Objectives

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The primary objective of the Croatian National Bank is maintaining price stability. In practice, this means that the central bank supports low and stable inflation.

Maintaining price stability is the primary objective of the Croatian National Bank. Without prejudice to the achievement of its primary objective, the Croatian National Bank supports the general economic policies of the European Union in accordance with the objectives of the European Union laid down in Article 3 of the Treaty on European Union. These objectives include the achievement of a balanced and sustainable economic growth and a high level of employment. It is important to note that the secondary objectives are subordinate to the primary objective of the CNB and can be met only provided that the primary objective is achieved.

In fulfilling its objectives, the Croatian National Bank acts in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources in compliance with the principles set out in Article 119 of the Treaty on the Functioning of the European Union.

Importance of price stability

Price stability is the key prerequisite for sustainable economic growth, as confirmed by economic research and evidence thus far. Generally, price stability in the context of monetary policy objectives does not mean that the inflation rate has to stand at zero; the objective rather implies that a slightly positive inflation rate is to be achieved in the long run.

Low and stable inflation contributes to higher economic activity and employment through several channels. Firstly, low and stable inflation increases price transparency, i.e. provides consumers with accurate, high-quality information about the relative value of goods from their respective prices. Experience shows that high inflation rates result in significant changes in relative prices. With lower inflation rates, prices are more stable, i.e. it is easier to compare values of various goods and anticipate their changes. In such an environment, consumers and corporations are able to reach more informed decisions on consumption, saving and investments, resulting in a more efficient allocation of total resources and, consequently, an increase in welfare and production capacity of the economy.

Secondly, stable prices reduce the likelihood that households and corporations will use their resources to hedge against inflation, instead of directing them into production. Using resources to hedge against inflation may discourage investment in more productive sectors, trigger capital outflow and, eventually, hamper economic growth. In addition, high and volatile inflation increases uncertainty regarding what the future may bring, thus additionally affecting judgement and influencing expectations that may seriously jeopardise making right economic and investment decisions.

Furthermore, low and stable inflation contributes to the decrease of inflation risk premium incorporated in interest rates (which represent compensation requested from the debtor by the creditor for the risk of loss of the creditor's asset value). Lower inflation risk premiums contribute to the decrease of real interest rates, thus encouraging investment.

High inflation may have an unfavourable effect on the stability of the tax system and social security system as well. In economies with significant time lags in tax and social security contribution collection, inflation will most probably have a negative effect on tax and contribution revenues. Finally, maintaining price stability contributes to the prevention of reallocation of wealth and income between the creditors and the debtors without any fundamental economic justification.

On the other hand, deflation, i.e. a decline in the general price level, may also result in numerous negative effects on economic growth and employment. If deflation persists, there is a risk that economic agents (households, corporations, the government, etc.) will incorporate it in their expectations and consequently decide to postpone consumption, expecting the prices to drop further in the future. This leads to a decrease in corporations' turnover, forcing them to reduce their costs, which can ultimately lead to wage reductions and/or layoffs. Growing unemployment additionally decreases household demand for goods and services, thus putting further downward pressures on prices. This may lead to a deflation spiral, which may have far-reaching and long-lasting negative consequences for the economy.