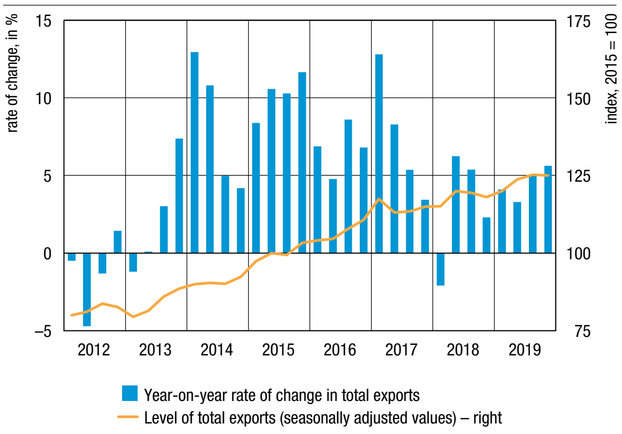
Source: CBS.

3.1 Aggregate demand

Real exports of goods and services picked up momentum in the second half of 2019, growing annually by 5.2%. The annual dynamics of overall exports further strengthened in the last quarter as a result of the upsurge in services exports. Real growth in total exports went up from 3.7% in 2018 to 4.6% in 2019, so that foreign demand made the largest positive contribution to overall economic growth.

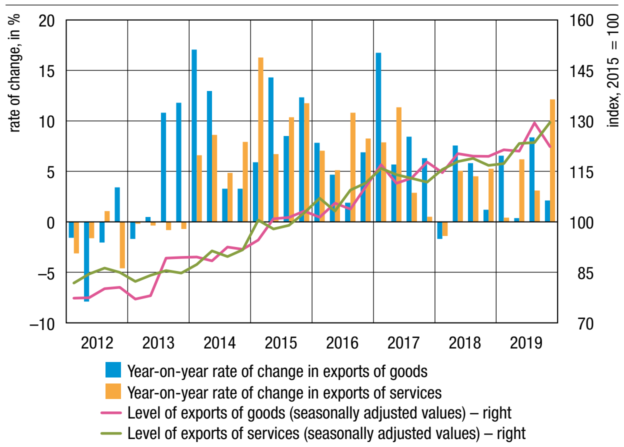
Goods exports accelerated sharply in the third quarter of 2019, growing by 8.4%

Figure 3.3 Exports of goods and services
real values



Source: CBS (seasonally adjusted by the CNB).

Figure 3.4 Real exports of goods and services

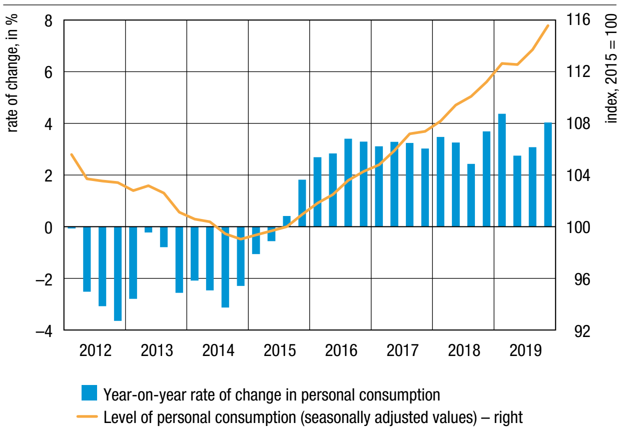


Source: CBS (seasonally adjusted by the CNB).

from the same period of 2018, but slackened to 2.1% in the last quarter of 2019, reflecting the quarterly slump of –5.4%. Nominal data on the trade in goods broken down by main industrial groupings show that such trends were the outcome of the fall in exports of intermediate goods in the third and fourth quarters and the plunge in exports of capital goods in the last quarter of the previous year. Exports of services rose annually by 5.0% in the second half of 2019, with the pick-up in annual growth being attributable to exceptionally favourable trends in the last quarter, when the annual increase was as high as 12.1%.

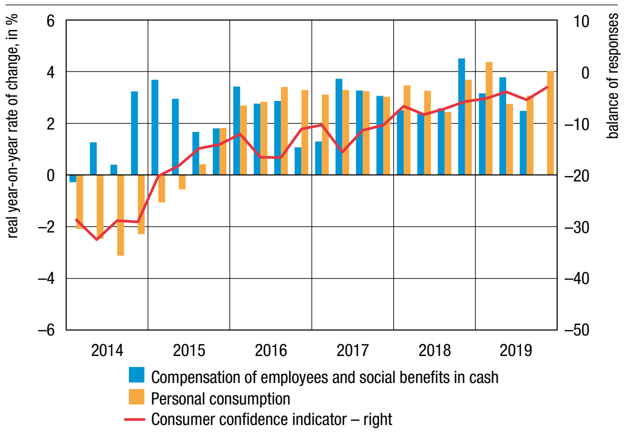
Personal consumption grew by 3.6% on an annual basis in the second half of 2019 (3.5% in the first half of the year), with a sharp quarterly acceleration seen late in the year. The rise in household consumption in the second half of the year reflected the steady favourable trends in the labour market, where employment continued to increase at a pace similar to that in the first half of the year, while the unemployment rate remained on a downward course. Wages also continued to rise, with nominal net wages

Figure 3.5 Personal consumption
real values



Source: CBS (seasonally adjusted by the CNB).

Figure 3.6 Determinants of personal consumption
real values and index



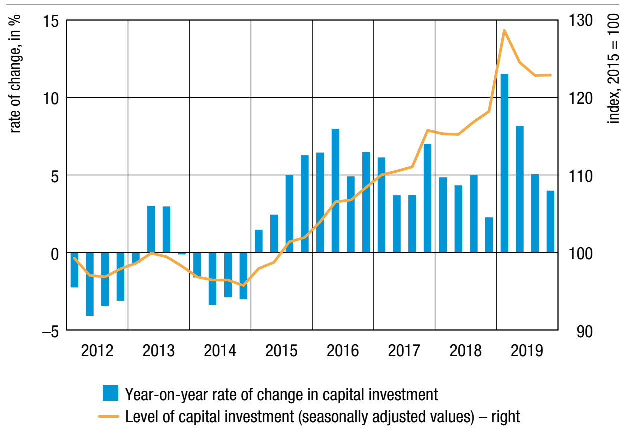
Note: Real values of compensation of employees and social benefits in cash were calculated by deflating nominal values using the personal consumption deflator.
Sources: CBS, Ipsos and CNB.

growing at the same annual pace from July to December as in the first half of the year. The expansion of household consumption is also evident in the Consumer Confidence Survey data, which suggest that consumer optimism reached a historical high at end-2019. Personal consumption grew by 3.6% in the whole of 2019 (3.2% in 2018), and was the domestic demand component that contributed the most to overall economic growth.

The annual rise in capital investment decelerated to 4.5% in the second half of 2019, from 9.7% in the first six months of 2019. Seasonally adjusted data show that capital investment shrank by 2.9% from the first to the second half of 2019, with a quarterly drop of 1.4% in the third quarter and stagnation (0.1%) in the fourth quarter. Available fiscal data suggest that the annual increase in investment was given a strong boost by investment by the general government. Gross fixed capital formation expanded by a total of 7.1% in the whole of 2019 (4.1% in 2018), increasing its positive contribution to overall economic growth.

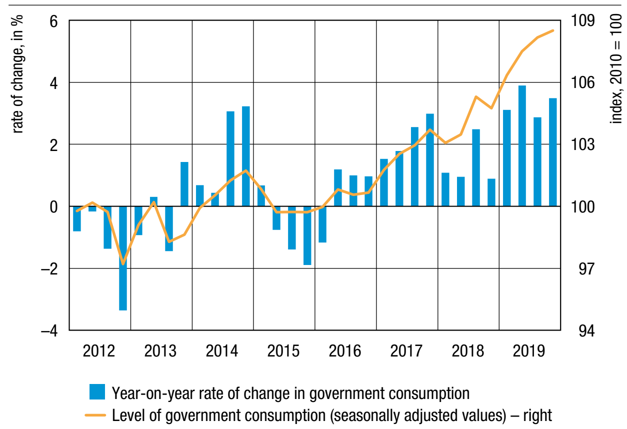
General government consumption rose at a slightly slower pace from July to

Figure 3.7 Gross fixed capital formation
real values



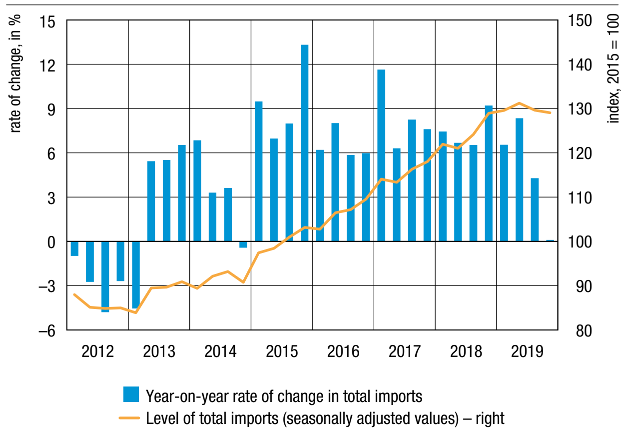
Source: CBS (seasonally adjusted by the CNB).

Figure 3.8 Government consumption
real values



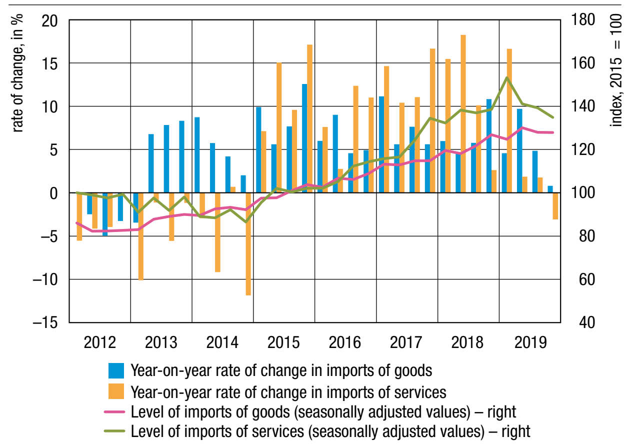
Source: CBS (seasonally adjusted by the CNB).

Figure 3.9 Imports of goods and services
real values



Source: CBS (seasonally adjusted by the CNB).

Figure 3.10 Real imports of goods and services



Source: CBS (seasonally adjusted by the CNB).

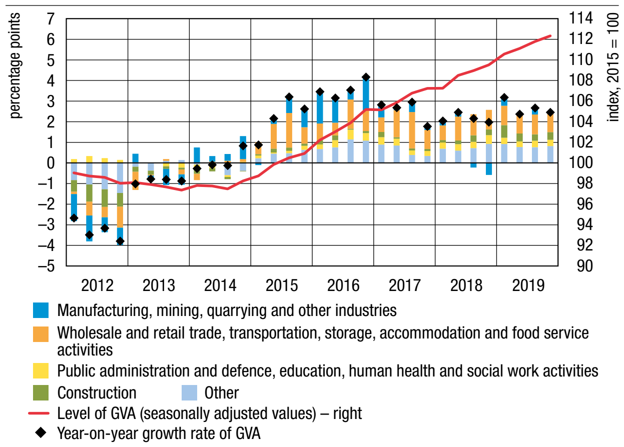
December 2019 than in the preceding six months, growing annually by 3.2% (3.5% in the first half of the year). The steady increase in government consumption was due to the ongoing growth in the number of civil servants and government employees, and government consumption of goods and services. Government consumption expanded by 3.3% in 2019, so that its positive contribution to real GDP growth was larger than in 2018, when it grew by 1.3%.

The annual increase in imports of goods and services slowed down from a high 7.7% in the first half of 2019 to 2.2% from July to December. The deceleration reflected the quarterly fall in total imports from the second to the third quarter and then again from the third to the fourth quarter. Such movements may be attributed to unfavourable trends in goods exports, which recorded a quarterly decrease towards the year-end. In addition, investment activity also lost momentum in the second half of 2019, as illustrated by nominal data on the contraction of imports of capital goods on a quarterly basis. The growth rate of total imports was 4.8% in 2019, down from 7.5% in 2018, so that the contribution of net exports to real GDP growth was almost neutral in 2019.

3.2 Aggregate supply

In the last six months of 2019, the increase in gross value added (GVA) continued at a pace similar to that in the first half of the year. GVA grew 2.6% on an annual basis, with the increase seen in all its components except manufacturing. The largest contribution to GVA growth came from trade, transportation and tourism, which reflected the continuation of favourable developments in tourism and the increase in household purchasing power. GVA rose by 2.7% in 2019 as a whole, up from 2.2% in 2018.

Figure 3.11 GVA rate of change
contributions to the annual change by components



Source: CBS (seasonally adjusted by the CNB).

4 Labour market

4.1 Employment and unemployment

The number of employed persons continued to grow in the second half of 2019 at a pace similar to that in the first half of the year. Employment growth slackened during the summer months but late in the year picked up slightly. Broken down by activities, employment growth was broadly based, with the largest increase seen in construction, information activities and business services, and tourism-related service activities. Employment in industry stood apart from this trend, as it began to contribute to total employment growth only towards the end of the year, after decreasing for two consecutive quarters. In the period from July to December 2019, total employment was 2.4% higher than in the same period of 2018, with one third of the growth accounted for by foreign workers who had obtained work permits.

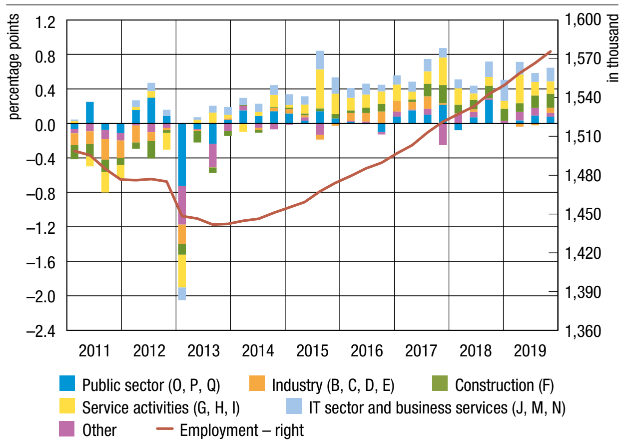
The rise in employment figures was also reflected in lower unemployment. The fall in the number of unemployed persons continued in the second half of 2019; having slowed down in the third quarter, it picked up pace late in the year, when unemployment stood at slightly more than 120 thousand. The decrease was due in equal measure to new employment and clearings from the CES records. The number of unemployed persons dropped by almost 20 thousand from the same period of 2018.

As a result, the registered unemployment rate (seasonally adjusted data) fell to 7.7% in the third quarter of 2019 (from 7.8% in the second quarter), and further to 7.2% in the fourth quarter, hitting its record low. This rate was 1.2 percentage points lower in the second half of 2019 than in the same period of 2018.

Data from the Labour Force Survey show that the unemployment rate (seasonally adjusted data) fell to 6.5% in the third quarter (from 6.6% in the second quarter) and was stagnant through to the end of 2019. The ILO unemployment rate dropped by 1.5 percentage points from the second half of 2018 to the second half of 2019.

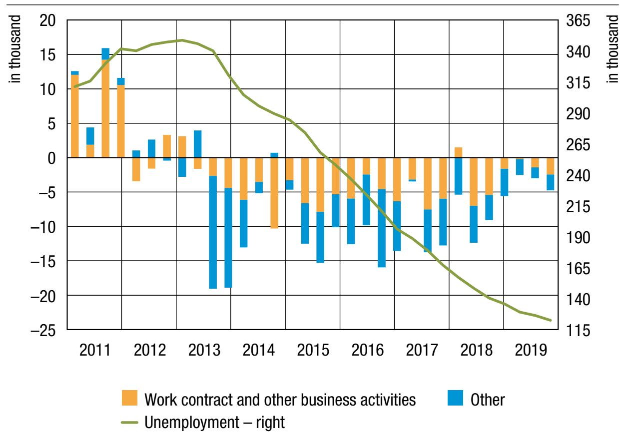
On the other hand, the Labour Force Survey data show that the employment rate and

Figure 4.1 Employment by NCA activities
seasonally adjusted data, contributions to the quarterly rate of change



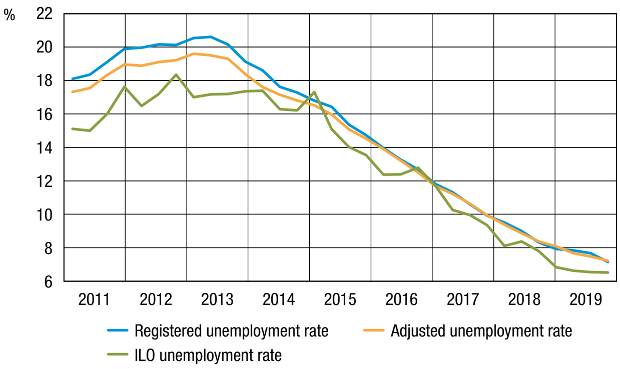
Source: CPII (seasonally adjusted by the CNB).

Figure 4.2 Total unemployment and net unemployment inflows
seasonally adjusted data



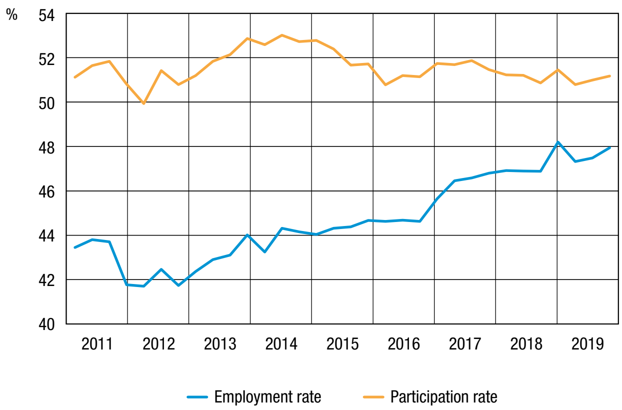
Source: CES (seasonally adjusted by the CNB).

Figure 4.3 Unemployment rates
seasonally adjusted data



Notes: The adjusted unemployment rate is the CNB estimate and is calculated as the share of the number of registered unemployed persons in the working age population estimated as the sum of unemployed persons and persons insured with the CPII. Since January 2015, the calculation of the registered unemployment rate published by the CBS has been made using the data on employed persons from the JOPPD form.
Sources: CBS and CES (seasonally adjusted by the CNB).

Figure 4.4 Labour Force Survey
seasonally adjusted series



Source: CBS (seasonally adjusted by the CNB).

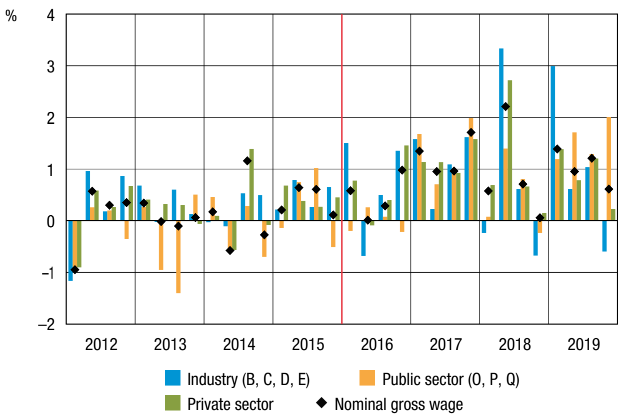
the participation rate (i.e. the share of the labour force in the working age population) edged up to 47.7% and 51.1%, respectively, in the second half of 2019. The employment rate increased, while the participation rate was almost stagnant on an annual basis.

4.2 Wages and unit labour costs

A steady increase in wages characterised the second half of 2019, with the average nominal gross wage growing by 1.8% from June to December 2019. Wages continued to trend up in the third quarter at a pace similar to that in the first half of the year, which was due in equal measure to wage increases in the private and in the public sector. By contrast, wage growth halved in the fourth quarter, mostly due to the much slower increase in the private sector, while the growth in the public sector picked up due to the increase in the base for the calculation of wages of civil servants and government employees in October 2019 (under the 2018 agreement between the Croatian government and public sector unions). When compared with its nominal value, the wage purchasing power dropped marginally in the third quarter of 2019 and remained constant late in the year. The average nominal gross wage grew by 3.8% from the second half of 2018 to the second half of 2019, whereas its purchasing power went up 2.9% due to the parallel increase in consumer prices.

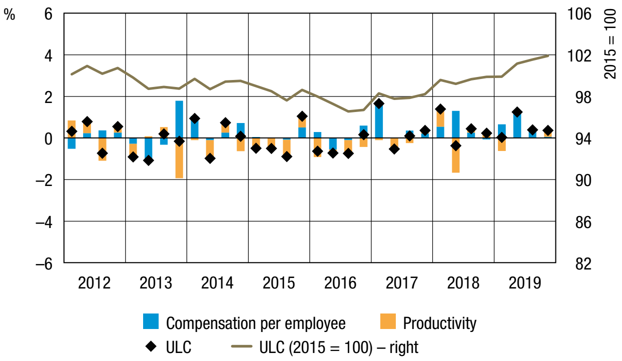
According to the national accounts data, compensation per employee grew in the third quarter and held steady in the fourth quarter. Coupled with the fall in labour productivity (employment growth outpacing real GDP growth) in the fourth quarter, such movements pushed up unit

Figure 4.5 Average nominal gross wage by NCA activities
seasonally adjusted data, quarterly rates of change



Note: As of January 2016, data refer to the JOPPD form, while earlier data refer to the RAD-1 form.
Sources: CBS and CNB calculations (seasonally adjusted by the CNB).

Figure 4.6 Compensation per employee, productivity and unit labour costs
seasonally adjusted data, quarterly rate of change and levels (2015 = 100)



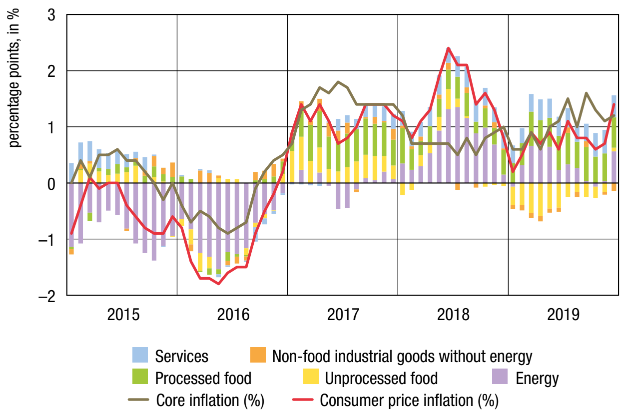
Notes: Productivity growth carries a negative sign. In the calculation of unit labour costs, paid compensation of employees and real GDP were taken from the national accounts, while data on the number of employees (persons employed in legal persons and natural persons who received compensation) and total employment were taken from the CPII.
Sources: Eurostat and CPII (seasonally adjusted by the CNB).

labour costs in the second half of 2019. Compared with the same period of 2018, unit labour costs were 2% higher.

5 Inflation

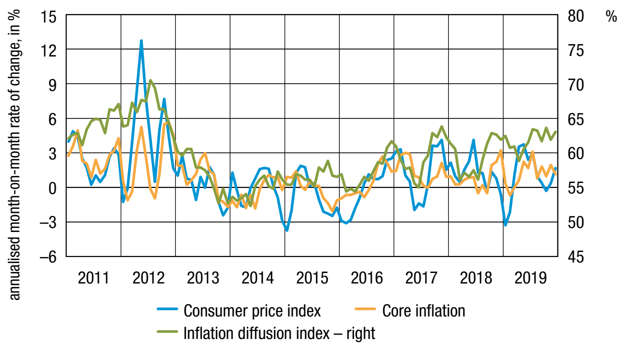
The average annual consumer price inflation decreased to 0.8% in 2019, from 1.5% in 2018, primarily due to a cut in the VAT rate on food and pharmaceutical products, made early in the year. In addition, imported inflationary pressures eased as a result of a drop in average global crude oil prices in 2019 and a slowdown in euro area inflation. Domestic inflationary pressures were relatively mild in 2019, although slightly stronger than in the previous year, related mainly to the acceleration of the growth of personal consumption and unit labour costs as well as of industrial producer prices (excluding energy). Cost pressures did not spill over significantly to consumer prices, having partly been alleviated by a drop in profit margins.

Figure 5.1 Year-on-year inflation rate and contributions of components to consumer price inflation



Notes: Core inflation does not include agricultural product prices, energy prices and administered prices. Processed food products include alcoholic beverages and tobacco.
Sources: CBS and CNB calculations.

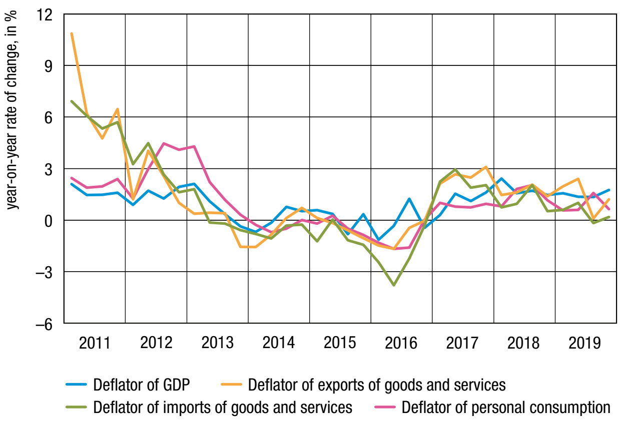
Figure 5.2 Indicators of current inflation trends



Notes: The month-on-month rate of change is calculated based on the quarterly moving average of seasonally adjusted consumer price indices. The inflation diffusion index shows the share of the number of products whose prices increased in a given month in the total number of products, measured by a 6-month moving average, and is based on the monthly rates of change derived from the seasonally adjusted components of the HICP.
Sources: CBS, Eurostat and CNB calculations.

Having slowed down in the first half of the year, largely owing to the VAT rate cut and the fall in crude oil prices on the global market, inflation picked up in the second half of the year, from 0.6% in June to 1.4% in December 2019. This was mostly due to the rise in the annual rate of change in the prices of unprocessed food products and energy. The annual rate of change in the prices of unprocessed food products grew from –4.7% in June to 0.7% in December, mostly driven by the rise in the annual rate of change in the prices of meat, in particular pork. The latter growth can be attributed to disturbance in the global market, that is, the growth in demand from China, reflecting a marked drop in the country's pork production caused by swine fever. This fuelled the rise in pork prices in the European agricultural product market. An increase was also seen in the annual rate of change of fruit prices, caused by poor weather conditions. The annual growth rate of energy prices went up from 1.4% in June to 3.4% in December, the main cause being the increase in the annual growth rate of the prices of refined petroleum products late in the year. This was a result of the positive base effect, that is, a sizeable decrease in Brent crude oil prices on the global market in late 2018 and their

Figure 5.3 Deflator of GDP and its individual components



Source: CBS.

increase in November and December 2019 due to the progress made in trade negotiations between the USA and China.[1] The contribution of services to overall inflation also increased in the second half of 2019, though to a smaller extent, largely owing to an acceleration in the annual growth of the prices of hairdressing and beauty salon services (probably attributable to cost pressures, that is, wage increases) and telephone services. In contrast, processed food products (mostly tobacco products) and industrial products made a slightly lower contribution to overall inflation in the second half of 2019.

Core inflation (which excludes agricultural product prices, energy prices and administered prices) accelerated from 1.1% in June 2019 to 1.2% in December 2019, with the main contributions coming from the prices of meat, non-durable household goods, and hairdressing and beauty salon services.

The implicit deflator of GDP grew from 1.4% in the second quarter to 1.8% in the fourth quarter of 2019, as a result of the pick-up in the deflator of government consumption and capital investments. Trade conditions deteriorated in the second half of the year as the annual growth rate of the deflator for goods and services exports in that

Table 5.1 Price indicators

year-on-year rate of change

	12/18	3/19	6/19	9/19	12/19
Consumer price index and its components					
Total index	0.8	0.9	0.6	0.8	1.4
Energy	0.9	4.0	1.4	0.2	3.4
Unprocessed food	–0.6	–5.7	–4.7	–2.7	0.7
Processed food	1.9	2.6	2.6	2.6	2.3
Non-food industrial goods without energy	0.1	–0.4	–0.3	0.4	–0.6
Services	1.1	1.2	1.3	1.2	1.5
Other price indicators					
Core inflation	1.0	0.9	1.1	1.6	1.2
Index of industrial producer prices on the domestic market	0.5	2.3	0.4	–0.3	1.4
Index of industrial producer prices on the domestic market (excl. energy)	–0.3	0.1	1.0	0.8	0.5
Harmonised index of consumer prices	1.0	1.1	0.5	0.6	1.3
Harmonised index of consumer prices at constant tax rates	0.8	1.7	1.1	1.1	2.1

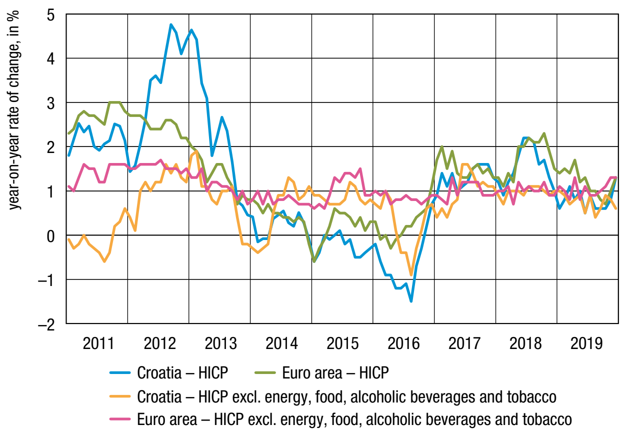
Sources: CBS and Eurostat.

1 The increase in crude oil prices in mid-September after the attacks on oil facilities in Saudi Arabia was temporary and prices stabilised by the end of the month.

period slowed down more than the annual growth rate of the deflator for goods and services imports.

The annual rate of inflation in the euro area measured by the harmonised index of consumer prices was 1.3% in December 2019, remaining unchanged from June. The increased contribution of unprocessed food products, industrial products and services to inflation developments was offset by the smaller contribution of energy (natural gas and electricity,[2] with a rise in the contribution of refined petroleum products). Core inflation (which excludes the prices of energy, food, alcoholic beverages and tobacco) picked up slightly in the euro area (from 1.1% in June to 1.3% in December 2019), spurred mostly by the faster annual growth rate of services prices. Such low core inflation suggests that wage spillover effects onto prices in the euro area were not significant in 2019.

Figure 5.4 Indicators of price developments in Croatia and the euro area



Source: Eurostat.

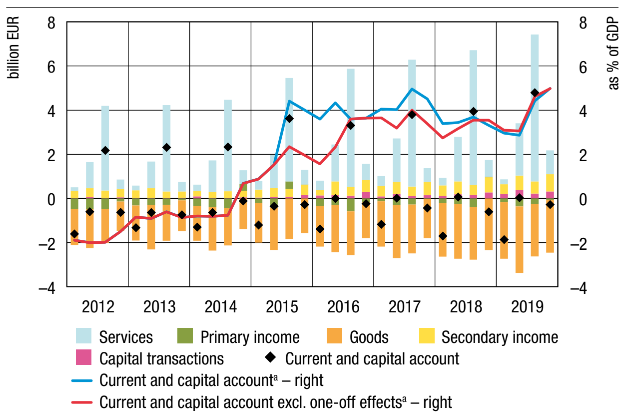
The annual HICP inflation rate in Croatia went up from 0.5% in June to 1.3% in December 2019. This was mainly a result of the growth in the annual rate of change in the prices of unprocessed food products and energy and, to a lesser extent, services. With a 0.8 percentage point increase in the second half of the year, Croatia's inflation was equal to that in the euro area in December 2019. Core inflation in Croatia, measured by the HICP excluding the prices of energy, food, alcoholic beverages and tobacco, edged up in the second half of 2019, from 0.5% in June to 0.6% in December. Core inflation in Croatia was 0.7 percentage points lower than that in the euro area in December 2019. A notably smaller contribution to core inflation in Croatia came from industrial products, in particular pharmaceutical products (owing to a cut in the VAT rate on these products) and textbooks (the prices of which are administratively controlled and which decreased sharply in September 2019).

2 By contrast, the contribution of electricity and gas to inflation in Croatia was the same at end-2019 as at the end of the first half of 2019.

6 Current and capital account

In the second half of 2019, the current and capital account balance improved considerably from the same period of the previous year, mostly driven by further growth in net services exports. The positive developments were also fuelled by an increase in the surplus in the secondary income and capital transactions accounts and, to a lesser extent, by a fall in the deficit in the primary income account. By contrast, the foreign trade deficit widened slightly. In 2019 as a whole, the surplus in the current and capital account rose sharply and stood at 5.0% of GDP, up from 3.3% of GDP in 2018.

Figure 6.1 Current and capital account balance and its structure



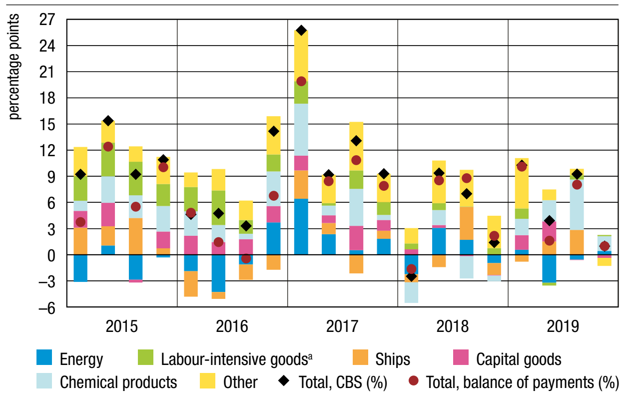
[a] Sum of the last four quarters.
Note: One-off effects include conversion of CHF-linked loans in 2015 and bank provisions for loans to the Agrokor Group in 2017 and 2018.
Source: CNB.

6.1 Foreign trade and competitiveness

The dynamics of foreign trade in the second half of 2019 was considerably slower than in the same period of the previous year, which was particularly evident on the imports side. The annual growth rate of goods imports, according to the balance of payments data, stood at 3.1% in the second half of 2019, in contrast with 10.4% in the same period of the previous year, which can partly be attributed to a slowdown in investment activity. Goods exports growth also slowed down, though at a slower rate, growing annually by 4.5% in the second half of 2019, compared to 5.3% in the same period of the previous year. As a result, the annual growth in goods trade deficit slowed down sharply from the second half of 2018 (1.2% compared to 18.1%). The cumulative values in 2019 show that the goods trade deficit stood at 19.2% of GDP, a deterioration of 0.5 percentage points from the whole of 2018.

According to CBS data[3], better export results in the second half of 2019 were mostly due to a pronounced

Figure 6.2 Goods exports (f.o.b.)
year-on-year rate of change and contributions



[a] Labour-intensive goods (according to the SITC) include: textile, wearing apparel, footwear, leather, paper, cork and wood, furniture, manufactures of metals and non-metallic mineral manufactures, prefabricated buildings and manufactured articles n.e.c.
Sources: CBS and CNB.

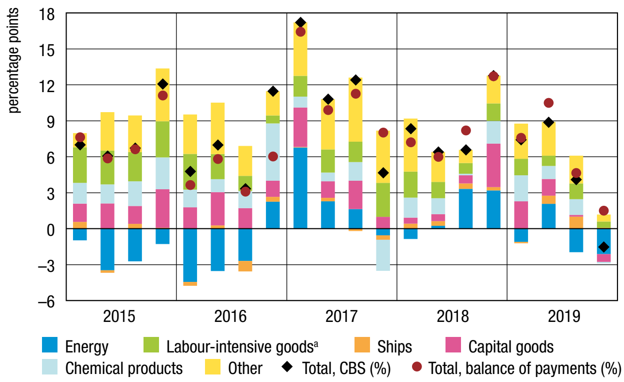
3 For more information on the differences in the scope of the trade in goods according to the balance of payments and CBS data, see Box 3 Foreign trade developments according to the balance of payments data, Macroprudential Developments and Outlook No. 2, July 2017.

rise in exports of medicinal and pharmaceutical products to Belgium. Exports of transport equipment, ships to Malta and the Marshall Islands and road vehicles to Germany, Belgium and Bosnia and Herzegovina also rose considerably. By contrast, slower exports of scientific and controlling instruments and optical products to South Korea had an unfavourable impact on exports. The exports of energy products held steady at the level recorded in the same period of the previous year.

The growth in goods imports was mostly driven by larger imports of transport equipment, primarily ships from Liberia and road vehicles from Germany and Slovenia. The imports of food products from Germany, Spain and Slovenia and medicinal and pharmaceutical products from Belgium and Germany also rose. By contrast, the imports of energy products, in particular imports of oil and refined petroleum products from Azerbaijan and Italy fell sharply.

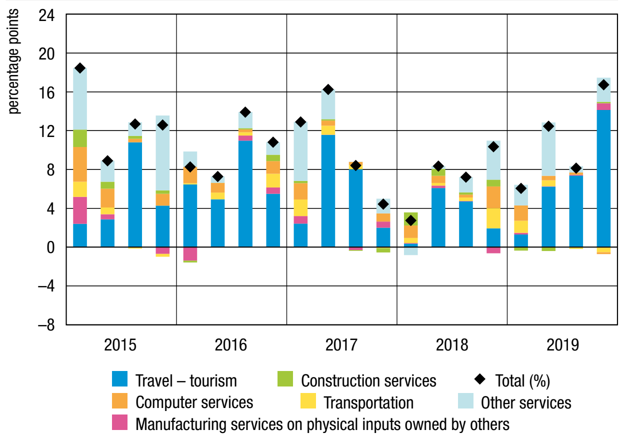
The balance in the international trade in services continued to improve considerably in the second half of 2019, compared with the same period of the previous year. This was mostly due to a further growth in revenues from tourism, which accelerated considerably from the second half of 2018 (from 5.5% to 11.9%). The growth in revenues from tourism was mostly due to the growth in the average consumption of foreign tourists in Croatia, while the increase in volume indicators in tourism was less pronounced. The CBS data show that the number of arrivals of foreign tourists rose by 3.0% and nights stayed by a slight 0.6%, mostly attributable to visitors from Slovenia. Unlike revenues, the growth in tourist consumption of residents abroad slowed down from 1.9% to 1.3%. As a result, the annual growth rate in net travel services exports of 13.2% in the second half of 2019 largely outdid the growth of 5.9% in the same period of the previous year. In addition to tourism, positive developments in international trade in services were also driven, although to a lesser extent, growth in net exports of other services, primarily operating lease and research and development services. The cumulative values recorded over the

Figure 6.3 Goods imports (c.i.f.)
year-on-year rate of change and contributions



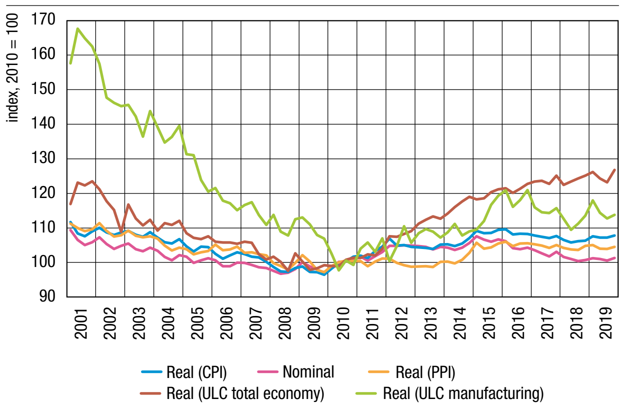
[a] Labour-intensive goods (according to the SITC) include: textile, wearing apparel, footwear, leather, paper, cork and wood, furniture, manufactures of metals and non-metallic mineral manufactures, prefabricated buildings and manufactured articles n.e.c.
Sources: CBS.

Figure 6.4 Services exports
year-on-year rate of change and contributions



Source: CNB.

Figure 6.5 Nominal and real effective exchange rates of the kuna



Notes: The unit labour cost is calculated as the ratio between compensation per employee and labour productivity (defined as GDP per person employed). A fall in the index indicates an effective appreciation of the kuna.
Source: CNB.

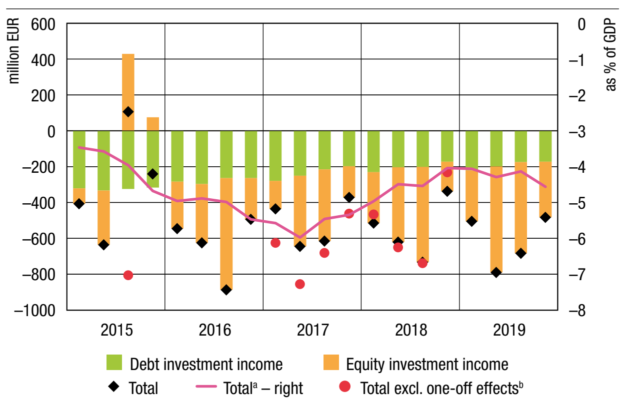
past year reveal that the surplus in the international trade in services rose from 17.9% of GDP in 2018 as a whole to 19.1% in 2019.

The indicators of price and cost competitiveness of Croatian exports mostly improved in the second half of 2019. The real effective exchange rate of the kuna deflated by consumer and producer prices and unit labour costs in the total economy depreciated as a result of weakening of the kuna against the basket of currencies and somewhat more favourable developments in domestic prices and costs relative to the main trading partners. By contrast the real effective exchange rate deflated by unit labour costs in manufacturing appreciated slightly as a result of faster growth in unit labour costs in manufacturing in Croatia than in the countries in the basket for the calculation of the real effective exchange rate of the kuna.

6.2 Income and transactions with the EU

The negative investment income balance rose additionally in the second half of 2019 from the same period of the previous year. This was due to higher expenditures on direct equity investments as a result of considerably better business results of domestic banks and non-financial corporations (primarily in the real estate and trade activities) in non-resident ownership. At the same time, unfavourable developments were partly mitigated by better business results of foreign enterprises in resident ownership and lower net interest expenditures on debt investments.

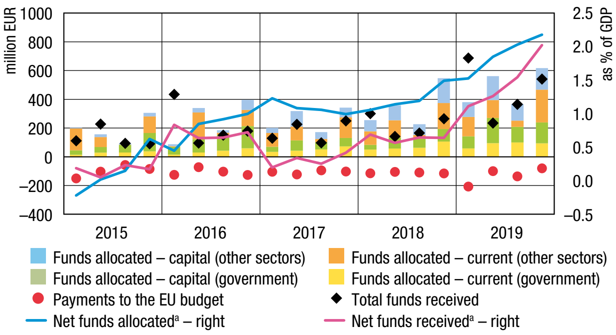
Figure 6.6 Investment income



[a] Sum of the last four quarters, excluding one-off effects. [b] One-off effects include the conversion of CHF-linked loans in 2015 and bank provisions for loans to the Agrokor Group in 2017 and 2018.
Source: CNB.

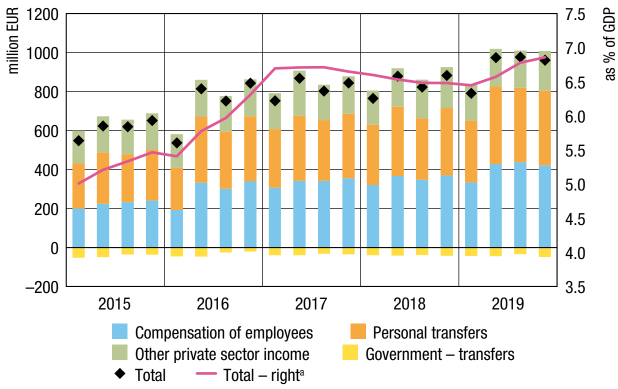
The second half of 2019 saw a considerable increase in net revenues from transactions with the EU budget from the same period of the previous year due to a considerably greater use of EU funds. As regards the structure of increase in the utilised funds, the bulk of the increase can be attributed to the government, which increased in particular the amount of capital revenues, in contrast with other sectors, which witnessed a somewhat greater increase in the use of current revenues. Throughout 2019, the surplus of funds utilised from EU funds over the

Figure 6.7 Transactions with the EU budget



[a] Sum of the last four available quarters.
Notes: As regards total funds received from EU funds, only funds allocated and paid out to end beneficiaries are recorded in the current and capital account of the balance of payments, while funds received but not allocated are recorded in the financial account. Payments to the EU budget carry a negative sign in the figure. The positive value of net received and net allocated funds is the surplus over the payments to the EU budget.
Sources: CNB and MoF.

Figure 6.8 Other income, excluding investment income and transactions with the EU



[a] Sum of the last four available quarters
Note: Compensation of employees is recorded in the primary income account, while other series (personal transfers, other private sector income and government transfers) are recorded in the secondary income account.
Source: CNB.

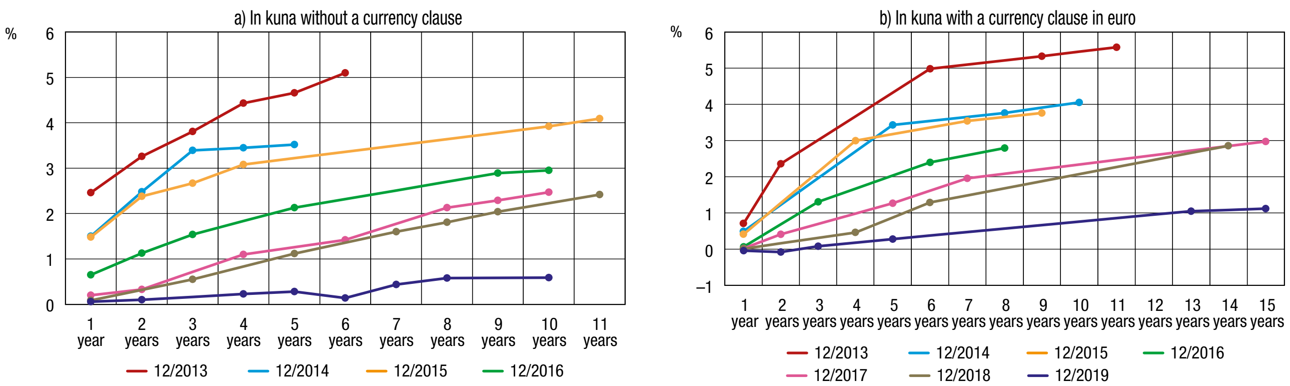
payments to the EU budget stood at 2.6% of GDP, a considerable improvement from 1.8% of GDP in 2018. Net inflow from other income, which excludes investment income and transactions with the EU budget also rose additionally owing to a further increase in revenues from compensation of persons temporarily employed abroad and revenues from personal transfers from abroad.

7 Private sector financing

Domestic sectors' financing conditions continued to improve in the second half of 2019. The interest rates on corporate and household loans fell, again driven by a reduction in the costs of sources of funding of the Croatian banking system. The costs of government borrowing, one of the determinants of the borrowing costs of other domestic sectors, reached historical lows. The interest rate on one-year kuna T-bills on the domestic market fell to 0.06% in October 2019 and held steady at that level until the end of the year. The auction of T-bills of the same maturity held in August 2019 witnessed for the first time a negative interest rate of –0.05%, which continued into October. Much more favourable conditions were observed on the entire yield curve, particularly as regards longer-term financing (Figure 7.1.a and Figure 7.1.b). In addition, in November the government also issued two bonds on the domestic capital market with thus far the most favourable borrowing conditions as regards debt maturity: a five-year kuna bond worth HRK 3.5bn with a 0.36% yield and a fifteen-year kuna bond with a currency clause in the euro worth HRK 7.5bn with a yield of 1.2%. The funds collected by the new bond issues were mostly used to refinance the existing issue of a fifteen-year bond worth EUR 1bn that fell due towards the end of November.

The cost of government borrowing on the foreign market, estimated by the sum of the EMBI index for Croatia and the yield on the German government bond was much more favourable in the second half of 2019 than in the first half of the year (Figure 7.3). Towards the end of December it amounted to 0.7%, a decrease of 1.7 percentage points from end-2018, influenced by a 1.2 percentage point fall in the EMBI index for Croatia. Croatia's credit default swap (CDS) fell from 96 basis points at end-2018 to 64 basis points at the end of 2019. The country's credit rating and outlooks by credit rating agencies as regards Croatia's risks did not change in the second half of 2019, after Standard & Poor's and Fitch upgraded Croatia's rating from BB+ to BBB– in the first half of the year (when the country reached again, after over four years, an investment

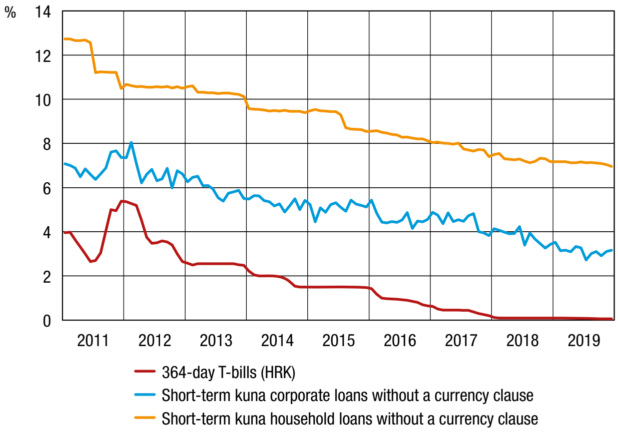
Figure 7.1 Yield-to-maturity on RC bonds



Notes: The dots show the achieved yields, while other values have been interpolated. Data for one-year yield refer to the achieved interest rate on one-year kuna T-bills without a currency clause.
Source: CNB.

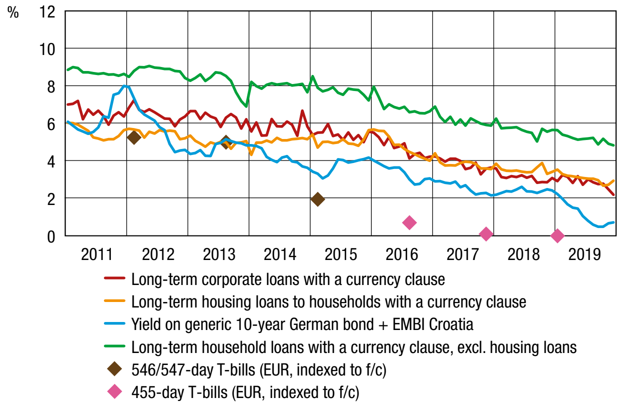
Notes: The dots show the achieved yields, while other values have been interpolated. Data for one-year yield refer to the achieved interest rate on one-year T-bills with a currency clause in euro. Data for the end of 2016 refer to November, data for the end of 2017 refer to October and data for June 2019 refer to May.
Source: CNB.

Figure 7.2 Short-term financing costs
in kuna without a currency clause



Sources: MoF and CNB.

Figure 7.3 Long-term financing costs
in kuna with a currency clause and in foreign currency



Note: EMBI, or the Emerging Market Bond Index, shows the spread between yields on government securities of emerging market economies, Croatia included, and risk-free securities issued by developed countries.
Sources: MoF, Bloomberg and CNB.

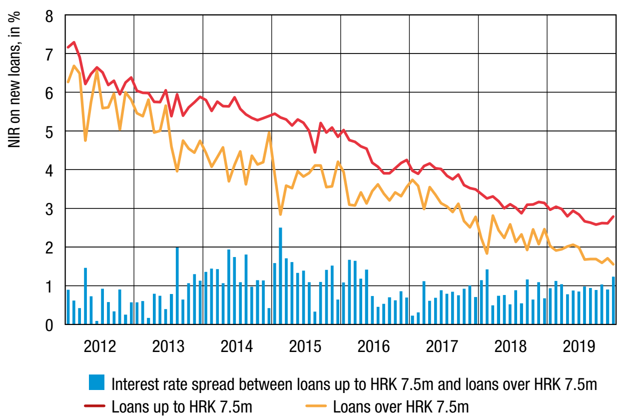
grade level with two credit rating agencies) and after Moody's changed the outlook from stable to positive, maintaining the rating two grades below investment grade at Ba2.

The costs of corporate financing continued to fall. The average interest rates on short-term corporate bank borrowing in kuna without a currency clause and long-term borrowing in kuna with a currency clause fell by 0.3 percentage points in the second half of 2019 from the first half of the year average and stood at 3.2% and 2.2%, respectively in December (Figure 7.2 and Figure 7.3). Favourable developments were also seen in a fall in interest rates by loan volume (Figure 7.4). Interest rates on loans above HRK 7.5m were lower and more volatile, since such loans are commonly used by a smaller number of large companies with more collateral and better access to alternative financing.

Household financing costs also continued to fall. The average interest rate on long-term housing loans with a currency clause fell by 0.3 percentage points in the second half of 2019 from the first half of the year and stood at 2.9% in December (Figure 7.3). Meanwhile, the average interest rate on long-term consumer and other loans with a currency clause also fell by 0.3 percentage points, reaching 4.8% at the end of the year. The average cost of short-term kuna household borrowing fell by 0.1 percentage point during the same period (Figure 7.2).

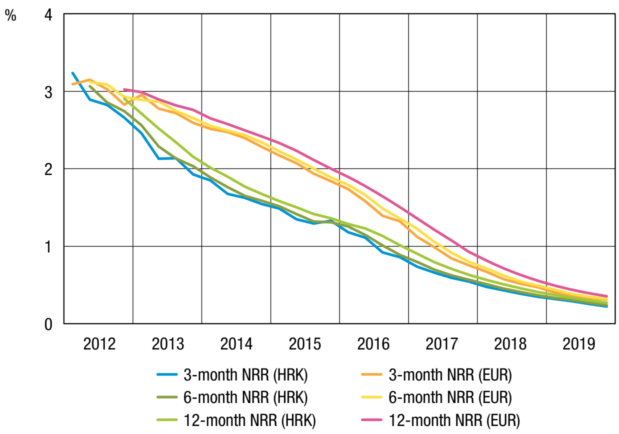
A further reduction of the costs of financing of the private sector is again driven by a fall in the costs of funding sources of the Croatian banking system. EURIBOR is still in the negative territory (Figure 2.3), while the national

Figure 7.4 Bank interest rates on loans to non-financial corporations by volume



Source: CNB.

Figure 7.5 National reference rate (NRR)



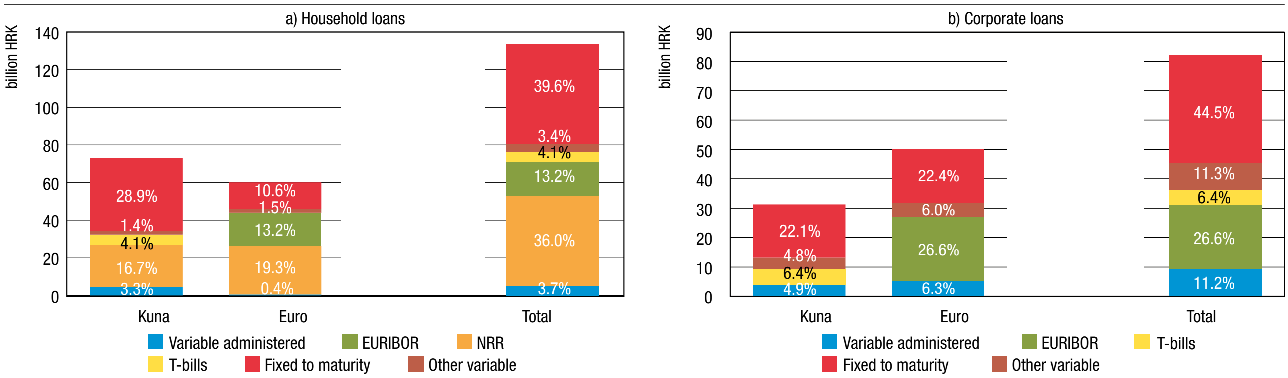
Note: The rates shown refer to rates applicable to all natural and legal persons.
Source: HUB.

reference rate (NRR)[4] continued to trend downwards slightly (Figure 7.5).

As regards the structure of interest rates, amid low interest rates the share of loans with a fixed interest rate continued to trend upwards in 2018 and 2019 with the shares of household and corporate loans rising by 5.9 percentage points and 12.4 percentage points, respectively. Due to growth in kuna lending, households witnessed an increased share of loans tied to the NRR. Thus at the end of 2019, observed by categories, household loans with a fixed-to-maturity interest rate (39.6%, Figure 7.6a) accounted for the biggest share, followed by loans tied to the NRR and the EURIBOR. Furthermore, 18.6% of household loans are loans with interest rates fixed over a period of time shorter than loan maturity, two thirds of which are loans with interest rates fixed over a period longer than three years. As regards corporate loans, if observed by categories, the largest portion of loans had a fixed-to-maturity interest rate (44.5%, Figure 7.6b), while EURIBOR was the most represented in loans with a variable interest rate, in accordance with the currency structure in which the euro is predominant.

The results of the bank lending survey for the second half of 2019 show that the

Figure 7.6 Structure of interest rates
December 2019



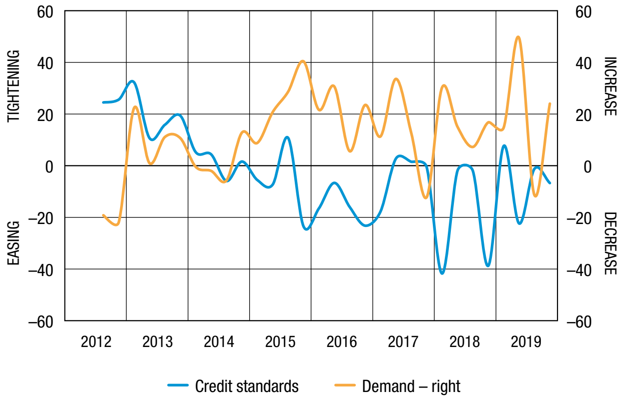
Notes: Percentages show shares in total household loans. Loans currently undergoing initial interest rate fixing are included in a category in accordance with the relevant parameter that will be applicable following the expiry of the fixing period.
Source: CNB.

Notes: Percentages show shares in total corporate loans. On account of its small share, the amount of corporate loans tied to the NRR is included in the category "Other variable". Loans currently undergoing initial interest rate fixing are included in a category in accordance with the relevant parameter that will be applicable following the expiry of the fixing period.
Source: CNB.

4 The national reference rate (NRR) is the average interest rate paid on deposits by the banking sector. It is used as one of the benchmark interest rates for determining the level of the variable component of the variable interest rate on loans, in accordance with Article 11a of the Credit Consumer Act (pursuant to the Act on Amendments to the Consumer Credit Act, OG 143/2013).

credit standards for corporate loans had been eased, but at a lower intensity than in the second quarter (Figure 7.7). The easing of credit standards for corporate loans in the second half of the year was mostly fuelled by favourable conditions on the banking market (bank competition and bank liquidity) and positive expectations regarding general economic developments. Corporate demand for loans, after having fallen in the third quarter, picked up in the last quarter of 2019. Rising demand in the second half of the year was mostly driven by gross fixed capital formation, financing of inventories and working capital. By contrast, the use of alternative sources of financing generally more accessible to large enterprises made the biggest negative contribution to credit demand in the third quarter.

Figure 7.7 Credit standards and corporate demand for loans

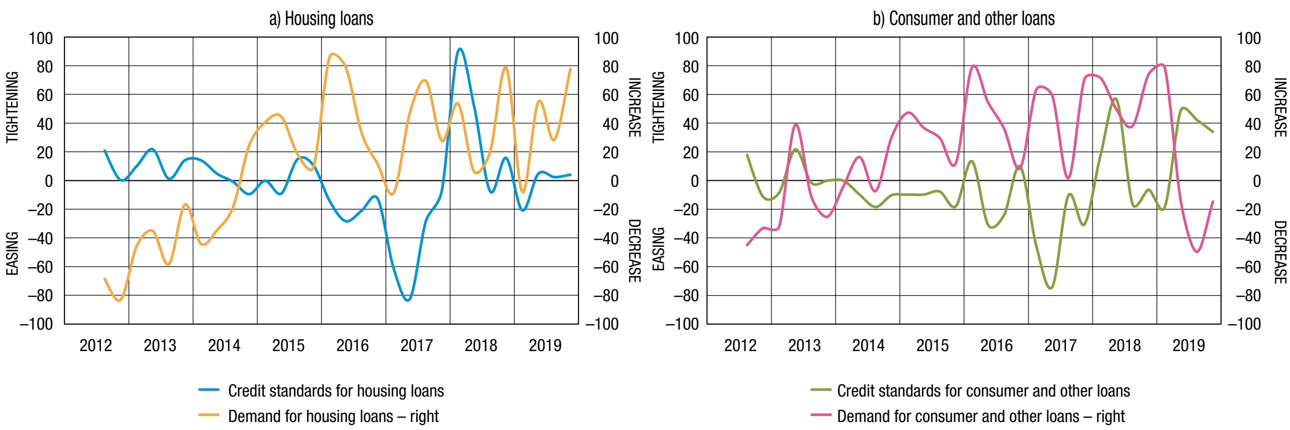


Note: Data show the net percentage of banks weighted by the share in total corporate loans.
Source: CNB.

As regards credit standards for household loans, they continued to tighten in the second half of 2019 (Figure 7.8). As in the second quarter, the tightening of the standards was more pronounced in the case of consumer and other loans, reflecting compliance with the Recommendation on actions in granting non-housing consumer loans, which, among others, invites credit institutions to apply more cautious conditions when granting new general-purpose cash loans, particularly those with longer maturities. The demand for consumer and other loans continued to fall, faster than in the second quarter, while the demand for housing loans continued to grow, fuelled by better housing market prospects and rising consumer confidence.

The total debt of non-financial corporations fell in the second half of 2019, mainly as a result of a fall in foreign debt of private enterprises. The debt of enterprises to

Figure 7.8 Credit standards and household demand for loans

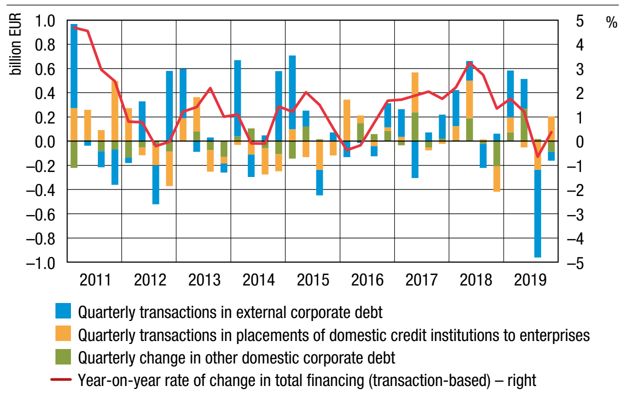


Note: Data show the net percentage of banks weighted by the share in total household loans.
Source: CNB.

domestic creditors also fell (Figure 7.9). If observed at the level of the whole of 2019, total corporate debt rose by 0.4% (transaction-based), mainly influenced by growth in other domestic financing. The growth of placements of domestic credit institutions was smaller than that of other domestic financing, which can mostly be attributed to a fall in claims on the Agrokor Group, while the negative effect of the activation of government guarantees for loans to shipyards was less pronounced, since the bulk of government guarantees were activated towards the end of 2018. By contrast, corporate foreign debt declined as a result of deleveraging of private enterprises, while public enterprises slightly increased their foreign financing.

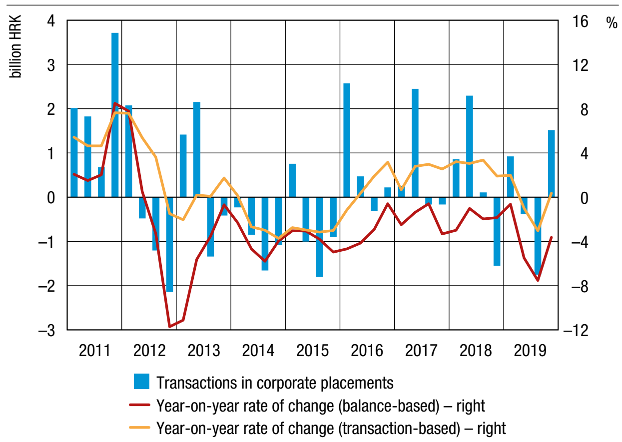
Domestic placements of credit institutions to non-financial corporations fell by HRK 0.2bn or –0.3% (transaction-based, Figure 7.10) in the second half of 2019. However, on an annual level corporate placements rose by 0.4% in 2019, while in the year before the rise was 1.9%. The slowdown in growth in 2019 was largely influenced by one-off effects, in particular a reduction in claims on the Agrokor Group, also associated with the operational implementation of the settlement while the effect of the activation of government guarantees for loans to shipyards was less pronounced. If these one-off effects are excluded, the growth in domestic corporate placements in 2019 was almost equal to the growth in the year before (Figure 7.11). The growth in lending to micro companies and small and medium-sized enterprise was bigger than the growth in large companies' financing. Nominally, the annual fall in corporate placements was 3.6%,

Figure 7.9 Corporate financing



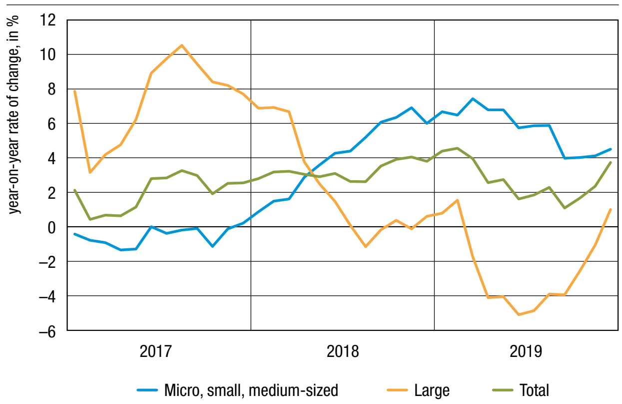
Notes: Other domestic financing includes borrowing from domestic leasing companies and the CBRD. External debt excludes the effect of debt-to-equity transactions. All changes were calculated according to transactions (except for other domestic debt).
Sources: HANFA, CNB and CNB calculations.

Figure 7.10 Corporate domestic placements of credit institutions



Source: CNB.

Figure 7.11 Growth of corporate placements by size, transaction-based
transaction-based



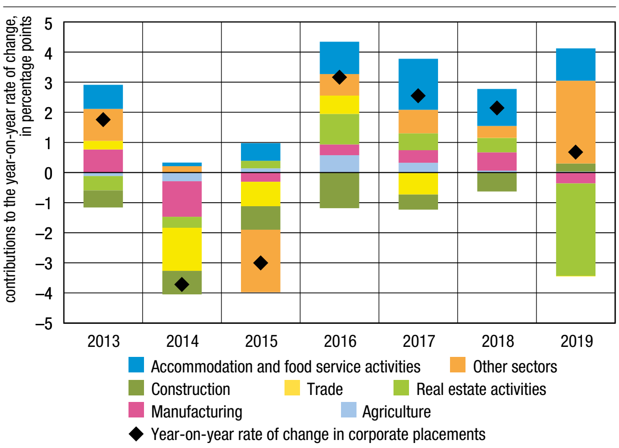
Note: Data are adjusted for the estimate of the effect of activation of government guarantees for loans to shipyards and a reduction of claims on the Agrokor Group, also associated with the operational implementation of the settlement.
Source: CNB.

considerably smaller than the growth based on transactions and mostly the result of the sale of irrecoverable corporate placements.

If corporate lending by activities is observed (Figure 7.12), the activity of accommodation and food services continued to have a positive effect on placement growth, although this contribution has been falling in the last two years. Construction also made a small positive contribution to placement growth. Positive developments in this activity followed years of deleveraging. In contrast to the past several years, manufacturing provided a negative contribution to the growth in placements, which was partly due to the activation of government guarantees for loans to shipyards. Real estate operations also made a negative contribution, however this was due exclusively to a change in the activity of one large enterprise.[5] As regards corporate loans by loan purpose, the weakening of overall credit activity in 2019 was the result of the annual fall in loans for working capital and other loans, while loans for investments continued to grow at an annual level with their growth reaching 10.2% at the end of 2019 (Figure 7.13).

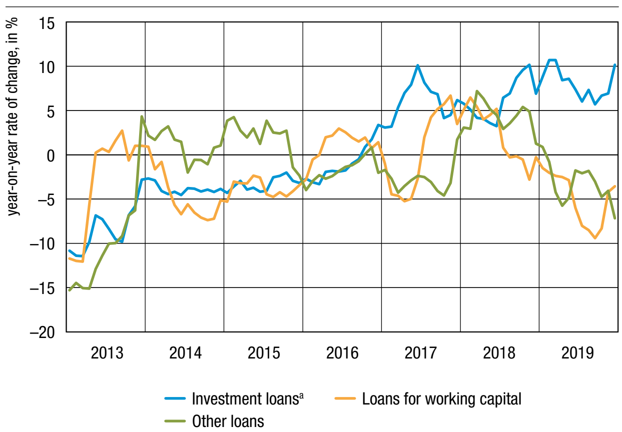
The recovery in household lending that started towards the end of 2016 was accompanied by a continuous acceleration of annual growth, which reached 7.4% (transaction-based, Figure 7.14) at the end of 2019. The fall in financing costs, employment growth and strong consumer confidence had a favourable effect on household credit activity. As regards loans structure, general-purpose cash loans were again the main drivers of growth (Figure 7.15), although their annual growth slowed down slightly after February and stood at 11.5% (transaction-based) at the end of December. This was also due to the CNB Recommendation on actions in granting non-housing consumer loans. By contrast, the growth in housing loans accelerated on an

Figure 7.12 Growth of corporate placements by activity
transaction-based



Source: CNB.

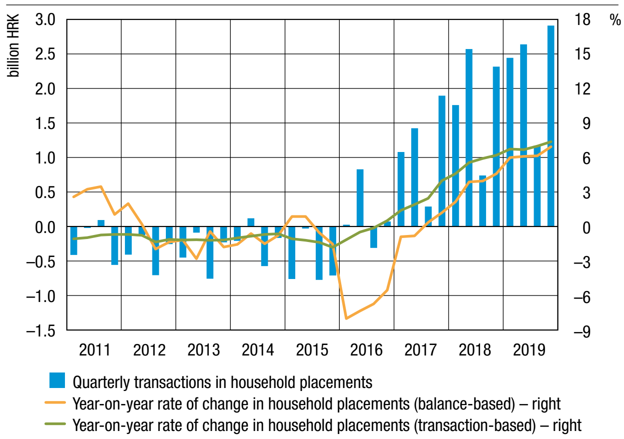
Figure 7.13 Growth in corporate loans by purpose
transaction-based



Source: CNB.

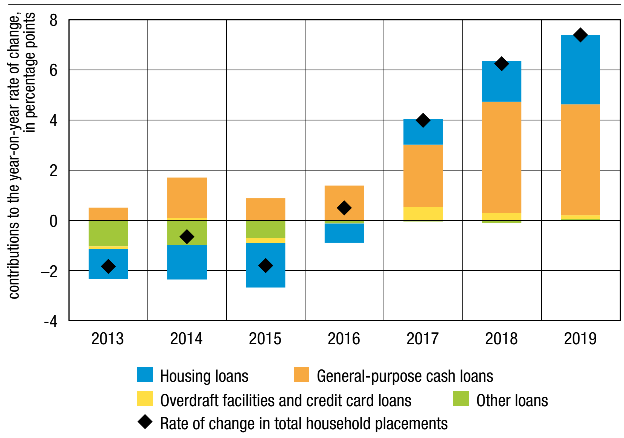
5 In October, one large company witnessed a change in activity from L Real estate activities to E Water supply; sewerage, waste management and remediation activities. This led to a sharp fall in placements in Real estate activities and a significant rise in Other sectors, which includes the Water supply activity.

Figure 7.14 Household placements



Source: CNB.

Figure 7.15 Growth of household placements by loan type
transaction-based



Source: CNB.

annual level in the second half of the year, reaching 6.4% in December (transaction-based). This was also due to the further implementation of the housing loan subsidy programme of the Government of the Republic of Croatia.

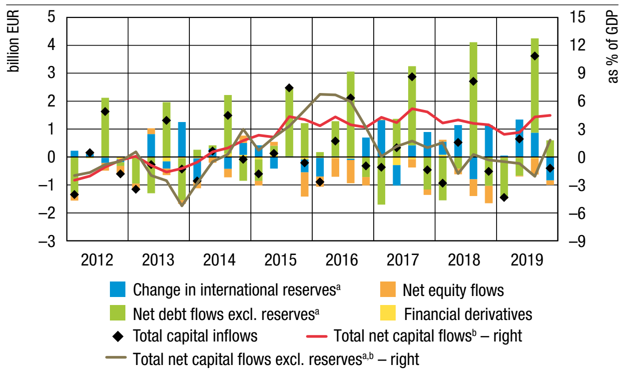
8 Foreign capital flows

The financial account of the balance of payments saw a net capital outflow of EUR 3.2bn in the second half of 2019, up by EUR 1.0bn from the same period of the previous year (Figure 8.1). The net capital outflow is the result of a fall in net foreign debt liabilities of domestic sectors, which was more pronounced than in the second half of 2018. At the same time, net inflows from equity investments were lower. The net foreign position of the central bank remained almost unchanged in the second half of 2019, following improvement in the same period of the previous year. Accordingly, the fall in net financial liabilities of domestic sectors of EUR 3.2bn (the amount does not include changes in international reserves and liabilities of the CNB) in the second half of 2019 was bigger by EUR 1.4bn than in the same period of 2018.

The net inflow of equity investments in the second half of 2019 stood at EUR 0.7bn, as a result of an increase in liabilities (EUR 1.2bn) that was bigger than the increase in assets (EUR 0.5bn). The growth in liabilities was for the most part the result of the reinvestment of earnings of domestic business entities in non-resident ownership, which was much bigger than in the same period of the year before due to profitability growth, particularly owing to the banking sector. New foreign direct equity investments in Croatia (Figure 8.2) mostly took place in the real estate sector and the activities of business consulting services and manufacture of motor vehicles. By contrast, assets growth mostly involved investments of residents in foreign shares and equity holdings.

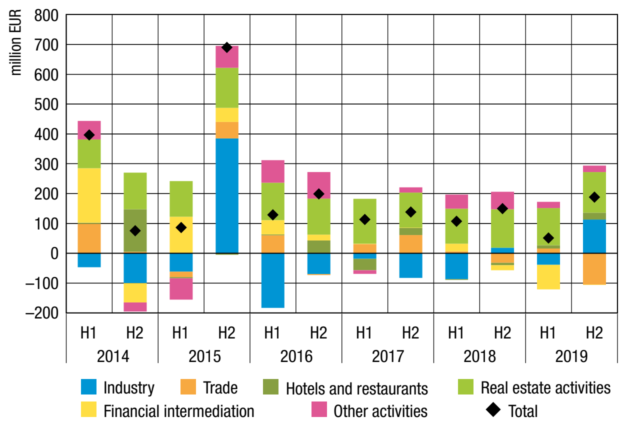
A sharp net outflow of debt capital of EUR 4.0bn (excluding the change in international reserves and liabilities of the CNB) in the second half of 2019 is the result of deleveraging of all domestic sectors, with the government standing out as regards the improvement in its net foreign position, having paid off the due dollar bond of USD 1.5bn in November. At the same time, the net foreign position of the central bank did not change much since the withdrawal of the temporarily deposited government funds (especially after June 2019 international bond issue) was accompanied by an increase

Figure 8.1 Flows in the financial account of the balance of payments



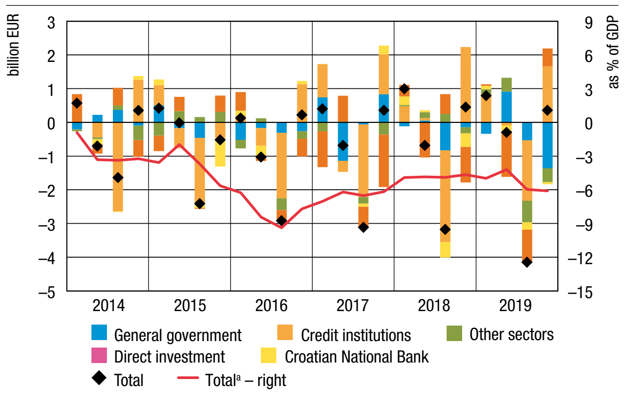
[a] Changes in gross international reserves net of CNB foreign liabilities.
[b] Sum of the previous four quarters.
Notes: Net flows mean the difference between changes in assets and liabilities. Equity flows comprise changes in foreign direct equity investments, reinvested earnings and portfolio equity investment. Positive value means net capital outflow abroad.
Source: CNB.

Figure 8.2 Foreign direct equity investment in Croatia by activities



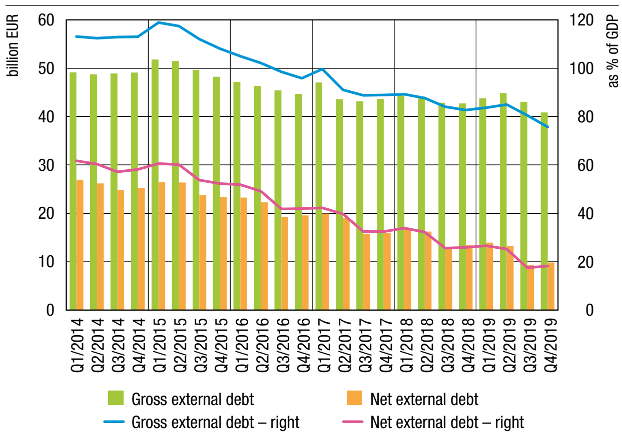
Note: Equity investment net of debt-to-equity transactions and round-tripping investments.
Source: CNB.

Figure 8.3 Net external debt transactions by sectors



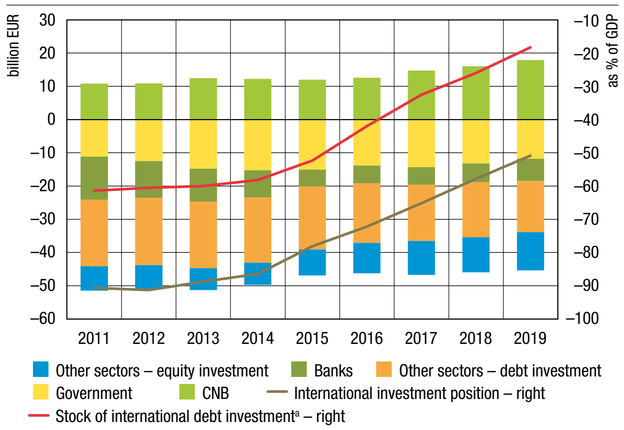
ᵃ Sum of the previous four quarters.
Notes: Transactions refer to the change in debt excl. cross-currency changes and other adjustments. Net external debt is calculated as the gross external debt stock net of foreign debt claims.
Source: CNB.

Figure 8.4 Stock of gross and net external debt



Note: Net external debt is calculated as the gross external debt stock net of foreign debt claims.
Source: CNB.

Figure 8.5 International investment position (net) by sectors



ᵃ Stock of international debt investments (net) equals the negative value of the net external debt.
Source: CNB.

in reserves following interventions in the foreign exchange market.

Domestic sectors' deleveraging led to an improvement in relative external debt indicators (Figure 8.4). At the end of 2019, the gross external debt stock stood at EUR 40.9bn or 75.7% of GDP, a decrease of 9.3 percentage points from the end of June 2019, attributable to the fall in debt stock and the nominal increase in GDP. The net external debt also fell, reaching EUR 9.9bn or 18.3% of GDP at the end of 2019, a decrease of 7.0 percentage points from the end of June.

The net international investment position also improved considerably (Figure 8.5) since the effect of domestic sectors' deleveraging was bigger than the increase in net liabilities from equity investments. The relative indicator of the international investment position thus stood at –50.8% of GDP at the end of 2019 while at the end of June it stood at –57.3% of GDP.

9 Monetary policy

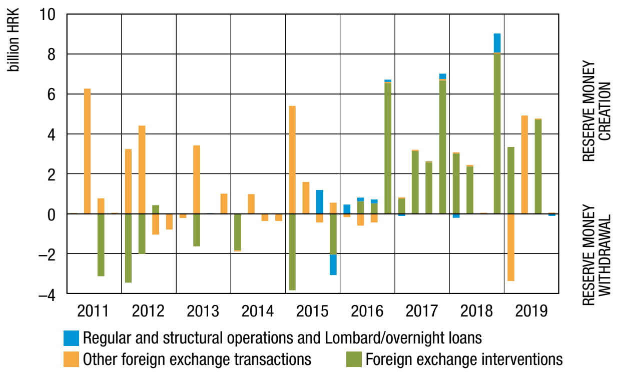
In the second half of 2019, the CNB continued to pursue an expansive monetary policy, maintaining a relatively stable exchange rate of the kuna against the euro. The appreciation pressures on the exchange rate prompted the central bank to intervene in February and August, purchasing altogether EUR 1.1bn from banks. On an annual level, the CNB also purchased EUR 228.1m from the Ministry of Finance. In total, the central bank created HRK 9.7bn of reserve money through foreign exchange transactions (Figure 9.1).

As regards kuna operations, the CNB continued to conduct regular weekly repo auctions at a fixed repo rate of 0.3%. However, due to exceptionally high kuna liquidity, the banks showed no interest in assets offered through this monetary policy instrument since December 2017. In the second half of 2019, no additional funds were created by structural operations, so their balance decreased slightly to HRK 1.9bn at the end of the year. This was a result of banks making partial early repayments.

The surplus kuna liquidity of the monetary system continued to grow in the second half of 2019, reaching HRK 34.1bn at the end of December (Figure 9.2). The average surplus kuna liquidity reached HRK 32.2bn on an annual level, up 30% on the average surplus in 2018. This was primarily a result of creating reserve money by purchasing foreign exchange from banks. The exceptionally high liquidity slowed down bank trading in demand deposits in the second half of the year and the overnight interest rate on bank trading in demand deposits ended the year at 0.04%.

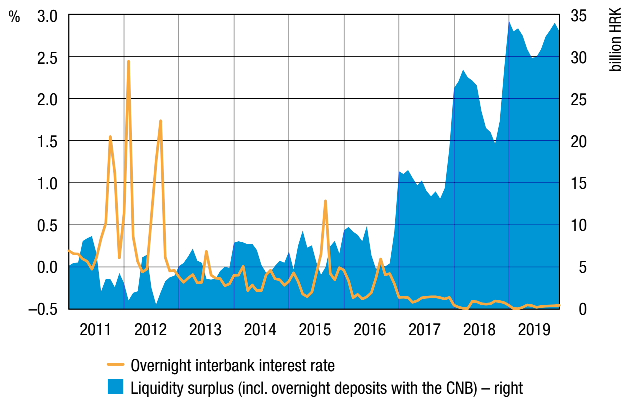
The kuna/euro exchange rate stood at EUR/HRK 7.44 at the end of the year, up 0.3% on the end of the same month in 2018, while the average exchange rate in 2019 totalled EUR/HRK 7.41 EUR/HRK almost equalling the exchange rate in 2018 (Figure 9.3). The CNB's foreign exchange interventions neutralised the impact of appreciation pressures on the exchange rate of the kuna against the euro which were a result of the balance of payments current account surplus, capital inflows from EU funds and

Figure 9.1 Flows of reserve money (M0) creation



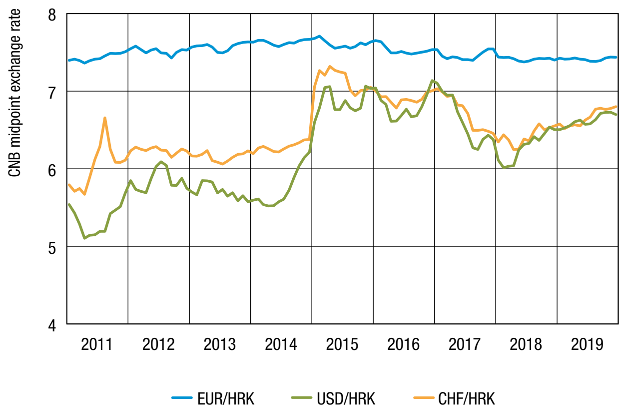
Notes: The possibility of using Lombard loans was abolished, while the possibility of using overnight credits was introduced on 28 September 2017. Other foreign exchange transactions include the purchase of foreign exchange from and the sale of foreign exchange to the MoF and the EC and foreign currency swaps with banks, where the positive values refer to the purchase of foreign exchange by the CNB.
Source: CNB.

Figure 9.2 Bank liquidity and overnight interest rate on bank trading in demand deposits



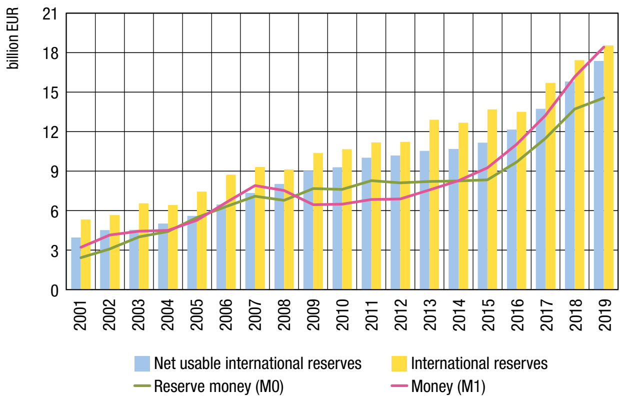
Note: Until the end of 2015 the overnight interest rate refers to the overnight interbank interest rate, while from the beginning of 2016 it refers to the overnight rate on bank trading in demand deposits.
Source: CNB.

Figure 9.3 Nominal exchange rates of the kuna against selected currencies



Source: CNB.

Figure 9.4 International reserves of the CNB and monetary aggregates



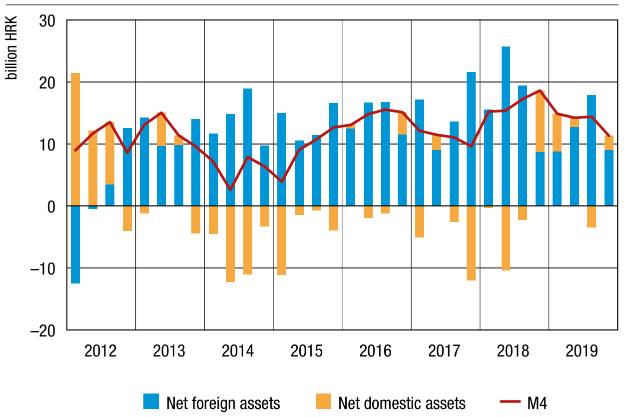
Note: Net usable international reserves are defined as international reserves net of the CNB foreign liabilities, reserve requirements in f/c, government foreign currency deposits and off-balance sheet liabilities (swaps).
Source: CNB.

reduction in euroisation. The exchange rate of the kuna against the US dollar and the Swiss franc was higher at the end of December 2019 than at the end of the same month the year before, reflecting the weakening of the euro against the two currencies on global financial markets.

Gross international reserves stood at EUR 18.6bn at the end of 2019, up EUR 1.1bn (6.4%) on the end of 2018. Net usable reserves also increased during the period, by EUR 1.5bn, reaching EUR 17.4bn at the end of the year. The growth in gross and net reserves was mostly due to the purchase of foreign exchange from banks and the government and to a lesser extent due to the strengthening of the US dollar against the euro since a portion of the international reserves is kept in US dollars. Gross international reserves continued to exceed money (M1) and reserve money (M0).

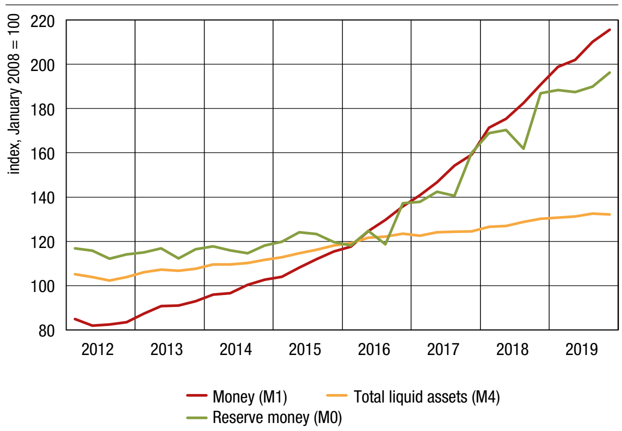
Although the annual growth of total liquid assets (M4) continued to be considerable, the second half of 2019 registered a slowdown in this growth to 3.5% at the end of 2019m from 6.1% at the end of 2018 (Figure 9.5.). These trends were a result of the

Figure 9.5 Net foreign assets, net domestic assets and total liquid assets (M4)
absolute change in the last 12 months



Note: Absolute changes excluding the exchange rate effect.
Source: CNB.

Figure 9.6 Real monetary aggregates
index of developments in seasonally adjusted values, deflated by the consumer price index



Source: CNB.

annual decrease in net domestic assets, while net foreign assets contributed positively to the growth of M4.

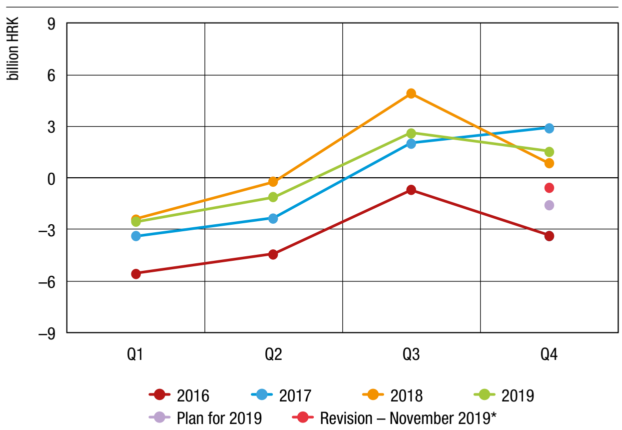
Real monetary aggregates continued to grow in 2019 (Figure 9.6). The annual growth rate of total liquid assets (M4) thus amounted to 1.5% at the end of the year, while money (M1) and reserve money (M0) went up at the annual rate of 13.0% and 5.0%, respectively. The several-years long upward trend in M1 is spurred primarily by the increase in kuna deposits on transaction accounts amid low interest rates on savings and time deposits, while the growth in M0 primarily reflects high kuna liquidity surpluses created by the CNB's foreign exchange transactions.

10 Public finance

The relatively favourable fiscal developments continued in the second half of 2019. According to the ESA 2010 methodology, general government boasted a positive balance of HRK 2.7bn. The surplus generated represents an HRK 1.6bn improvement from the same period in 2018. The increase in general government surplus reflects a slightly faster growth in revenues (7.3%) over expenditures (5.7%) than in the second half of 2018. The general government surplus stood at HRK 1.5bn (0.4% of GDP) in 2019 as a whole, its overall annual performance also being more favourable than the general government budget balance in 2018, which showed a surplus of HRK 850m (0.2% of GDP).

Decomposition of the change in nominal general government balance shows that the change in the nominal balance in 2019 as a whole was, to a degree, positively affected by structural factors (mainly due to the fall in capital transfers in 2019 from 2018, driven by the activation of government guarantees in shipbuilding). At the same time, due to the stagnation in interest expenditures there was no stronger positive impact of this category in 2019 on the change in the nominal balance that was seen over the previous few years, while the impact of cyclical developments in economic activity was neutral.

Figure 10.1 General government cumulative balance by quarters (ESA 2010)

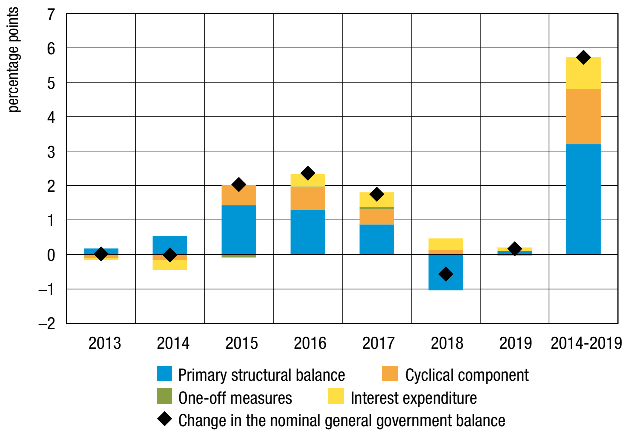


Sources: Eurostat and MoF (CNB calculations).

The annual increase in total revenues picked up to 7.3% in the second half of 2019 from 6.0% in the first half of the year. Such developments primarily reflect an acceleration in the growth of the other revenues category, which also includes revenues from EU funds. Revenues from indirect taxes grew as well amid the continued increase in personal consumption and favourable developments in tourism. Direct taxes grew as well, their growth being attributable to favourable labour market developments and better business results of economic entities. Favourable trends in the labour market also contributed to the edging up of revenues from social contributions.

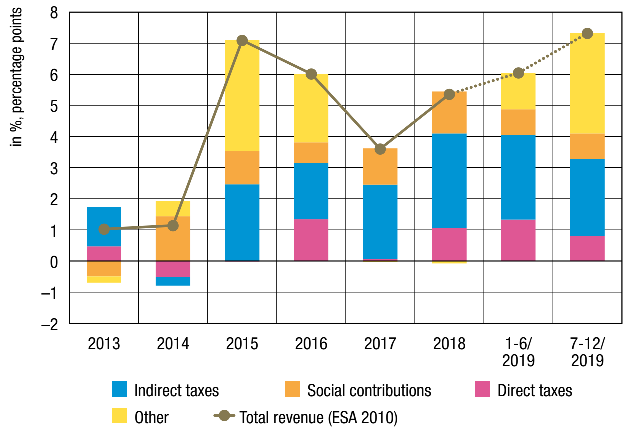
As regards the expenditure side of the budget, total general government expenditures increased by 5.7% in the second half of 2019 on an annual level, reflecting a mild slowdown from the first half of the year. Expenditures for investments contributed the most to the growth of total expenditures, increasing by 20.5% on an annual level in the second half of the year. This probably reflects the intensification of investments by local governments and public enterprises included in the general government sector. The increase in certain categories of current expenditures, such as expenditures for intermediary consumption and employee benefits, also substantially contributed to the growth of overall expenditures. At the same time, expenditures for subsidies also grew significantly in the second half of the year after having fallen in the first half. However, the influence of a variable intra-annual

Figure 10.2 Decomposition of the change in the nominal general government balance



Source: CNB.

Figure 10.3 Consolidated general government revenue (ESA 2010)
year-on-year rate of change and contributions

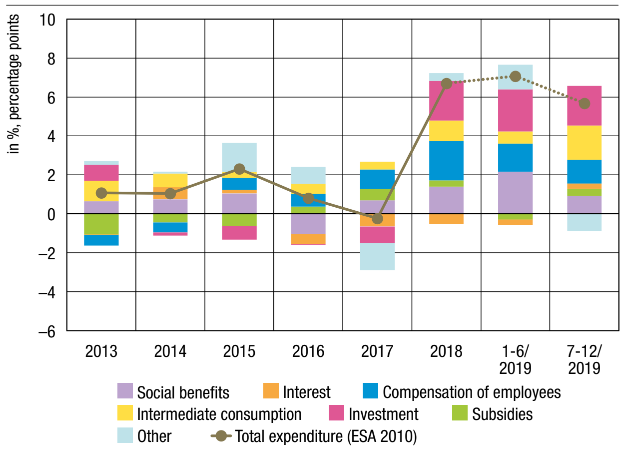


Source: Eurostat (CNB calculations).

dynamic of payments on this category remains strong. Interest expenditures stagnated on an annual level after falling for several years in succession on account of favourable financing conditions and the lower financing needs of the general government.

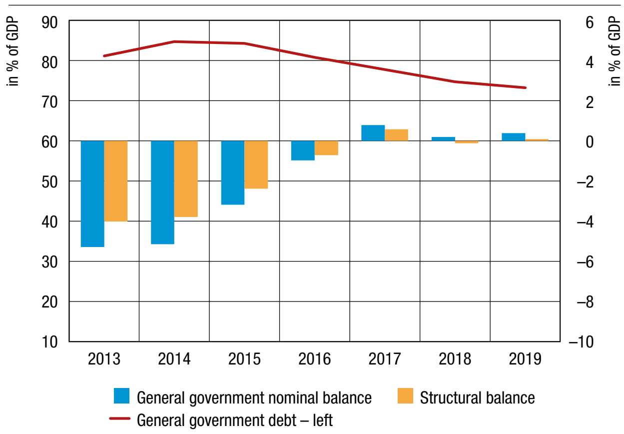
Consolidated general government debt stood at HRK 293.0bn or 73.2% of GDP at the end of 2019, up HRK 4.0bn on the end of June 2019. The higher level of public debt at the end of December 2019 is predominantly a result of the raising of a portion of funds needed to finance liabilities falling due in 2020 by issuing domestic long-term securities in November 2019. As regards the relative indicator, the public debt-to-GDP ratio went down by 1 percentage point at the end of 2019 from the end of June 2019. A review of the change in the share of public debt at the end of 2019 from the end of 2018 shows that despite the increase in the level of public debt, the growth in domestic product resulted in the reduction of the share of public debt in GDP from 74.7% at the end of 2018 to 73.2% at the end of 2019.

Figure 10.4 Consolidated general government expenditure (ESA 2010)
year-on-year rate of change and contributions



Source: Eurostat (CNB calculations).

Figure 10.5 General government debt and deficit



Source: CNB.

11 International reserves management

The upward trend in international reserves that started in 2017 continued in 2019. In strategic and tactical terms, international reserves management adhered to the same principles as in the previous years, with special efforts put in to adjust the structure of net reserves to a prolonged period of low and negative interest rates in the financial market and to the inflows and maturities in the net reserves portfolios in the best possible way, all in line with the objectives of reserves management. The primary objective of international reserves management remained the same, namely to ensure a high level of liquidity and safety of international reserves and generate adequate levels of earnings.

The Council of the CNB formulates the strategy and policy for international reserves management and specifies the guidelines, criteria and limits on risk exposures. In accordance with the objectives set by the Council of the CNB, the International Reserves Commission develops international reserves investment strategies and adopts tactical decisions taking into account market conditions and the primary objective of international reserves management.

The CNB manages international reserves in two ways: in line with its own guidelines and in accordance with the obligations assumed, depending on the way in which international reserves are formed. The component of international reserves acquired through purchases of foreign currency from banks and the MoF, through IMF membership and through the income derived from the investment of international reserves and other CNB assets, is managed by the CNB in line with its own guidelines (the term ‘net reserves’ is used for this part of the reserves).

The other component of the reserves, formed on the basis of deposits of the MoF, repo agreements with banks, foreign currency swaps in the domestic market, IMF membership and other assets owned by other legal persons, is managed by the CNB in accordance with obligations assumed.

11.1 Structure of and developments in international reserves

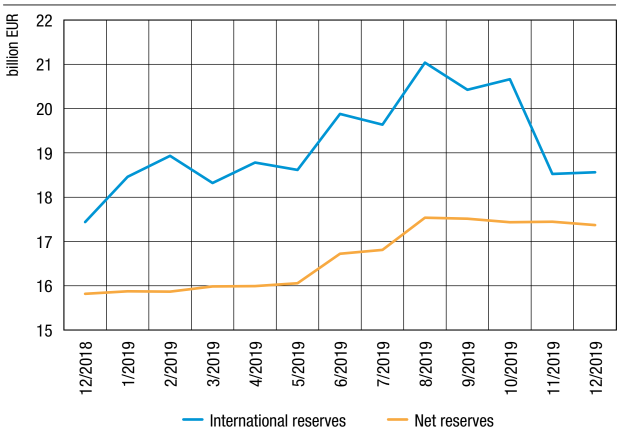
International reserves of the CNB stood at EUR 18,562.4m as at 31 December 2019, up by EUR 1,123.6m or 6.4% from the end of 2018, when they stood at EUR 17,438.8m. Over the same period, net reserves rose by EUR 1,549.7m, or 9.8%, from EUR 15,820.0m to EUR 17,369.7m.

The strong growth of international reserves was predominantly a consequence of the purchase of foreign exchange from banks aimed at countering appreciation pressures.

Securities of governments and government institutions, deposits with central banks and reverse repo agreements accounted for the largest share in the structure of international reserves investment at the end of 2019.

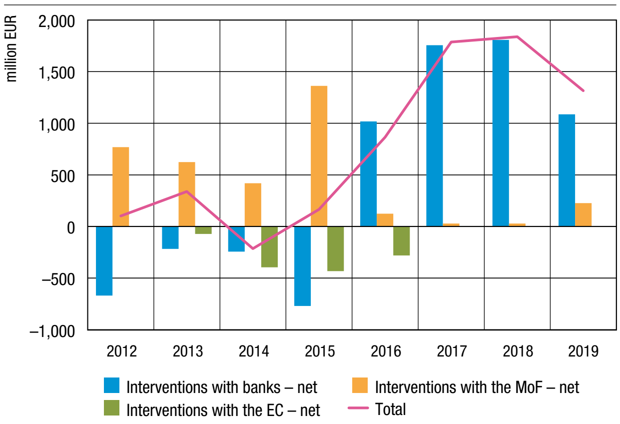
The CNB invests funds with financial institutions and in countries with an investment grade rating; the assessment of creditworthiness is based on ratings issued by internationally recognised rating agencies (Moody’s, Standard & Poor’s and

Figure 11.1 Monthly changes in total and net CNB international reserves in 2019



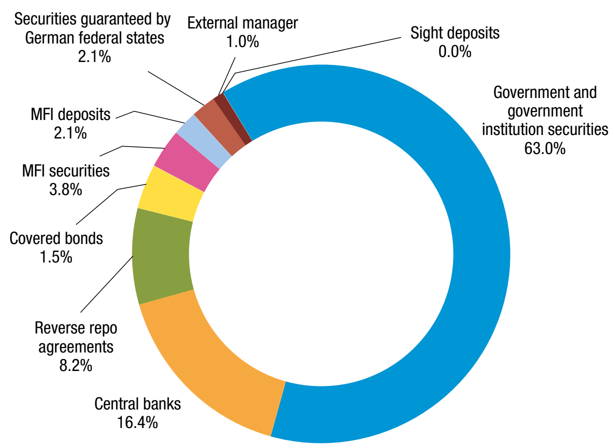
Source: CNB.

Figure 11.2 Foreign exchange interventions of the CNB with the banks, the EC and the MoF
in net amounts



Note: Positive values refer to the purchase and negative to the sale of foreign exchange by the CNB.
Source: CNB.

Figure 11.3 Structure of international reserves investment
as at 31 December 2019



Source: CNB.

Figure 11.4 Currency structure of total international reserves
as at 31 December 2019

Source: CNB.

FitchRatings) and on an internally-developed creditworthiness assessment model.

In its management of international reserves, the CNB is governed primarily by the principle of safety and applies restrictions on investments in individual financial institutions and countries and individual instruments, which serves to diversify credit risk. At the end of December 2019, around one half of the CNB international reserves were invested in countries, banks and institutions within the two highest credit rating categories or invested in the BIS and the IMF or in foreign cash in the CNB vault.

In 2019, the currency structure of international reserves changed slightly in favour of the US dollar. This was a consequence of the decision on the change in currency structure of net reserves adopted at the end of the year. Thus, the share of the US dollar, whose share amounted to 12.7% at the end of 2018, increased to 15.9% in 2019, while the share of the euro decreased from 85.1% to 82.0%. The share of SDRs in international reserves edged down from 2.1% to 2.0% due to the increase in international reserves.

11.2 Financial markets and international reserves management results in 2019

Financial markets in 2019 were marked by a reversal of the expected trend of ongoing normalisation of monetary policies. In these circumstances, the ECB adopted a new set of incentive measures, including the relaunching of the programme of securities purchase and lengthening of the horizon for maintaining negative and low interest rates. The Fed on the other side, firstly interrupted the cycle of raising its benchmark interest rates and went on to lower them on three occasions. The exceptionally expansive monetary policy ensured high liquidity and contributed to the fall in the yields on government bonds and to the growth of global stock exchange indices to record levels, while the US dollar strengthened against the euro.

Yields on almost all issued European government securities decreased in 2019, so that a half of government securities of the euro area member states had negative yields. The yield curve for German bonds for all maturities up to fifteen years was in negative territory at the end of December.

US yields dropped sharply across the entire curve in 2019, the average fall for all maturities up to ten years totalling some 83 basis points.

International reserves managed by the CNB in line with its own guidelines comprise the held-for-trading portfolios, the investment portfolios, the funds entrusted to an external manager and foreign cash in the vault.

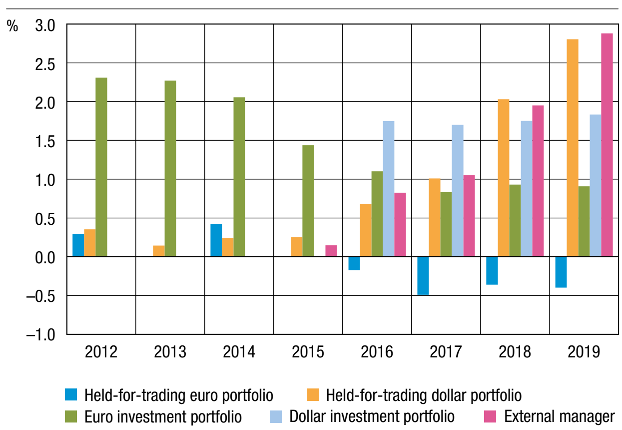
In 2019, net international reserves investments generated an income of EUR 59.9m or HRK 443.7m.

Despite the negative rate of the euro yield curve, in 2019, the rate of return on the entire euro portfolio of net reserves was 0.07%, while the rate of return on the entire dollar portfolio totalled 2.10%. If held-for-trading and investment portfolios are observed separately, the euro held-for-trading portfolio generated an annual rate of return of –0.40%, while the dollar held-for-trading portfolio generated an annual rate of return of 2.80% in 2019. The euro-denominated investment portfolio yielded a return of 0.91%, while the dollar-denominated investment portfolio yielded a return of 1.83%.

The held-for-trading portfolios, which account for approximately 49% of net reserves, have short average maturities and are used as a source of liquidity. Investment portfolios, which account for approximately 48% of net reserves, have a longer average maturity and serve as a source of more stable long-term income.

In 2019, the rate of return on the US dollar funds entrusted for management to an international financial institution was 2.88%. The entrusting of funds to an international financial institution enabled additional diversification as well as knowledge-exchange in the field of investment management.

Figure 11.5 Annual rates of return on the CNB foreign currency portfolios from 2012 to 2019

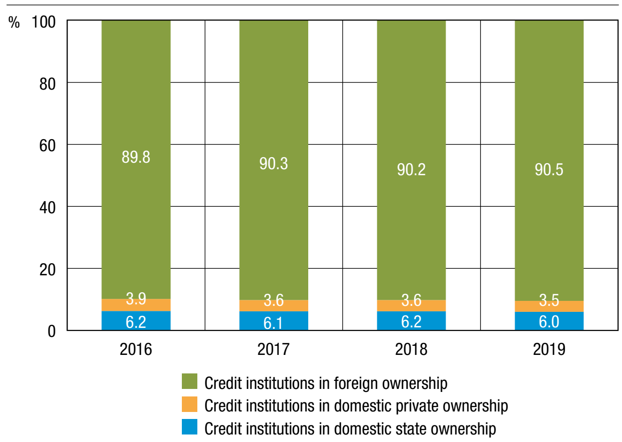


Source: CNB.

12 Business operations of credit institutions in 2019

The years-long downward trend in the number of credit institutions continued in 2019. The consolidation of state-owned credit institutions, i.e. the merger of Jadranska Banka d.d. and HPB Stambena štedionica with Hrvatska poštanska banka d.d., decreased the number of credit institutions by two, so that at the end of 2019 there were 20 banks and three housing savings banks operating in the Republic of Croatia. In addition, there was one branch of an EU credit institution operating in the country, while some 200 institutions from the EU (and the EEA) had notified the CNB of the direct provision of mutually recognised services in the territory of the Republic of Croatia.[6]

Figure 12.1 Ownership structure of credit institutions and their share in total assets of credit institutions



Source: CNB.

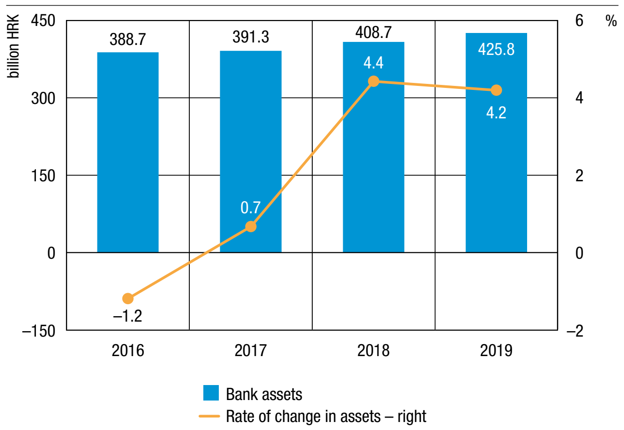
The mentioned reduction in the number of credit institutions in domestic ownership, to nine, mildly strengthened the dominance of foreign-owned credit institutions, their assets accounting for 90.5% of total assets of credit institutions. The effect of the reduction in the number of credit institutions is also evident in the increase of the indicator of banking system concentration, for instance the years-long upward trend in the Herfindahl-Hirschman Index (HHI) for assets, which reached 1,642 at the end of 2019. Although higher, its value continued to indicate only a moderate concentration in the market. Except for the dominance of foreign-owned institutions, the credit institution system is also marked by the dominance of systemically important banks (90.2%).[7]

12.1 Banks

The year under review is the second year in succession registering a recovery in bank assets, following years of decline or stagnation. In 2019, total assets increased by HRK 17.1bn (4.2%) to a record HRK 425.8bn. The increase was mostly driven by the rise in domestic sources of financing, especially as a result of the usual impact of the tourist season. The greatest changes in assets had to do with increase in loans and investments in securities. There were also strong developments in the structure of deposits received.

6 Updated information on credit institutions operating in the territory of the Republic of Croatia may be found here.
7 Other systemically important (O-SII) credit institutions are credit institutions the failure or malfunction of which could lead to systemic risk in the Republic of Croatia. Information on the last review of other systemically important credit institutions may be found here.

Figure 12.2 Bank assets



Source: CNB.

Bank lending was predominantly directed at lending to households, the increase in loans to this sector outstripping the increase in total loans. The strongest impact was made by a further increase in general-purpose cash loans but the steady growth of housing loans was also important. Growing steadily for years, general-purpose cash loans reached one fifth of total bank loans, i.e. 41.0% of total loans to households. To mitigate potential risks associated with excessive growth in non-housing loans to consumers, the CNB issued recommendations to credit institutions,[8] instructing them to impose stricter conditions for long-term cash loans (i.e. comply with the conditions applied to housing loans), to establish records of collateral data and other data on loans and establish records on key indicators required to assess and monitor borrowers' creditworthiness. In addition, credit institutions were advised of the CNB's supervisory expectations regarding appropriate inclusion of risks arising from such loans in the internal capital adequacy assessment process (ICAAP).

Housing loans went up strongly in the fourth quarter of 2019, which is attributable to the government continuing to subsidise housing loans.[9] Consequently, housing loans grew at the highest annual growth rate since 2010 and maintained the leading share in the structure of loans to households, totalling 42.5%.

The rise in loans to non-financial corporations was mostly spurred by the continued upward trend in loans to entities engaged in accommodation and food service activities. However, the overall increase of loans to this sector was relatively weak due to further sale of claims. Loans to the central government increased as well, while loans to the financial sectors decreased.

The bulk of the growth of investments in securities was a result of the growth in investments of central governments, especially the growth of investments into RC bonds. Banks classified the largest portion debt securities in the portfolio of financial assets measured at fair value through other comprehensive income. This is an accounting aspect worth stressing because the improvement of RC credit rating in the first half of 2019 and thus the connected growth in the prices of RC bonds contributed to the growth of accumulated other comprehensive income, generating a positive impact on bank capital.

Almost one fourth of total bank assets continued to be accounted for by highly

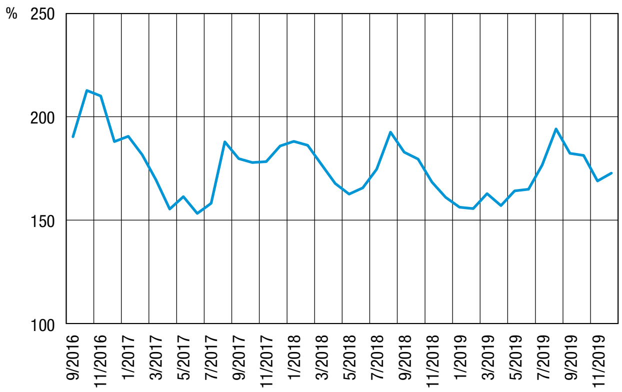
8 Recommendation on actions in granting non-housing consumer loans

9 A total of 12 credit institutions participated in the Government's 2019 housing loans subsidy programme, in accordance with the Act on Housing Loan Subsidisation (OG 65/2017, 61/2018 and 66/2019). Sources: https://mgipu.gov.hr/ and http://apn.hr/.

liquid assets – cash and received deposits. The greatest contribution to this share came from assets in settlement accounts with the CNB, whose share additionally increased after the spillover of a share of deposits from foreign financial institutions.

The increase in these items and other highly liquid assets, increased the banks' liquidity buffer and ultimately their liquidity coverage ratio (LCR) to a high 172.7%. At the same time, the increase in most stable sources of funding, household deposits and tier 1 capital contributed to the increase in the net stable funding ratio (NSFR) to 151.9%. All banks complied with the minimum liquidity requirements (100%-level).

Figure 12.3 Liquidity coverage ratio (LCR)



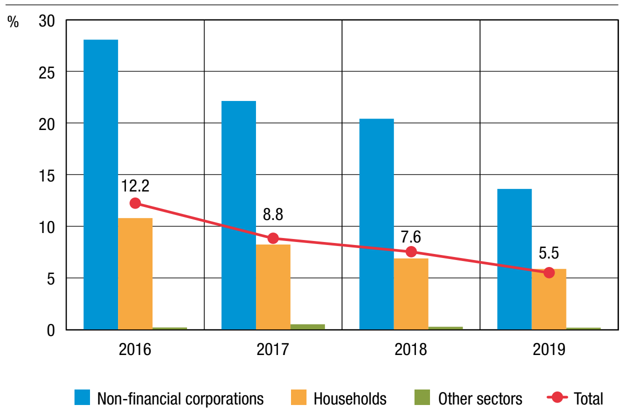
Source: CNB.

The increase in bank assets was partly a result of regulatory changes. In particular, 1 January 2019 marked the beginning of the application of International Financial Reporting Standard 16 – Leases, which changed the treatment of operating leases in lessees' books. An analysis of its initial impact showed that banks' tangible assets associated with leases grew by HRK 1.3bn, with lease liabilities also increasing by the same amount.

The years-long trend of improvement in the quality of bank assets continued in 2019. The overall amount of non-performing loans decreased by almost one third and their non-performing exposures ratio went down from 7.1% at the end of 2018 to 4.7% at the end of 2019. The continuation of this trend in 2019 is mostly a result of the decrease in non-performing exposures to non-financial corporations resulting from the sale of claims and the settlement deal being completed by Agrokor. Although the volume of claims sold has gone down from the previous years, this continues to represent an important tool for reducing non-performing exposures. In 2019, banks sold a total of HRK 4.2bn in claims (gross amount of principal and interest), almost the total of non-performing loans.

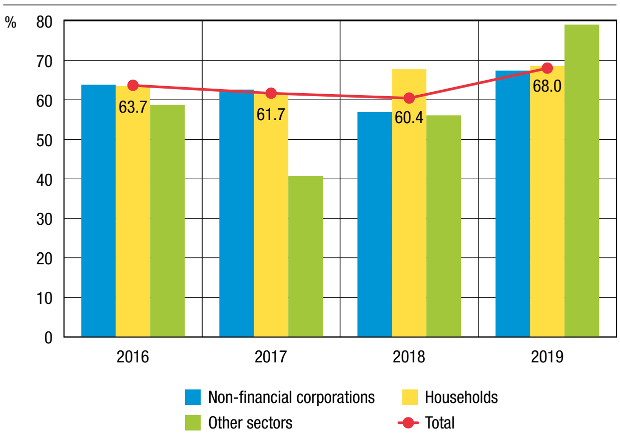
The non-performing loans ratio (NPLR) went down from 7.6% to 5.5%. Despite the positive trend, , in comparison with other EU member states, this is still among the highest in EU member states

Figure 12.4 Share of non-performing loans in total bank loans



Source: CNB.

Figure 12.5 Coverage of non-performing loans by impairment



Source: CNB.

and less favourable than the EU NPLR average (2.9).[10] In only four banks was this indicator below the acceptable threshold of 5%[11], while at a half of them the NPLR continued to exceed 10%. In the portfolio of non-financial corporations, the NPLR decreased to 13.6%. As regards loans to households, it went down to 5.9%, with the largest contribution coming from the decrease in housing loans. In addition to the mentioned noticeable growth of the principal a large contribution also came from the reduction in the amount of non-performing housing loans. The NPLR of general-purpose cash loans increased as well. However, it is noteworthy that although this share of the portfolio has continuously been deteriorating, new credit activity and sale of claims have managed to compensate for the trend.

The coverage of non-performing loans by impairment increased due to a considerable difference in the dynamics of the decrease in impairments and underlying exposures. This can be attributed to the sale of claims whose coverage is, on average, very low (44% vis-à-vis 75% over the previous years), under the influence of the sale of a large amount of non-performing claims for which relatively small impairments were made.

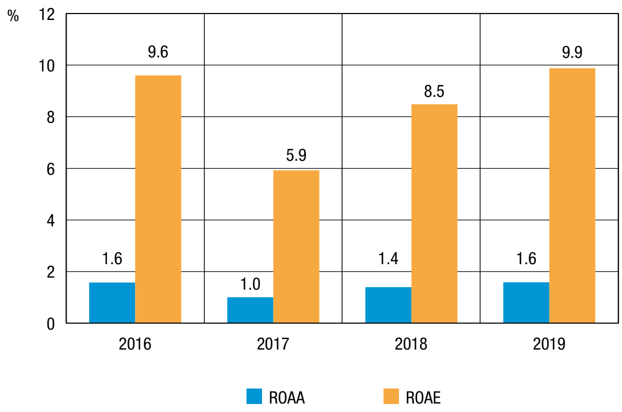
The greatest change in bank liabilities from 2018 was related to the increase in total deposits, which went up by HRK 11.1bn (3.5%), to HRK 329.6bn. Most of these developments were registered in the third quarter and are connected to the effect of the tourist season. The greatest contribution to the increase in total deposits came from the increase in household deposits (4.6%). Developments in the deposit structure of this sector are also mostly to be credited with the continuation of the strong maturity transformation in total deposits, i.e. for the increase in the share of deposits in transaction accounts, to 57.7%, and reduction in the share of time deposits, to 37%, of total deposits.

In 2019 banks generated the highest profits on record. Current year profit totalled HRK 5.8bn, up 17.9% from the profit realised in 2018. With the rise in profits, return on average assets (ROAA) and return on average equity (ROAE) also increased, to 1.6% and 9.9%, respectively. Profits grew mostly on account of the increase in non-interest income, primarily income from dividends. A positive

10 Data of the European Banking Authority (EBA) on the values of key risk parameters for EU and individual Member States are drawn from a representative sample of credit institutions and may be found here.

11 Pursuant to Guidelines for the management of non-performing and restructured exposures credit institutions whose NPLR exceeded 5% as at 31 December 2018 are required to set up a strategy, an appropriate management structure and an operational model for reducing non-performing exposures as of 30 June 2019.

Figure 12.6 Bank return on average assets (ROAA) and return on average equity (ROAE)



Source: CNB.

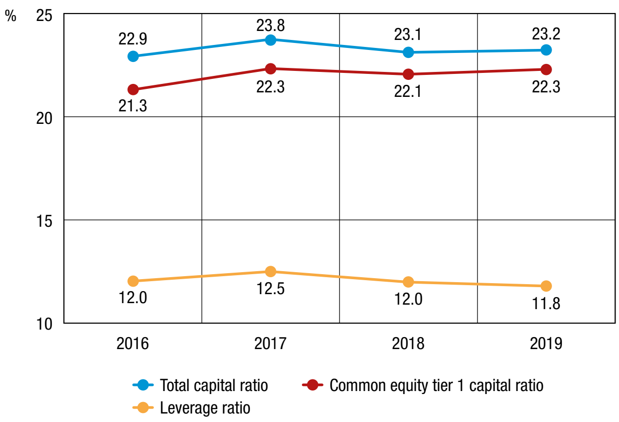
contribution also came from lower expenses on impairment for credit risk and the effect of the base period.[12] A noticeable increase in provisions for litigation costs (HRK 1.1bn or 1,506%), resulting from the multiplied number of court proceedings against banks, had an opposite effect. These proceedings primarily include new proceedings initiated by consumers – borrowers of loans with a currency clause in CHF against seven banks, which accounted for the bulk of the increase in these provisions in 2019.

Net operating income increased by 10.8%. In addition to the mentioned income from dividends, there was an increase in interest income after seven years of decline. The effect of this long-term reduction in interest income is reflected in it being 1.8 times lower than at the end of 2011 when the downward spiral began. Although not significant, the increase in interest income (HRK 303.2m or 2.6%) paired with a further decrease of interest expenses led to an increase in net interest income (6.8%). Developments in the household sector had the key effect on both of the above changes, primarily the growth in interest income from general-purpose cash loans and the decrease in interest expenses on the time deposits of this sector. Net income from fees and commissions grew as well (9.7%), also primarily due to the growth of this income from households. These developments resulted in the increase of the share of other non-interest income in total net income to 12.7%, i.e. in the decrease of the share of net interest income and net income from fees and commissions to 65.1% and 22.2%, respectively. The increase in net income improved the cost efficiency of bank operations, reducing the cost-to-income ratio (CIR) to 46.2%. Both this and the profitability indicator were under the key influence of leading banks.

The high capitalisation that characterises the banking system continued in 2019. The growth of own funds outstripped the growth of risk exposures (3.0% vs 2.5%), which resulted in a negligible increase in the total capital ratio from 23.1% to 23.2%. High capitalisation is underlined by the value of this indicator which is among the highest of EU Member States and noticeably higher than the average EU total capital ratio (18.9%). Own funds increased in the segment of tier 1 capital primarily due to the increase in the accumulated other comprehensive income, inclusion of the part of current year profit, retention of the part of previous year profit and the inclusion of additional tier 1 capital instruments. Total capital ratio of all banks exceeded the 8%-minimum, while in nine banks, accounting for a 92% share of total assets of all banks, this ratio exceeded 20%.

12 The profit of Splitska banka was not included in the aggregated income statement of banks at the end of 2018. Splitska banka merged with OTP bank on 3 December 2018. The income statement of Splitska banka was closed as at the date of the merger and the profit generated in the first eleven months of 2018 was transferred to retained profit of OTP bank.

Figure12.7 Key indicators of bank capitalisation



Source: CNB.

The increase in assets slightly reduced the financial leverage. However, it (11.8%) continued to exceed the proscribed EU minimum of 3%.[13] Greater exposure to credit risk contributed the most to the growth of total exposure. However, the average credit risk weight decreased, from 48.9% to 47.6%, because of the increased application of lower risk weights.

12.2 Housing savings banks

The assets of housing savings banks decreased by 3.4%, to HRK 5.3bn in 2019, their share in total assets of credit institutions declining to 1.2%. The fall in their total assets was a consequence of the decrease in the key source of funding, the deposits of housing savings bank depositors (3.0%). This, as well as the change in most other reviewed items was affected by the HPB Stambena štedionica merger. The greatest change in assets had to do with the decrease in investments in RC bonds and the increase in deposits with credit institutions, while the growth of housing savings banks' loans was very weak (0.5%). The share of housing savings banks in total housing loans of the system thus decreased to 5.5%. The mentioned decline in deposits of housing savings bank depositors was undoubtedly impacted by the cut in state incentives for housing savings.[14]

The characteristically good quality of loans improved marginally owing to the reduction in the non-performing loan ratio to 0.8% and the increase in the coverage of non-performing loans to 60.5%. Housing savings banks generated HRK 16.2m in profits, in 2019. This was much more (58.3%) than in the same period of the previous year.

Indicators of return recovered – ROAA and ROAE stood at 0.3% and 3.3%, respectively. However, they remained noticeably lower than the bank average. Total net operating income increased negligibly (2.0%), so a greater contribution to these developments in profits came from the decrease in general operating expenses. This mildly improved cost efficiency, although a sizeable portion of total net income remained burdened by general expenses (CIR was 80.2%).

Total capital ratio stood at 23.8%. Its fall of 1.4 percentage points from 2018 was due to the decrease in own funds, which was a result not only of the decline in the number of housing savings banks but also of a decrease in accumulated other comprehensive profit.

13 Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 575/2013 sets the new leverage ratio requirement at 3, with the exception of certain business models and lines of business, which is calculated as the ratio of tier 1 capital and the institution's total exposure measure. This regulation shall apply from 28 June 2021 with exemptions for earlier and later application.

14 Under the Decision on the amount of state incentives for housing savings in 2019, a limit is set on state incentives, at 1.2%, or a maximum of HRK 60 per saver (OG 4/2019). For the sake of comparison, when housing savings were first introduced in 1998 state incentives were set at 25%, or a maximum of HRK 1,250.

Abbreviations and symbols

Abbreviations

bn	– billion
b.p.	– basis points
BEA	– U. S. Bureau of Economic Analysis
BOP	– balance of payments
c.i.f.	– cost, insurance and freight
CBRD	– Croatian Bank for Reconstruction and Development
CBS	– Central Bureau of Statistics
CDS	– credit default swaps
CEE	– Central and Eastern European
CEFTA	– Central European Free Trade Agreement
CES	– Croatian Employment Service
CHF	– Swiss franc
CHIF	– Croatian Health Insurance Fund
CHY	– Yuan Renminbi
CICR	– currency-induced credit risk
CPF	– Croatian Privatisation Fund
CPI	– consumer price index
CPII	– Croatian Pension Insurance Institute
CM	– Croatian Motorways
CNB	– Croatian National Bank
CR	– Croatian Roads
EBA	– European Banking Authority
ECB	– European Central Bank
EEA	– European Economic Area
EFTA	– European Free Trade Association
EMU	– Economic and Monetary Union
EU	– European Union
EUR	– euro
excl.	– excluding
f/c	– foreign currency
FDI	– foreign direct investment
Fed	– Federal Reserve System
FINA	– Financial Agency
f.o.b.	– free on board
GDP	– gross domestic product
GVA	– gross value added
HANFA	– Croatian Financial Services Supervisory Agency
HICP	– harmonised index of consumer prices
HRK	– kuna

HUB	– Croatian Banking Association
incl.	– including
IMF	– International Monetary Fund
JPY	– Japanese yen
m	– million
MIGs	– main industrial groupings
MM	– monthly maturity
MoF	– Ministry of Finance
NBS	– National Bureau of Statistics of China
NCA	– National Classification of Activities
n.e.c.	– not elsewhere classified
NUIR	– net usable international reserves
OECD	– Organisation for Economic Co-Operation and Development
OG	– Official Gazette
R	– Republic
RAMP	– Reserves and Advisory Management Program
ROAA	– return on average assets
ROAE	– return on average equity
o/w	– of which
PPI	– producer price index
Q	– quarter
RR	– reserve requirement
SDR	– special drawing rights
SE	– South-East
SGP	– Stability and Growth Pact
SITC	– Standard International Trade Classification
USD	– US dollar
VAT	– value added tax
ZSE	– Zagreb Stock Exchange
ZMM	– Zagreb Money Market

Symbols

–	– no entry
....	– data not available
0	– value is less than 0.5 of the unit of measure being used
ø	– average
a, b, c,...	– indicates a note beneath the table and figure
*	– corrected data
()	– incomplete or insufficiently verified data

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