Semi-annual Information

Semi-annual Information on the Financial Condition, the Degree of Price Stability Achieved and the Implementation of Monetary Policy in the First Half of 2022

Zagreb, December 2022

HRVATSKA NARODNA BANKA • CROATIAN NATIONAL BANK

HNB

HNB

SEMI-ANNUAL INFORMATION 2022

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

in the First Half of 2022

CROATIAN NATIONAL BANK

PUBLISHER

Croatian National Bank
Trg hrvatskih velikana 3
10000 Zagreb

www.hnb.hr

Those using data from this publication are requested to cite the source.

ISSN 1849-3483 (online)

Contents

1 Summary

The first half of 2022 was marked by the Russian invasion of Ukraine, with the war exacerbating the increase in the prices of energy and raw materials that had begun as early as in 2021. Still, the domestic economy managed to resist these pronounced negative impacts in the first half of the year, primarily due to a strong growth in foreign demand. Seasonally adjusted data suggest that economic activity accelerated from January to June, with real GDP growing by 5.0%, from the 3.0% recorded in the second half of 2021. In the first half of 2022, real gross domestic product was 8.2% higher than in the same period last year. The highest individual contribution to total growth in the period from January to June came from the growth of total exports, especially services exports, owing to the good results in tourism following the rebound in demand for tourist services amid the gradual waning of the negative effects of the pandemic. All domestic demand components also made a positive contribution to the growth in GDP.

Owing to the relatively strong growth of real economic activity, favourable developments in the labour market continued in the first half of 2022. The total number of employed persons continued to grow at a pace similar to that of the end of the previous year, while employment in service activities, the IT sector and business services made the largest contribution to the rise in employment. There is a growing number of foreign nationals in employment. According to the CPII data, in June 2022, there were in all 50 thousand employed foreign nationals, as against the 31 thousand a year before. Finally, the number of pensioners employed part-time also grew. The employment growth led to a fall in the number of unemployed persons, even though the intensity of the decrease in the number of unemployed persons was less pronounced than the increase in employment, which can partly be attributed to employment of foreign nationals and pensioners. Labour Force Survey data show that the unemployment rate increased in the first part of the year, to 6.6% of the labour force in the first quarter (seasonally adjusted, from 6.1% at the end of the previous year) and to 7.6% in the second quarter. As a result, the ILO unemployment rate exceeded the registered unemployment rate.

Nominal wages grew in the first half of 2022, primarily driven by the developments in the private sector. However, growing inflation led to a further fall in the purchasing power of households due to the decrease in real wages that started in the second half of the previous year. The average nominal gross wage was 9.3% higher in June 2022 than in June 2021, while the real net wage dropped by 3.4%.

Consumer price inflation picked up noticeably in the first half of 2022, from 5.5% in December 2021 to 12.1% in June 2022, mostly due to factors present globally, albeit some of them specific to Europe. At the beginning of this period, imported inflationary pressures largely stemmed from supply chain disruptions (for instance, shortages of semiconductors and elevated freight rates), as well as the high prices of energy products and other raw materials (notably food raw materials), that rose further in the wake of the Russian aggression against Ukraine. In addition to a strong non-resident demand for tourist services and amid a relatively high demand, domestic enterprises passed the higher costs of raw materials and energy on to customers. Despite the accelerated growth in nominal wages, they are still lagging behind the rise in the general price level. Inflation diffusion also increased, while all of the main components of the consumer price index contributed to the acceleration of total inflation. In addition to energy prices, food prices also went up (especially of meat, bread and cereals, as well as milk, cheese and eggs), as did the prices of industrial products and, to a lesser extent, of services (notably tourism-related services).

The current and capital account balance deteriorated considerably in the first half of 2022 from the same period of the previous year. The major contributor to this was the sharp increase in the foreign trade deficit triggered by the spike in the prices of energy products and other raw materials in the global market. Albeit to a much lesser extent, the total surplus in the secondary income and capital transaction accounts also decreased, due to smaller net use of EU funds, while the primary income account balance also deteriorated slightly. By contrast, unfavourable trends were partly offset by the rise in net exports of services owing to higher tourism revenues. The financial account of the balance of payments saw a large net inflow of capital, mainly due to the rise in net equity liabilities of domestic sectors and, to a lesser extent, the increase in net debt liabilities. However, owing to the increase in nominal GDP, the relative indicators of gross external debt and international investment position improved, while the relative indicator of net external debt deteriorated slightly.

Against the backdrop of mounting global inflationary pressures, the first half of 2022 was marked by the expectations of a faster and sharper tightening of the monetary policies of many central banks. The expected reversal of monetary policies, backed by the first steps taken in that direction and announcements regarding future actions, spurred a substantial worsening of global financing conditions, also reflected in the growth in market yields on government debt securities in the first half of the year. In such conditions, the exchange rate of the kuna against the euro remained stable, while monetary system liquidity held steady at a very high level. Though the rise in geopolitical tensions spurred by the Russian aggression against Ukraine created some pressures in the foreign exchange market in March, their intensity was relatively limited, as market expectations were further anchored by Croatia’s participation in the exchange rate mechanism and the expected introduction of the euro. The CNB intervened three times by selling only quite small amounts of foreign currency to commercial banks, after which the pressures subsided. Banks’ free reserves remained at very high levels, which contributed to maintaining the favourable costs of corporate and household financing, despite the tightening of global and European financing conditions. Individual interest rates dropped to their historic lows. The growth in corporate placements, particularly in loans for working capital, accelerated considerably, under the influence of elevated costs caused by higher prices of energy and raw materials, especially for corporates operating in the energy sector, as well as due to the anticipated potential increase in borrowing costs. Household lending continued to edge up, with the sharpest growth seen in housing loans, but also with a rise in general-purpose cash loans.

According to the internationally comparable methodology of the European System of National and Regional Accounts (ESA 2010), the consolidated general government ran a surplus of HRK 2.0bn, which is a significant improvement of HRK 11.0bn on an annual level. Such budget performance is the reflection of the rise in total revenues, primarily the increase in tax revenues, influenced by favourable cyclical developments and the change in the level of prices, but also of the slight drop in total expenditures. The Croatian government's original plan projected a consolidated general government deficit of HRK 12.0bn in 2022, while the upward budget revision in May foresaw a deficit of HRK 13.4bn, in view of the uncertain and potentially unfavourable expected effect of economic developments in the second half of the year on the situation in the public finance sector. In April 2022, the Croatian government adopted a comprehensive package of measures worth HRK 4.8bn (around 1.0% of GDP) aimed at mitigating the effects of inflation on businesses and citizens' living standards, with the estimated direct effect of the package of measures adopted in April 2022 on general government balance standing at around 0.9% of GDP. The consolidated general government debt stood at HRK 343.7bn at the end of June 2022, a decrease of HRK 65m from the end of 2021. The growth in nominal GDP resulted in a drop in the public debt-to-GDP ratio to 73.1% from 78.4% at the end of 2021.

International reserves rose slightly in the first half of 2022. Notwithstanding adverse market conditions resulting from a surge in yields in the first half of 2022, CNB foreign currency portfolios performed positively owing to a number of investment decisions to reduce exposure to interest rate risk. Liquidity and safety of investment, the main objectives of international reserves management, were successfully accomplished.

The strong capitalisation and high liquidity of credit institutions supported stable and smooth operations of the banking system amid continued uncertainty. The assets of credit institutions continued to increase in the first half of 2022, mostly due to the rise in received deposits, which was used predominantly to enhance lending activity. The years-long upward trend in the quality of total exposure persisted, largely due to the impact of the fall in non-performing loans to non-financial corporations. The business performance of credit institutions in the first half of 2022 was better than in the same period in the previous year, owing to the less burdensome credit loss costs and the growth in non-interest income.

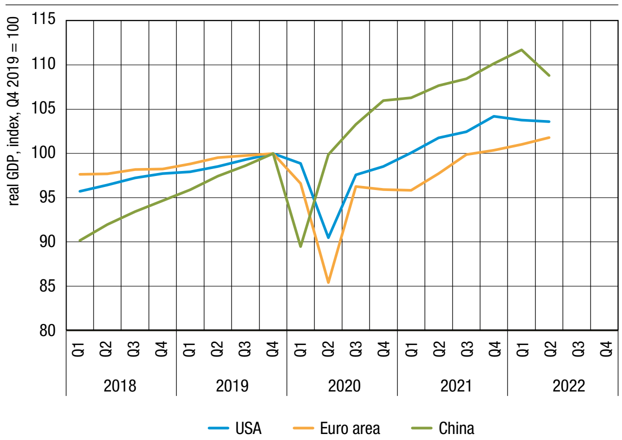
2 Global developments

The negative effects of the Russian invasion on Ukraine spilled over to the global economy, triggering a slump in trade and a leap in the prices of energy and other raw materials. Investments were cut in response to mounting geopolitical tensions and uncertainty surrounding Russian energy supplies, while the shutting down of important trade and production zones in China, paired with a new wave of the coronavirus, caused further global supply chain disruptions. Global inflation continued to rise sharply in the first half of 2022. This triggered monetary policy tightening by major central banks and led to a deterioration in global financing conditions.

The recovery of the global economy faltered noticeably in the first half of 2022 amid growing inflation and heightened uncertainty caused by the Russian invasion of Ukraine (Figure 2.1). The negative effects of war spilled over to the global economy through the weakening of trade and a leap in the prices of energy and other raw materials, while the heightened geopolitical tensions and the uncertainties over Russian energy supplies strongly affected the investment climate, especially in Europe, due to its heavy reliance on Russian gas. In addition, shutting down important trade and production zones in China in April and May due to a new wave of COVID-19 infections not only considerably harmed the Chinese economy, which recorded a sharp contraction, but also caused further global supply chain disruptions. Against such a backdrop, global inflation continued its sharp upward trend in the first half of 2022, triggering a faster process of normalisation, that is tightening of monetary policy in large economies, and leading to the worsening of global financing conditions.

The US economy recorded a slight contraction of 0.6% in the first half of 2022 from the end of last year (Figure 2.1). In this period, the largest decrease was seen in private sector investments, especially in the second quarter, due to increased uncertainty and harsher financing conditions. Government consumption also decreased due to the gradual lifting of support measures introduced during the pandemic. The negative contribution of net exports also increased due to the much slower growth in exports than in imports of goods and services. Personal consumption continued to grow in the first half of the year, albeit at a very low rate and only in the segment of services that witnessed a sharp growth in demand following the almost full abolishment of containment measures. Labour market developments continued

Figure 2.1 Economic growth in selected markets



Sources: Eurostat, BEA and NBS.

to improve, with the unemployment rate down to 3.6% of the labour force at the end of June 2022, standing around the pre-pandemic level. The rise in energy and raw materials prices and disruptions in global supply chains boosted US inflation, reaching 9.1% in June. Core inflation, excluding the prices of energy and food, was 5.9% on an annual basis.

In contrast with the US economy, the euro area economy surpassed expectations, growing by 1.4% in the first half of 2022 from the end of the previous year, even though the intensity of recovery from the effects of the pandemic waned considerably. In addition to the uncertainty caused by the war in Ukraine, particularly in countries heavily reliant on Russian gas, the operations in the manufacturing sector were also hindered by high costs of energy and supply chain disturbances. On the other hand, a strong demand for services following the lifting of most containment measures from the start of the year boosted the recovery of the services sector, especially tourism. The countries with a large share of services in GDP, such as Italy, Spain and the Netherlands, made the largest individual contributions to growth in the euro area in the first half of 2022. The German economy started to sag noticeably in the second quarter due to the weakening of global demand, only partially offset by the growth in personal consumption, owing to fiscal support to households. Inflation in the euro area has surged since the beginning of the year, reaching an elevated 8.6% in June 2022. Although energy and food prices were the biggest contributors, the annual rise in other consumer prices accelerated to 3.7%.

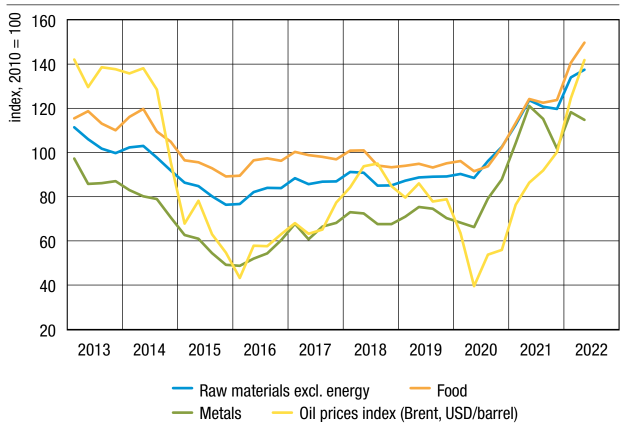
2.1 Croatia's main trading partners

The majority of Croatia's main trading partners recorded economic slowdowns in the first half of 2022. Among euro area partners, economic growth decelerated most in countries with strong manufacturing sectors. Economic developments were somewhat more favourable in trading partners from Southeastern Europe, since these countries are less integrated and less sensitive to global supply chain disruptions. However, their direct exposure to Russian and Ukrainian markets is relatively limited, alleviating the negative effects of the war in Ukraine.

2.2 Prices, exchange rates and financing conditions

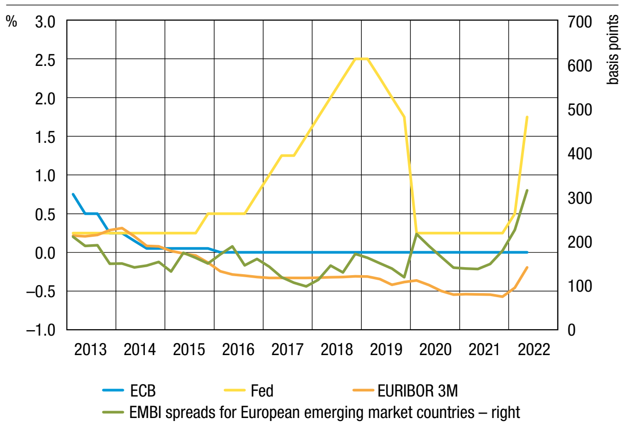
The prices of energy continued to rise sharply in the first half of 2022. Following a decrease in the second half of last year, the prices of most other raw materials rose again as well (Figure 2.2). At the very beginning of 2022, oil prices rose moderately, mostly due to limited supply from OPEC countries, but spiked in the first days of the war in Ukraine, periodically exceeding USD 130 per barrel. Oil prices remained extremely

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



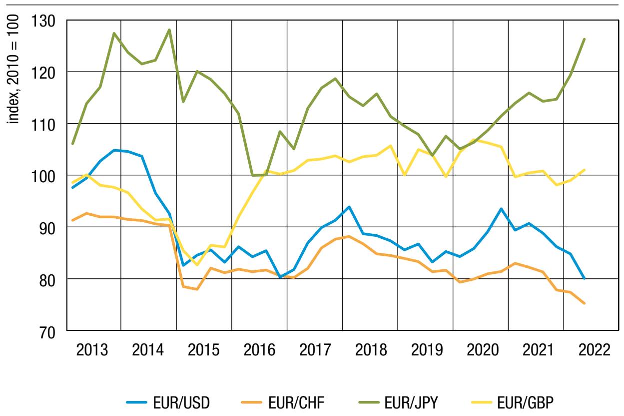
Sources: IMF and Bloomberg.

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



Notes: End-of-period exchange rates. A growth in the index indicates a depreciation of a currency against the euro.
Source: Eurostat.

volatile afterwards, although moving at slightly lower levels, only to again exceed USD 120 per barrel in late May following the European Union's partial embargo on Russian oil, holding steady at that level until the end of the first half of the year.

Following a mild decrease in late 2021, the prices of raw materials excluding energy grew by 14.8% in the first half of 2022, to a large extent due to the war in Ukraine. To be more precise, due to concerns about potential shortages caused by the conflict in Ukraine and sanctions imposed against Russia, there was a strong rise in the prices of certain agricultural raw materials and metals largely produced in Russia and Ukraine, especially of cereals and oil seeds. However, having peaked in April, the prices of food raw materials in the global market partly decreased in the following months. Having reached their peak in March, the prices of metals slumped afterwards due to the expected weakening of global demand.

The mounting of inflationary pressures from the beginning of 2022 was followed by an intensified reduction of the monetary stimuli introduced during the pandemic, leading to the gradual tightening of monetary policy (Figure 2.3). The fastest tightening of monetary policy was that of the Fed, which lifted the benchmark interest rate by 0.25 percentage points in March, followed by a further rise of 0.5 percentage points in May and 0.75 percentage points in June. The ECB also sped up the discontinuation of monetary stimuli. In March, it abolished the pandemic emergency purchase programme (PEPP) and further decreased purchases made within the scope of its asset purchase programme (APP) during the second quarter.

Developments in the global foreign exchange market in the first half of 2022 mostly reflected the expectations regarding a faster normalisation of the US monetary policy relative to other large economies. Against this backdrop, the US dollar strengthened against the euro by 7.1% from the beginning of the year (Figure 2.4). With regard to other currencies, the euro weakened slightly against the Swiss franc, but strengthened against the pound sterling and even more against the Japanese yen.

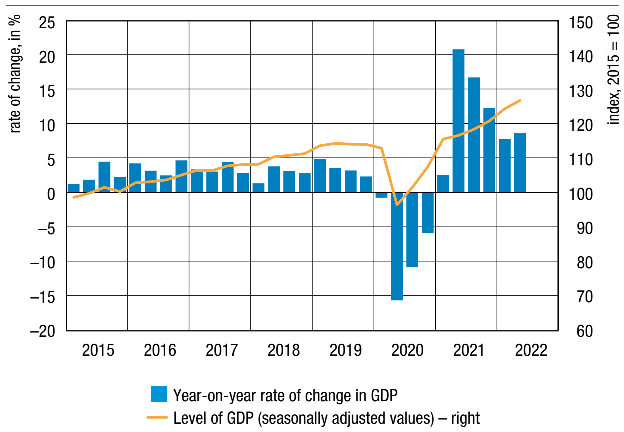
3 Aggregate supply and demand

In the first half of 2022, real GDP was 8.2% higher than in the same period last year. The highest individual contribution to total growth came from the growth of total exports, especially of services exports, resulting from the good results in tourism. All domestic demand components also made a positive contribution to GDP growth. Personal consumption growth slowed down, while wages, despite their rise in nominal terms, decreased in real terms due to soaring inflation.

The first half of 2022 was marked by the Russian invasion of Ukraine, with a continued rise in the prices of energy and raw materials that had begun in 2021. The domestic economy managed to resist these negative impacts, primarily due to a strong growth in foreign demand, especially for tourist services. Seasonally adjusted data suggest that economic activity accelerated, with real GDP growing by 5.0%, from the 3.0% recorded in the second half of 2021. Observed on a quarterly basis, real GDP grew by 2.9% from January to March, and by 1.9% from April to June. In the first half of 2022, real GDP was 8.2% higher than in the same period last year. The highest individual contribution to total growth from January to June came from the growth of total exports, especially of services exports, resulting mainly from the good results in tourism. All domestic demand components also made a positive contribution to the growth in GDP. Goods and services imports grew, but less than total exports, with the result that net foreign demand made a slight positive contribution to the total change in economic activity.

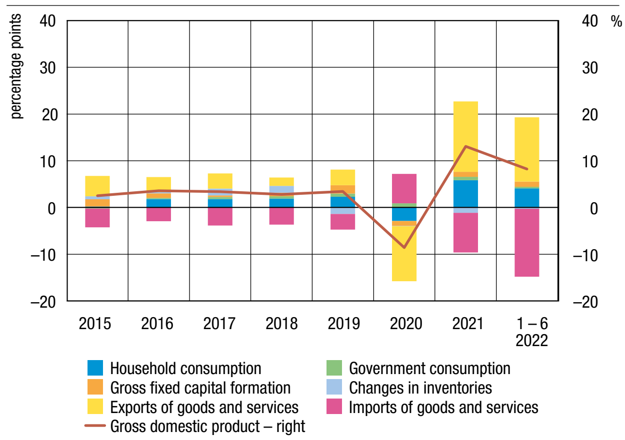
GDP by the production approach shows that gross value added was 8.9% higher in the first half of 2022 than in the same period in 2021. By far the strongest increase in activity was recorded in wholesale and retail trade, transportation and storage, accommodation and food service activities (26.3%). On an annual level, GVA also rose

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.

in all other activities, except for other service activities.

3.1 Aggregate demand

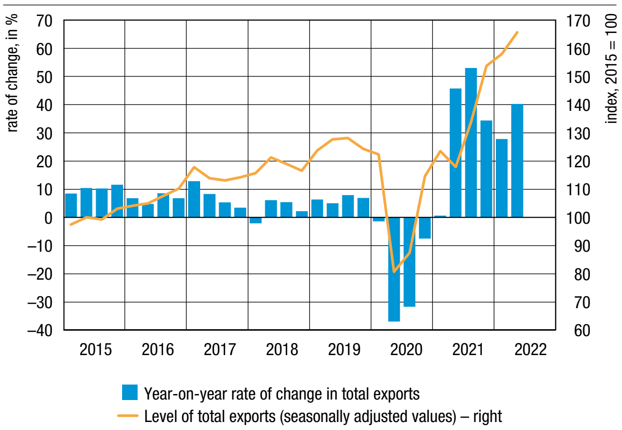
In the first half of 2022, real goods and services exports continued to grow at a high rate, up by 35.0% from the same period in the previous year. Such an increase resulted mainly from the strong recovery of exports of services, supported by a successful tourist pre-season. Real exports of services increased by 56.0% from the same period in the previous year. Goods exports also increased sharply in the first half of 2022, up by 22.9% from the same period in the previous year, with the same growth rate in the first and second quarter.

Nominal data on the trade in goods broken down by the main industrial groupings show that exports, especially of energy, increased annually in all main industrial groupings from January to June 2022, which can probably be attributed to the growth in prices.

In the first half of 2022, personal consumption held steady at the level seen in the period from July to December last year, and its annual growth slowed to 7.1% from 11.3% in the second half of 2021. On the one hand, personal consumption growth was spurred by the increase in employment and decrease in unemployment, whereas the opposite effect was produced by wages, which, despite their rise in nominal terms, decreased in real terms due to scorching inflation. In addition, consumer confidence index was very low, which might point to a decreased household propensity for spending.

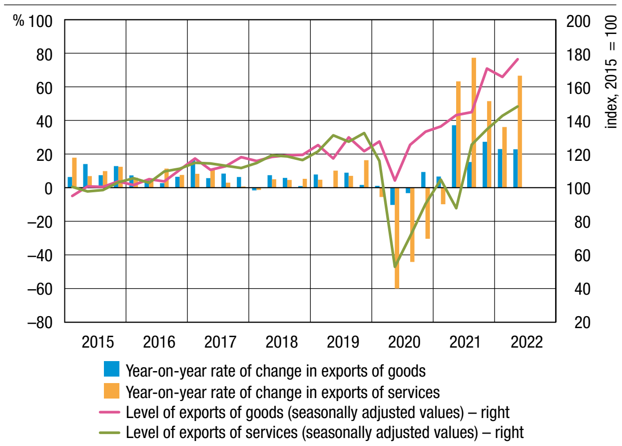
Gross fixed capital formation increased by 4.9% in the first half of 2022 from the same period in 2021. Seasonally adjusted data show that investment activity grew sharply from the previous half of the year (9.2%), when a decrease of 4.1% was recorded. Such developments primarily reflect stronger capital investments in the first three months of this year, when their quarterly growth was as high as 10.1%, only to drop by 2.8% in the second quarter. A quarterly downturn in investment activity from April to June is also evident from the data on construction, suggesting that developments in

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



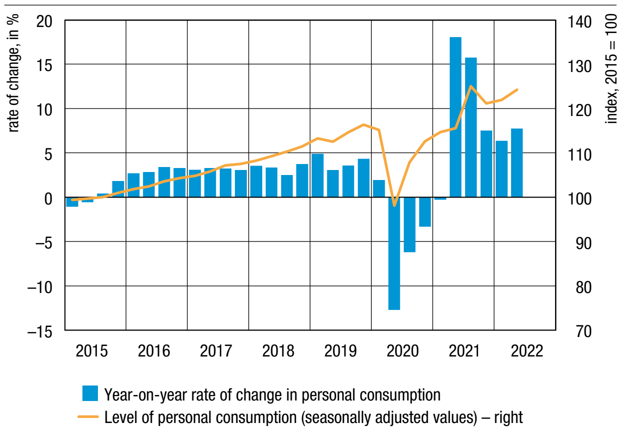
Source: CBS (seasonally adjusted by the CNB).

construction were slightly less favourable than early in the year. A slump in the volume of civil engineering works suggests a decline in general government investments.

General government consumption rose by 1.6% from January to June 2022 relative to the same period of the previous year. Specifically, a nominal increase was seen in expenditures on goods and services, employee compensations and benefits in kind. Seasonally adjusted data show that government consumption dropped by 3.5% from the previous half of the year, when the recorded growth stood at 5.4%.

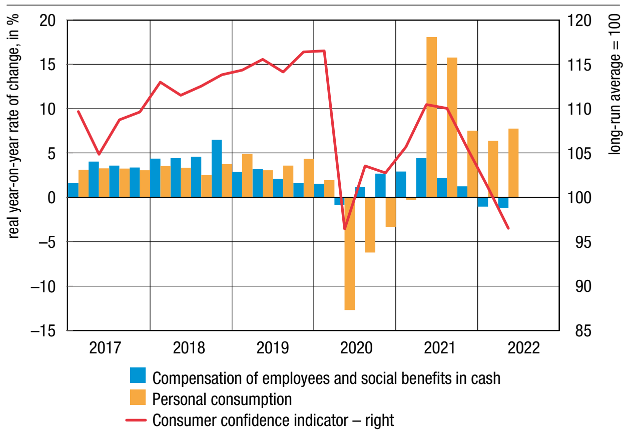
Total imports continued to grow strongly in the first half of 2022, rising by 27.9% from the same period in 2021 (the annual growth in the previous half of the year stood at 20.0%). A quarterly growth was recorded in both the first and the second quarter, reflecting the strengthening of both domestic and foreign demand. Nominal data on imports of goods suggest that energy imports increased sharply on an annual level in the period from January to June this year, mostly reflecting changes in prices, even though imports rose also in other main industrial groupings. Although the imports of

Figure 3.5 Personal consumption
real values



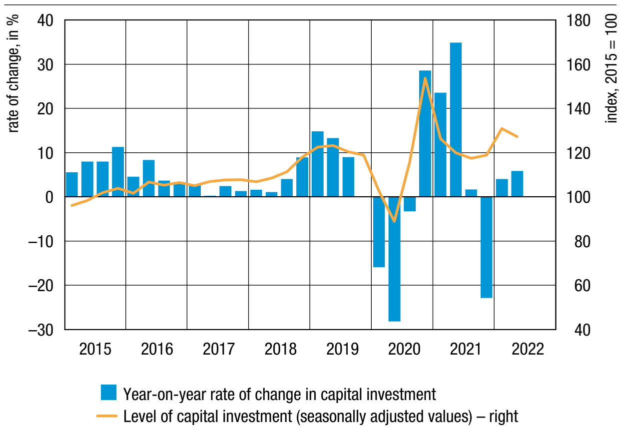
Source: CBS (seasonally adjusted by the CNB).

Figure 3.6 Determinants of personal consumption
real values and index



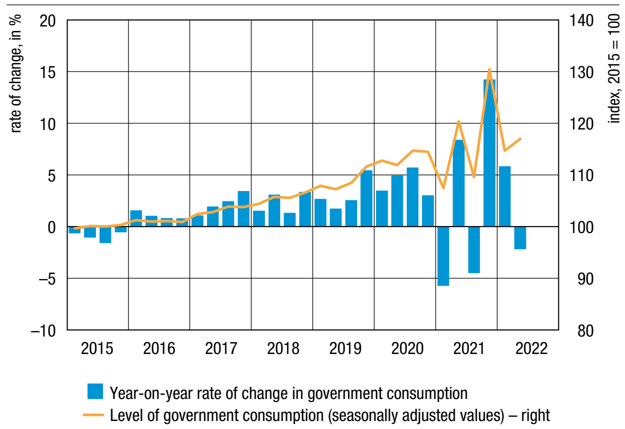
Note: Real values of compensation of employees and social benefits in cash were calculated by deflating nominal values using the personal consumption deflator.
Sources: CBS, Ipsos and CNB.

Figure 3.7 Gross fixed capital formation
real values



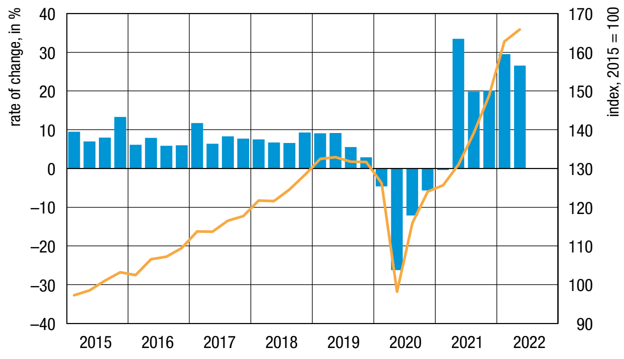
Source: CBS (seasonally adjusted by the CNB).

Figure 3.8 Government consumption
real values



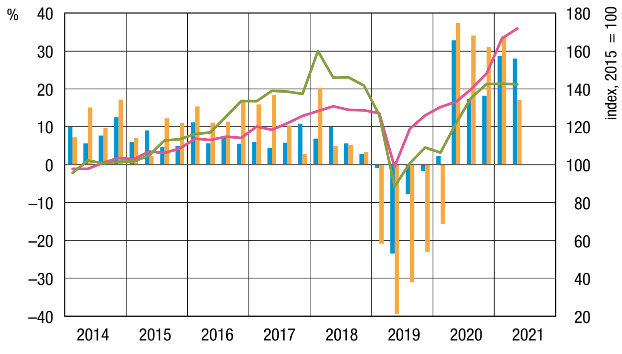
Source: CBS (seasonally adjusted by the CNB).

Figure 3.9 Imports of goods and services
real values



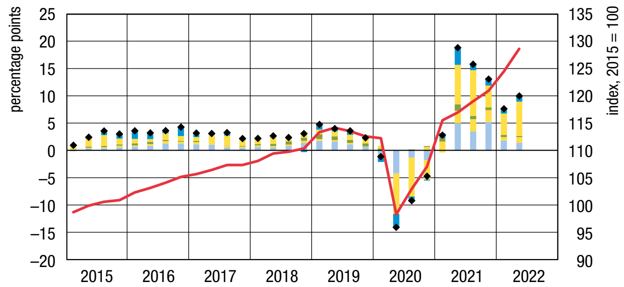
Source: CBS (seasonally adjusted by the CNB).

Figure 3.10 Real imports of goods and services



Source: CBS (seasonally adjusted by the CNB).

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



Source: CBS (seasonally adjusted by the CNB).

goods and services in the first half of 2022 grew more slowly than total exports, the contribution of net exports to annual real GDP growth was negative (standing at –0.8 percentage points) due to a larger share of imports in the base.

3.2 Aggregate supply

Gross value added increased by 8.9% in the first half of 2022 from the same period in the previous year. Real GVA grew on an annual basis in all activities. The highest increase was recorded in wholesale and retail trade, transportation and storage, accommodation and food service activities (26.3%), accounting for two-thirds of the total GVA growth. Seasonally adjusted data point to an acceleration of GVA growth to 5.5% from 3.2% in the previous six months.

4 Labour market

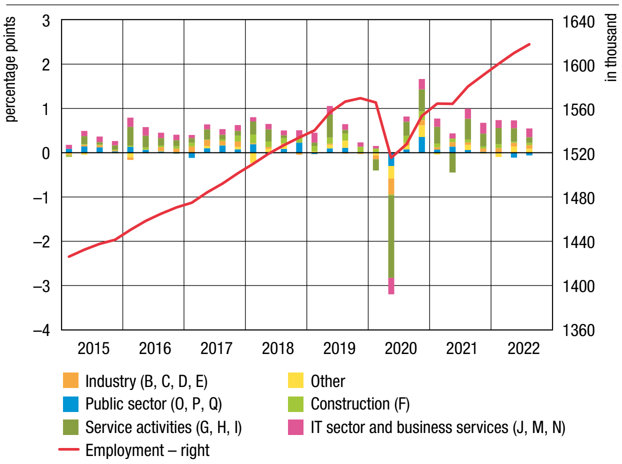
The total number of employed persons continued to grow at a pace similar to that at the end of the previous year, mostly due to employment in service activities, the IT sector and business services. A positive contribution to the total growth in employment was made by employment of foreign nationals and part-time employment of pensioners. The downward trend in the unemployment rate continued, albeit at a slower pace. Due to the growth in the level of prices, the decrease in real wages, which started in the second half of 2021, continued in the first half of 2022.

4.1 Employment and unemployment

Real economic activity growth in the first half of 2022 was accompanied by favourable developments in the labour market. The total number of employed persons in the first and second quarter grew at a pace like that of late 2021, by 0.6% (Figure 4.1). The average number of employed persons in the first half of this year was up by 1.3% from the previous six months and up by 2.6% from the same period last year. Employment in service activities, the IT sector and business services made the biggest contribution to employment growth. Employment of foreign nationals also made a positive contribution to the total growth in employment (according to data submitted to the CPII by employers, a total of 50 thousand foreign nationals were employed in the Republic of Croatia in June 2022, compared to around 31 thousand foreign nationals employed in Croatia in the same month of 2021). An additional positive contribution to the growth in employment came from the part-time employment of pensioners.

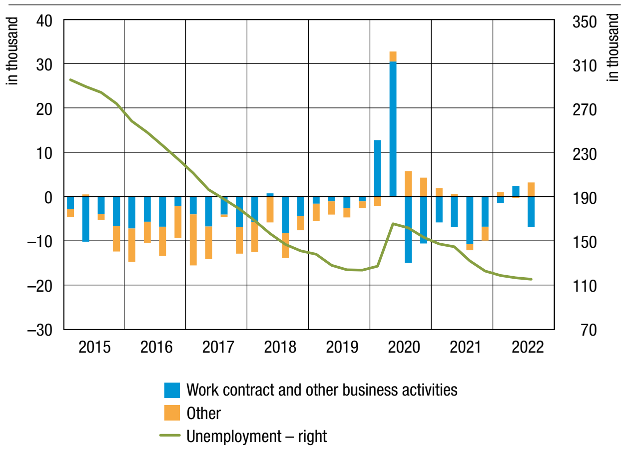
The unemployment rate continued its downward trend in the first half of 2022, even though the intensity of the decrease in the number of unemployed persons was less pronounced than the increase in employment, which can partly be attributed to the

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



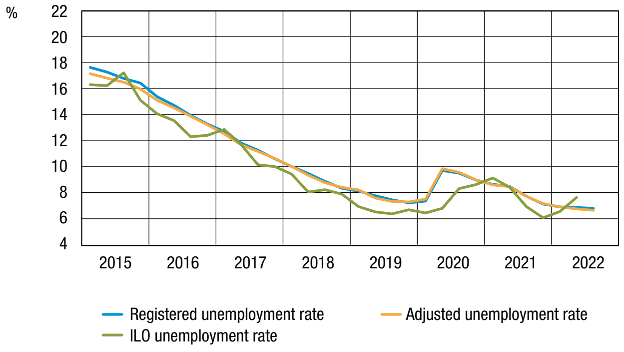
Source: CPII (seasonally adjusted by the CNB).

Figure 4.2 Total unemployment and net unemployment inflows
seasonally adjusted data



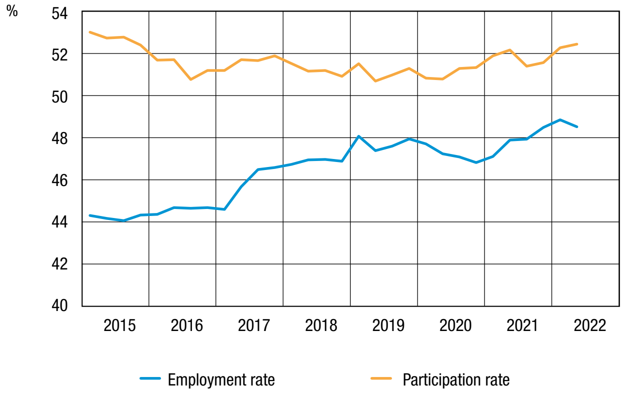
Source: CES (seasonally adjusted by the CNB).

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 used the data on employed persons from the JOPPD form.
Sources: CBS and CES (calculated and seasonally adjusted by the CNB).

Figure 4.4 Labour Force Survey
seasonally adjusted series



Source: CBS (seasonally adjusted by the CNB).

mentioned employment of foreign nationals and pensioners. The fall in the number of unemployed persons from January to March 2022 decelerated and stood at 3.3% on a quarterly level, following its decline of 6.9% in the last three months of 2021. The drop in unemployment slowed down further in the second quarter of 2022, and the number of unemployed persons was down by 1.8% from the previous three months. There were 106 thousand unemployed persons in June 2022, while there were 126 thousand in the same month of 2021.

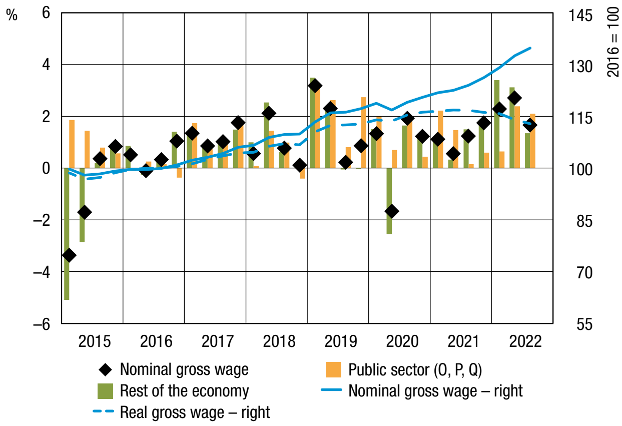
In the first quarter of 2022, the seasonally adjusted registered unemployment rate kept at 6.9%, trending down to 6.8% in the second quarter. Labour Force Survey data show that the unemployment rate increased in the first part of the year, to 6.6% in the first quarter (from 6.1% at the end of the previous year) and to 7.6% in the second quarter. As a result, the ILO unemployment rate exceeded the registered unemployment rate.

The ILO unemployment rate rose to 48.9% in the first quarter (having stood at 48.5% in the last quarter of 2021) and decreased to 48.5% in the period from April to June. The participation rate went up to 52.3% at the beginning of the year, from 51.6% in the period from October to December 2021, remaining almost unchanged from April to June 2022 (52.4%) (Figure 4.4).

4.2 Wages and unit labour costs

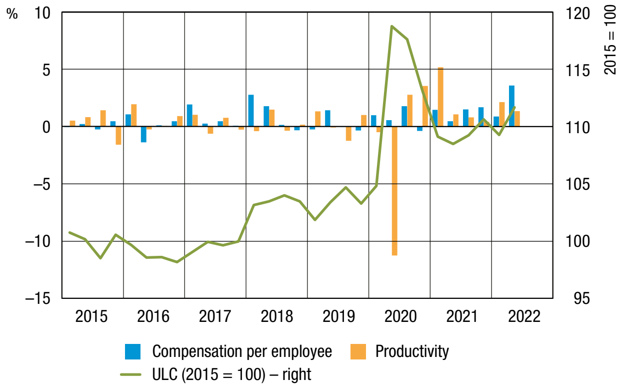
In the first quarter of 2022, the quarterly growth in nominal gross wage accelerated to 2.3% from 1.7% at the end of last year. Wage growth acceleration reflects the more vigorous increase in wages in the private sector, while public sector wages grew as about as fast as they did in the previous quarter, much slower than in the rest of the economy. From April to June 2022, the quarterly growth in nominal gross wages accelerated additionally to 2.7%. Wages accelerated in the public sector, coming close to wages in the rest of the economy, which grew at a pace to that in the previous quarter (Figure 4.5). However, the growth in the level of prices led to a deepening of the fall

Figure 4.5 Average nominal gross wage
seasonally adjusted data, quarterly rate of change and levels



Note: Since January 2016, data have referred to the JOPPD form, while earlier data referred 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)



Note: 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).

in real wages in the first half of 2022 that had begun in the second half of the previous year. Thus, real net wages in the first quarter were down 1.0% from the previous three months, when the fall was less pronounced (0.5%). The fall in real net wages continued from April to June, when it came to 1.6%. Observed at an annual level, the average nominal gross wage was 9.3% higher in June 2022 than in June 2021, while the real net wage dropped by 3.4%.

Unit labour costs dropped in the first quarter of 2022 because labour productivity rose more than compensation per employee. However, unit labour costs rose in the second quarter of 2022 due to the build-up of inflationary pressures and consequently due to compensation per employee growing more than productivity.

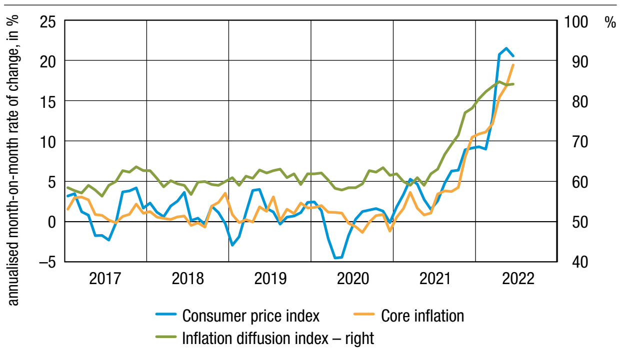
5 Inflation

The annual consumer price inflation (CPI) rate accelerated from 5.5% in December 2021 to 12.1% in June 2022, influenced by the rise in the contributions of all major CPI components, particularly of food and energy. The annual growth rate of energy prices went up from 11.0% to 22.2%, largely due to the increase in the prices of refined petroleum products caused by the growth in crude oil prices in the global market. The further rise in the prices of crude oil and natural gas started to be gradually incorporated in the prices of a growing number of consumer products and services.

Consumer price inflation picked up noticeably in the first half of 2022 due to a number of different factors. Imported inflationary pressures mounted significantly, primarily reflected in supply chain disruptions (such as shortages of semiconductors and elevated freight rates), which persisted longer than expected, and the high prices of raw materials in the global market. High prices of energy and other raw materials (particularly food raw materials) in the global market spiked further following the Russian aggression against Ukraine.

A further rise in the prices of energy products (primarily crude oil and natural gas) started to be gradually incorporated into the prices of a growing number of consumer products and services. The elevated prices of imported intermediate goods and finished products also spilled over to domestic consumer prices. Because of strong non-resident demand for tourist services in addition to relatively high demand, domestic enterprises were able to pass the higher costs of raw materials and energy on to customers. Although nominal wages have experienced accelerated growth, they are still lagging behind the rise in the general price level. Against this backdrop, inflation diffusion trended up, as evident from the rise in the share of products whose prices increased in the total number of products (Figure 5.1).

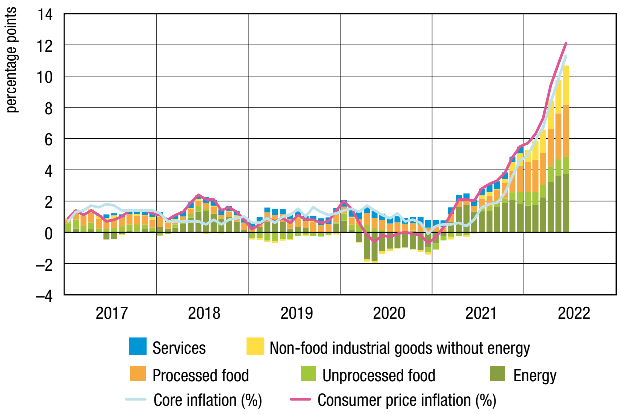
Figure 5.1 Indicators of current inflation trends



Notes: The month-on-month rate of change is calculated from 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.

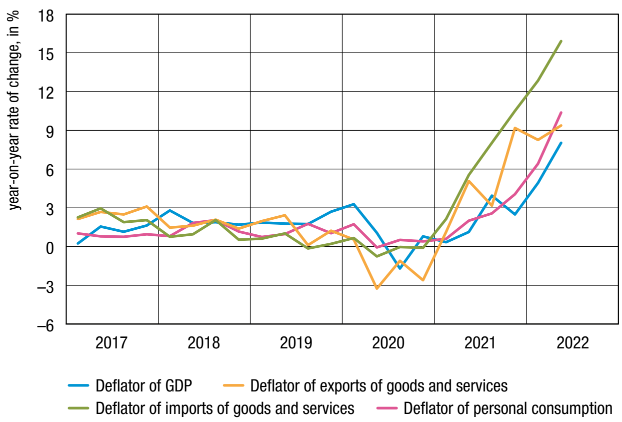
The annual consumer price inflation rate (CPI) accelerated from 5.5% in December 2021 to 12.1% in June 2022, influenced by the rise in the contributions of all major CPI components (Figure 5.2), particularly of food and energy. The annual growth rate of energy prices went up from 11.0% to 22.2%, largely due to the increase in the prices of refined petroleum products caused by the growth in crude oil prices in the

Figure 5.2 Year-on-year inflation rate and contributions of components to consumer price inflation



Notes: Core inflation excludes agricultural product prices, energy prices and administered prices. Processed food products include alcoholic beverages and tobacco.
Sources: CBS and CNB calculations.

Figure 5.3 Deflator of GDP and its individual components



Source: CBS.

global market. Also, administered prices of gas and electricity rose in April, which also contributed to the annual increase in energy prices.

The annual rate of growth in the prices of food products also increased, from 7.5% in December 2021 to 14.3% in June 2022. This was predominantly the result of the spillover of imported cost pressures, that is, the increase in the prices of food raw materials, mineral fertilisers and energy in the world's markets, onto consumer prices. Particularly significant was the rise in the contribution made by the prices of meat, followed by those of bread and cereals, as well as milk, cheese and eggs.[1]

A hike in the prices of raw materials and energy products, amid relatively strong demand, also brought about a rise in the prices of industrial products and services (Table 5.1). The annual rate of growth in the prices of industrial products rose from 3.1% in December 2021 to 9.6% in June 2022, largely under the influence of the rise in the prices of household goods (including household appliances), clothing and footwear, as well as motor vehicles (as with the case of household appliances, this may be related to the lower global supply of semiconductors). The faster growth in the prices of services (which was somewhat less pronounced than in other components), from 1.7% in December to 5.3% in June, was mostly spurred by the prices of tourism-related services (such as catering services, accommodation services and package holidays) due to the growth in demand for travel services ahead of the summer tourist season and the build-up of cost pressures (the increase in the prices of energy and food and the rise in wages).

The annual growth rate of the implicit deflator of GDP increased from 2.5% in the fourth quarter of 2021 to 8.0% in the second quarter of 2022 (Figure 5.3). Trade conditions deteriorated in the first half of the year; the growth of the deflator for goods and services imports accelerated markedly, whereas the deflator for goods and services exports increased

1 Energy and food product prices would have increased even more had there not been numerous measures taken by the Croatian government to curb price increases of many products. Among other things, the VAT rate on gas, heating energy and solid fuels was reduced, the margins of oil traders were fixed and excise duties on diesel and gasoline were temporarily reduced. Gas and electricity prices grew on average by 16% and 9.6%, respectively (instead of 79% and 23%). In addition, VAT on many food and other products was also cut.

Table 5.1 Price indicators
year-on-year rate of change

	6/21	9/21	12/21	3/22	6/22
Consumer price index and its components					
Total index	2.0	3.3	5.5	7.3	12.1
Energy	8.1	9.8	11.0	13.3	22.2
Unprocessed food	–0.9	3.0	9.0	9.5	12.9
Processed food	1.5	3.5	7.0	9.0	14.9
Non-food industrial goods without energy	0.0	0.3	3.1	5.8	9.6
Services	1.6	1.9	1.7	2.6	5.3
Other price indicators					
Core inflation	0.8	1.9	4.6	6.7	11.3
Index of industrial producer prices on the domestic market	7.8	13.7	19.6	24.7	30.8
Index of industrial producer prices on the domestic market (excl. energy)	1.4	3.0	4.3	6.8	9.9
Harmonised index of consumer prices	2.2	3.5	5.2	7.3	12.1
Harmonised index of consumer prices at constant tax rates	2.0	3.3	5.0	7.3	13.4

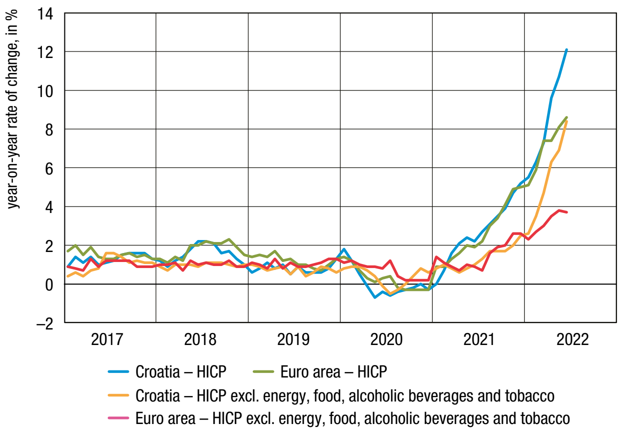
Sources: CBS and Eurostat.

only slightly.

Consumer price inflation picked up in the euro area, where it was also affected by the high prices of energy and food, supply chain disruptions and the recovery in demand amid the re-opening of the economy as the pandemic began to ease. The annual inflation rate measured by the harmonised index of consumer prices (HICP) in the euro area accelerated from 5.0% in December 2021 to 8.6% in June 2022, mostly as a result of the growth of energy and food prices. In addition to refined petroleum products, the acceleration of inflation was also driven by other energy components, especially natural gas and electricity. The contribution of industrial products and services to the total inflation in the euro area also increased to a smaller extent. Accordingly, core inflation (which excludes the prices of energy, food, beverages and tobacco) accelerated at a slower pace than total inflation (from 2.6% in December to 3.7% in June).

Croatia's annual inflation rate measured by the HICP stood at 12.1% in June 2022, 3.5 percentage points higher than in the euro area (Figure 5.4). Croatia's core inflation (measured by the HICP excluding energy, food, beverages and tobacco) stood at 8.4% in June, 4.7 percentage points higher than euro area inflation. Inflation, which was almost the same in Croatia and the euro area in late 2021, gained much more speed in Croatia than in the euro area in the first half of 2022. This is true in particular of core inflation, as the prices of industrial products and services grew more in

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



Source: Eurostat.

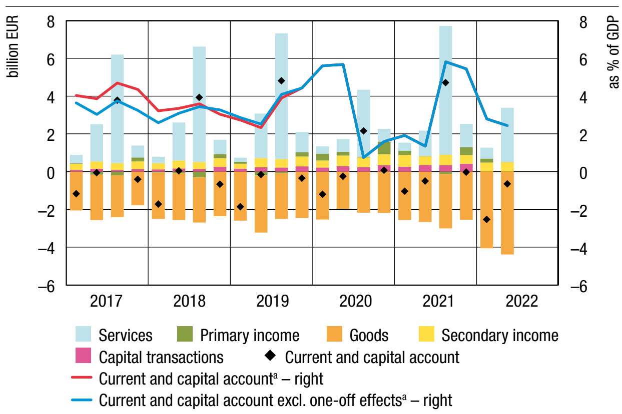
Croatia than in the euro area. The increase in the contribution of food prices was only slightly larger in Croatia than in the euro area. In contrast, the contribution of energy prices grew slightly less in Croatia than in the euro area, owing to a slower rise in natural gas prices in Croatia.

6 Current and capital account

The current and capital account balance deteriorated considerably in the first half of 2022 from the same period of the previous year. Disruptions in global supply chains gave a strong upward push to the foreign trade deficit. Unfavourable trends were partly offset by the rise in net exports of services owing to higher tourism revenues, which more than doubled from the first six months of 2021.

The current and capital account balance deteriorated considerably in the first half of 2022 from the same period of the previous year. The major contributor to this was the sharp increase in the foreign trade deficit triggered by the deterioration in trading conditions due to hikes in the prices of energy products and other raw materials in the global market. Albeit to a much lesser extent, the total surplus in the secondary income and capital transaction accounts also decreased, due to smaller net use of EU funds, while the primary income account balance also deteriorated slightly. By contrast, unfavourable trends were partly offset by the rise in net exports of services owing to higher tourism revenues. If the last four quarters are observed, the surplus in the current and capital account in the period up to the end of June 2022 totalled 2.4% of GDP, having gone down by 3.0 percentage points from the level recorded in the whole of 2021 (Table 6.1).

Figure 6.1 Current and capital account balance and its structure



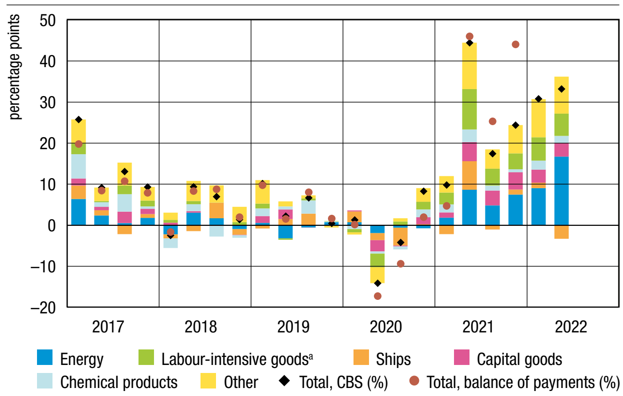
ª Sum of the last four quarters.
Note: One-off effects include the conversion of CHF-linked loans in 2015 and bank provisions for loans to the Agrokor Group in 2017 and 2018.
Source: CNB.

6.1 Foreign trade and competitiveness

Foreign trade in goods stepped up considerably in the first half of 2022 from the same period in 2021, growing at an extremely fast rate. This was due to the ongoing recovery of domestic and foreign demand following the pandemic and the spike in the prices of energy products and other raw materials in the global market, partly caused by the war in Ukraine, resulting in a substantial deterioration in the terms of trade. According to the balance of payments data, the nominal growth of goods exports and imports in the first half of 2022 was 39.7% and 49.1% respectively, which resulted in a very strong increase in goods trade deficit, by 61.6% on an annual level. Observing the cumulative values over the past year, the goods trade deficit in the period up to the end of June 2022 stood at 22.2% of GDP, as against 18.3% in the whole of 2021.

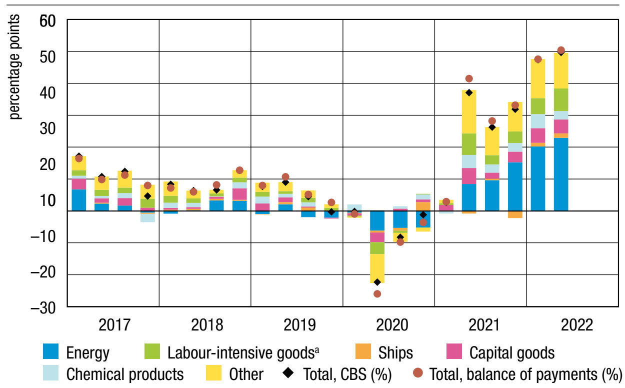
Detailed CBS data[2] show that better export performance on an annual level was mostly due to energy products (Figure 6.2), particularly larger exports of gas to Hungary, electricity to Hungary, Serbia and Bosnia and Herzegovina, as well as oil and refined petroleum products to Bosnia and Herzegovina. In addition to energy products, the exports of other goods also rose considerably, particularly the exports of food products to Italy, capital goods (especially electrical machinery, apparatus and appliances) to Germany and the USA and metal industry products to Slovenia, Italy and Germany. Albeit to a somewhat lesser extent, export performance was also favourably influenced by larger exports of other chemical products (excluding medical and pharmaceutical products) to Italy, Germany and Slovenia, wood industry products to Germany and textile industry products to Italy and Bosnia and Herzegovina.

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.

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



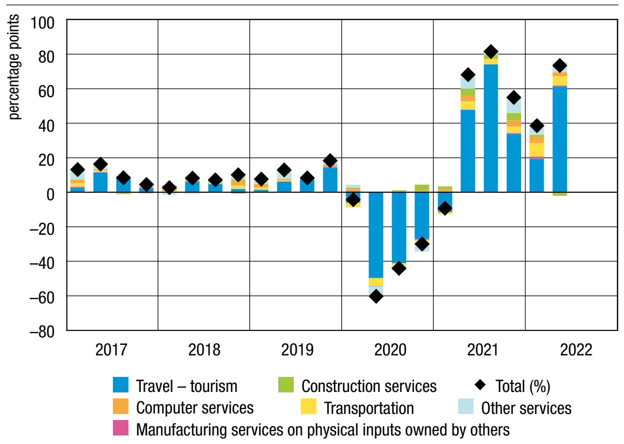
[a] Labour-intensive goods (according to the SITC) include: textile, wearing apparel, footwear, leather, paper, cork and wood, furniture, manufactures of metals and non-metallic mineral manufactures, prefabricated buildings and manufactured articles n.e.c.
Sources: CBS and CNB.

Imports of goods (Figure 6.3) rose largely on the strength of the same production categories as exports, in particular energy products, that is, natural and manufactured gas from the USA, electricity from Hungary and oil and refined petroleum products from Italy. A sharp increase was also recorded in the imports of metal industry products from Italy, Germany and Slovenia, followed by capital goods (notably electrical machinery, apparatus and appliances from China), food products from Hungary, Italy and Slovenia and other chemical products (excluding medical and pharmaceutical products) from Italy and Germany.

In contrast to the foreign trade in goods, international trade in services saw a noticeable improvement of the balance. In the first half of 2022, net exports of services increased significantly owing to a sharp growth in tourism revenues, which more than doubled from the first six months of 2021. This was due to the further relaxation of

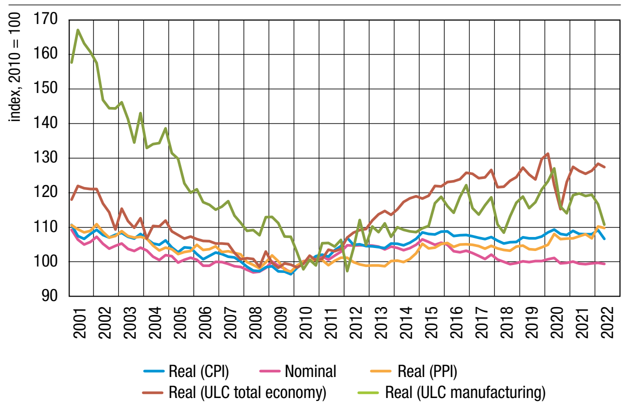
2 For more information on the differences in the scope of the trade in goods according to the balance of payments and CBS data, see Box 3 Foreign trade developments according to the balance of payments data, Macroeconomic Developments and Outlook No. 2, July 2017.

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.

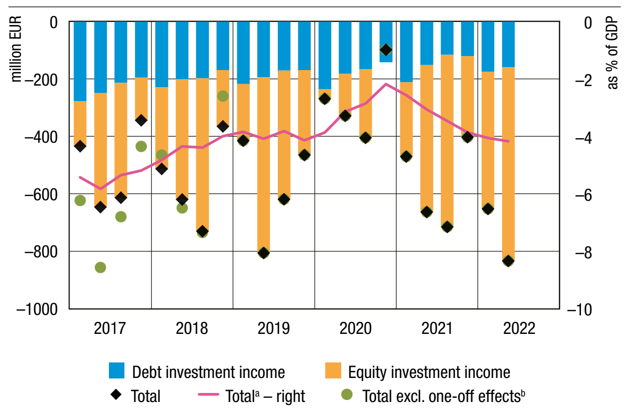
containment measures early in the year, the rebound in demand for services, which had been largely subdued during the pandemic, and considerably higher prices of accommodation and catering services. Net exports of other services not related to tourism also increased, although much less. The cumulative values recorded over the past year reveal that the surplus in the international trade in services increased from 16.8% of GDP in 2021 to 18.4% at end-June 2022.

The nominal effective exchange rate of the kuna remained stable in the first half of the year, but the different pace of growth in consumer and producer prices in Croatia relative to the countries included in the basket for the calculation of the effective exchange rate of the kuna was reflected in divergent movements of Croatian export price competitiveness in that period. The real effective exchange rate deflated by consumer prices appreciated during the first half of 2022 as prices grew faster in Croatia than in its major trading partners, while the real effective exchange rate of the kuna deflated by producer prices depreciated. Diverse trends were also seen in terms of the cost competitiveness of Croatian exports, with the real effective kuna exchange rate deflated by unit labour costs for the economy as a whole weakening slightly, while the real effective exchange rate of the kuna deflated by unit labour costs in manufacturing strengthened (Figure 6.5).

6.2 Income and transactions with the EU

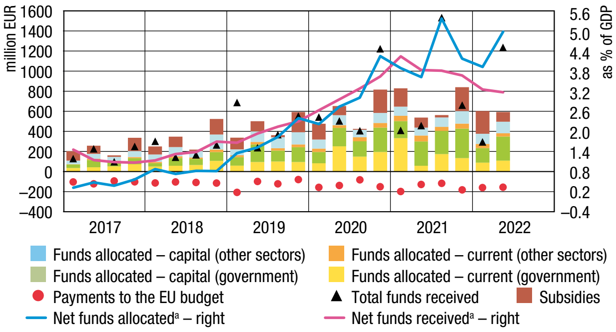
The negative investment income balance deteriorated noticeably in the first six months of 2022 relative to the

Figure 6.6 Investment income



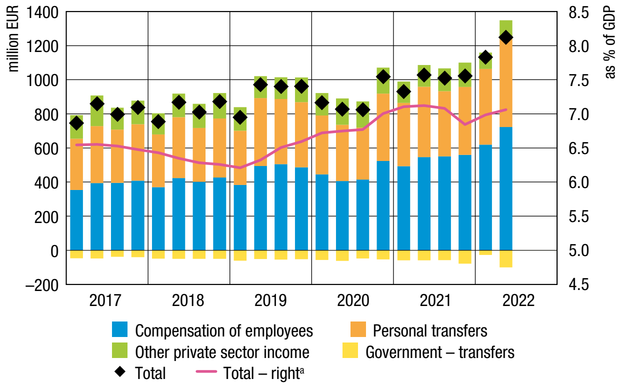
[a] Sum of the last four quarters, excluding one-off effects. [b] One-off effects include bank provisions for loans to the Agrokor Group in 2017 and 2018.
Source: CNB.

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.

same period in 2021 due to higher net expenditures on equity investments (Figure 6.6) resulting from the better performance of foreign-owned banks and enterprises (particularly in the oil industry, trade and accommodation activities). At the same time, net interest expenditures on foreign debt liabilities of domestic sectors decreased slightly, particularly expenses of other domestic sectors and the government on issued securities.

Net revenues arising from transactions with the EU budget decreased in the first half of 2022 (by EUR 0.2bn) relative to the same period in 2021. This was due to lower absorption of current funds, especially those allocated to the government sector, while absorption of agricultural subsidies and capital transfers edged up. The surplus of EU funds utilised over payments to the EU budget, reported as the sum of the last four quarters, thus decreased from 3.7% of GDP at the end of 2021 to 3.2% of GDP at the end of June 2022 (Figure 6.7).

By contrast, net inflow from other income, which excludes income from equity and debt investments and transactions with the EU budget, also increased perceptibly in the first half of 2022 relative to the equivalent period in 2021 due to a further rise in net revenues from compensations of persons temporarily employed abroad and from personal transfers (Figure 6.8).

7 Private sector financing

While market yields on government debt securities grew in the first half of the year, the tightening of financing conditions in financial markets has had no spillover effect on financing costs for the private sector so far. The interest rate on pure new corporate loans stood at 1.8% on average in the first half of 2022, while the cost of corporate financing was 33 basis points lower in mid-June. Total corporate financing trended up strongly in the first half of 2022, by EUR 2.3bn, with the largest increase seen in borrowing from domestic credit institutions.

The interest rate on pure new household loans dropped to the lowest-ever of 3.45% in April, edging up in the following two months. The growth rate of household placements continued to accelerate slightly, but has not yet reached that seen in pre-pandemic 2019.

Mounting concerns over geopolitical uncertainties, strong inflationary pressures and the worsening of global financing conditions were reflected in the growth in market yields on government debt securities in the first half of the year. However, the tightening of financing conditions in financial markets has had no spillover effect on financing costs for the private sector so far. Interest rates on loans to corporates and households remained close to their record lows. In the first half of the year, credit standards for corporate loans tightened, while remaining mostly unchanged for household loans in the second quarter, following their easing in the first quarter. There was a strong demand for loans during the first half of the year, especially for housing loans, although the demand for corporate loans slowed down in the second quarter, as did household demand for consumer and other loans. The sharp pick-up in corporate borrowing is largely tied to the higher costs of procurement owing to the rapid increase in the prices of imported energy products and raw materials, as well as attempts by enterprises to pre-empt the expected rise in borrowing costs by borrowing under the existing favourable conditions. All types of financing intensified, in particular borrowing from domestic credit institutions and external debt. The rise in household placements continued to accelerate slightly, with housing loans still seeing the sharpest growth, which was partially driven by the government subsidy programme.

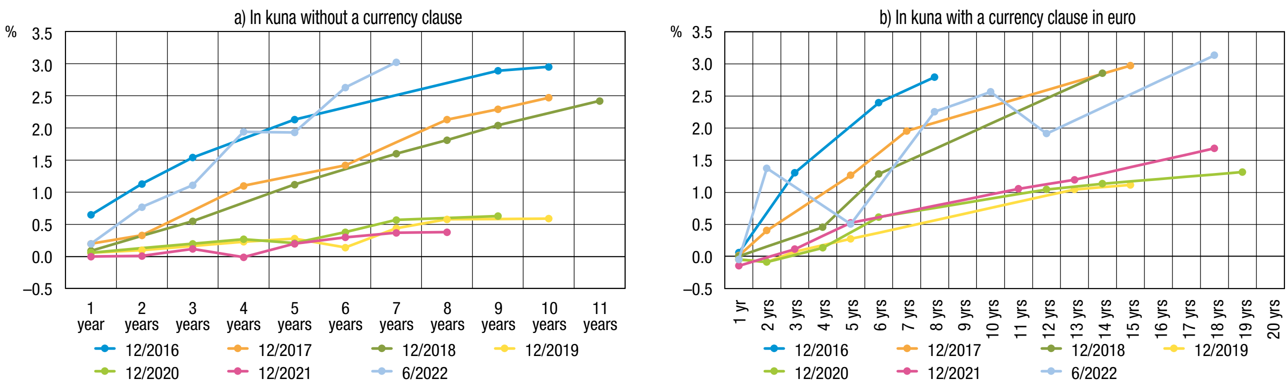
Government borrowing costs, one of the determinants of borrowing costs for other domestic sectors, were on the rise in the first half of the year, with short-term borrowing costs edging up. The interest rate on one-year kuna T-bills in the domestic market went up from 0.00% in late 2021 to 0.2% in June (Figure 7.1a), while the interest rate on euro T-bills of the same maturity issued in the domestic market went up to –0.05% in May (Figure 7.1b), after standing at –0.15% in last October. In May, the government refinanced a large issue of one-year euro T-bills, reducing the amount to EUR 1.0bn from EUR 1.2bn a year ago, while the interest rate rose from –0.05% to 0.1%. Long-term borrowing costs grew faster, e.g. the yield on seven-year kuna bonds without a currency clause increased by 2.7 percentage points in the first six months of the year, reaching 3.0% in June (Figure 7.1a). The yield on eighteen-year bonds in kuna with a currency clause in euro grew by 1.5 percentage points in the same period, standing at 3.1% in June (Figure 7.1b). In early 2022, the government obtained financing on very favourable conditions. In early February, the government issued an eight-year bond on the domestic market worth EUR 1bn, with a currency clause and a yield of 1.39%. However, as the yields grew fast, in mid-April a 10-year eurobond worth EUR 1.25bn was issued on the international capital market with a yield of 2.98%. However, the impact of the rise in the yields on total government interest expenses should be limited due to the relatively long average maturity of public debt.

The country's credit rating remained unchanged in the first half of 2022. The credit rating agency Fitch maintained Croatia's BBB investment rating with a positive outlook (two notches above speculative rating), while Standard & Poor's maintained its BBB– rating with a stable outlook (one notch above speculative rating). In late June, Moody's announced that it might upgrade Croatia's credit rating by two notches, to Baa2 (two notches above speculative rating), once Croatia's euro-area membership becomes formally confirmed and codified in EU law.

The interest rate on pure new corporate loans stood at 1.8% on average in the first half of 2022 (Figure 7.2), remaining close to all-time lows. Relative to June last year, the cost of corporate financing fell by 33 basis points in the first half of 2022 (Figure 7.3), mostly fuelled by a fall in the interest rate on investment and syndicated loans (reducing the interest rate on total loans by 18 basis points). Broken down by size of enterprise, this annual drop was equally due to the decline in the interest rate on loans to large enterprises (by 23 basis points) and the decrease of the share of micro, small and medium-sized enterprises in total financing (19 basis points), which mostly borrow at higher interest rates than large enterprises.

For most categories of enterprises in terms of size, the quarterly average of financing costs was higher in June than in the last quarter of the previous year (Figure

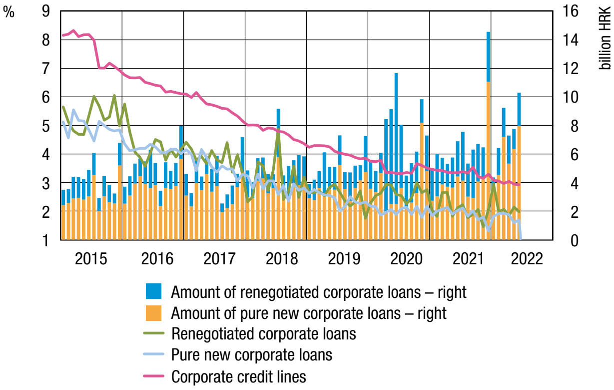
Figure 7.1 Yield-to-maturity on RC bonds



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

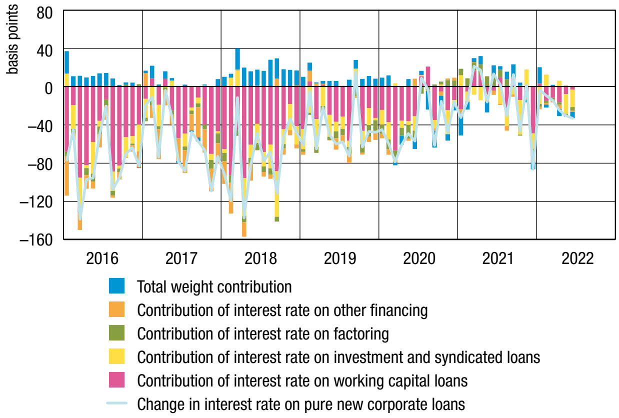
Notes: The dots show the achieved yields, while other values have been interpolated. Data for a one-year yield refer to the achieved interest rate on one-year T-bills with a currency clause in euro. Data for the end of 2016 refer to November, for the end of 2017, 2019, 2020 and 2021 refer to October, and for 2022 refer to May.
Source: CNB.

Figure 7.2 Interest rates and amounts of corporate loans



Note: Data on pure new loans are not available for credit card loans, overdrafts, revolving loans and receivables on charge cards since their new business volume (for other instruments, this includes both pure new loans and renegotiated loans) is equal to balances and thus included in the credit line category.
Source: CNB.

Figure 7.3 Contributions to the annual change in interest rate on pure new corporate loans

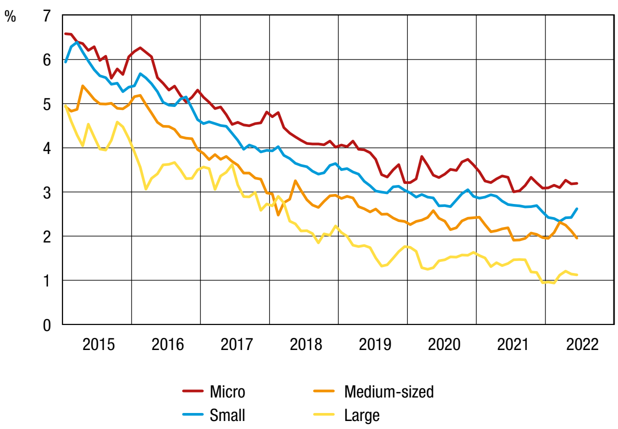


Note: Calculated by applying the Bennet index, according to which total contribution is divided into interest rate effect and weight effect.
Source: CNB.

7.4), when corporate financing costs hit record lows. Interest rates were mostly lower for larger enterprises, since they are generally perceived as less risky. The quarterly weighted interest rate on pure new loans to micro enterprises was 2.1 percentage points higher in June than that on such loans to large enterprises, slightly exceeding the average difference over the past year.

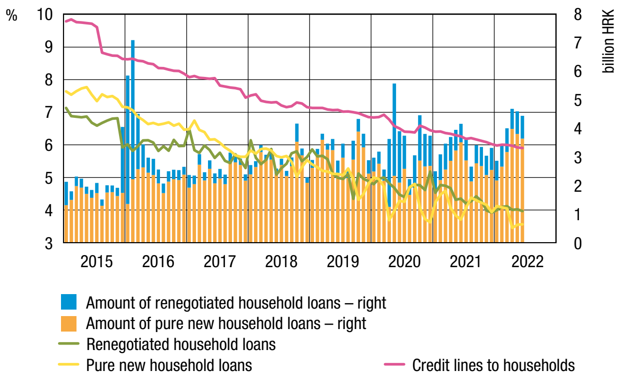
As regards households, the interest rate on pure new loans to that sector fell significantly to the then lowest-ever of 3.45% (Figure 7.5) in April, edging up in the following two months. The decrease in household financing costs mostly reflects a considerable increase in the share of housing loans in total financing as a result of the subsidy programme, within the scope of which these housing loans are granted at lower interest rates than the market average. Such oscillations recur each time favourable housing loans under the government subsidy programme are granted. The costs of household financing on an annual level decreased by 14 basis points (Figure 7.6), due largely to the fall in interest rates on general-purpose cash loans.

Figure 7.4 Interest rates on pure new loans by the size of enterprises



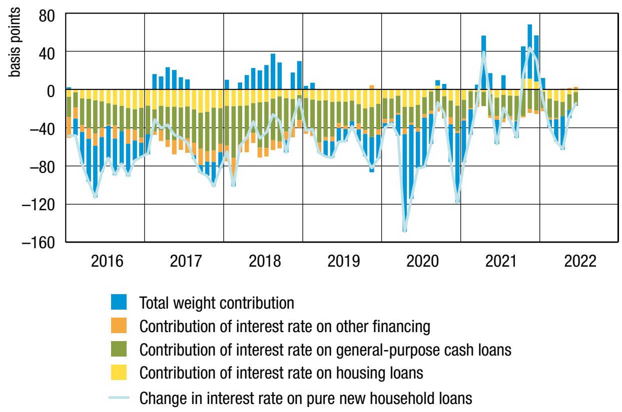
Note: Quarterly weighted moving averages.
Source: CNB.

Figure 7.5 Interest rates and amounts of household loans



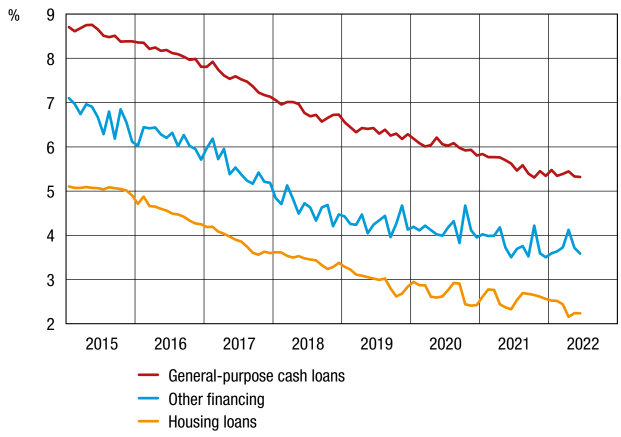
Note: Data on pure new loans are not available for credit card loans, overdrafts, revolving loans and receivables on charge cards since their new business volume (for other instruments, this includes both pure new loans and renegotiated loans) is equal to balances and thus included in the credit line category.
Source: CNB.

Figure 7.6 Contributions to the annual change in interest rate on pure new household loans



Note: Calculated by applying the Bennet index, according to which total contribution is divided into interest rate effect and weight effect.
Source: CNB.

Figure 7.7 Interest rates on pure new household loans by purpose

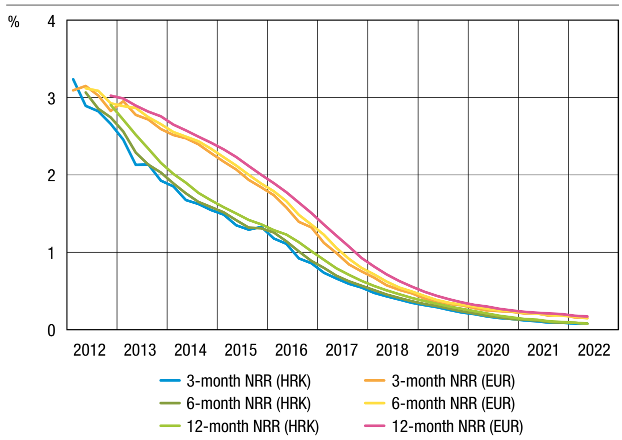


Source: CNB.

The interest rate on general-purpose cash loans was close to historic lows in the first half of 2022, averaging 5.4% in that period (Figure 7.7), while the interest rate on housing loans stood at 2.4% on average in the same period.

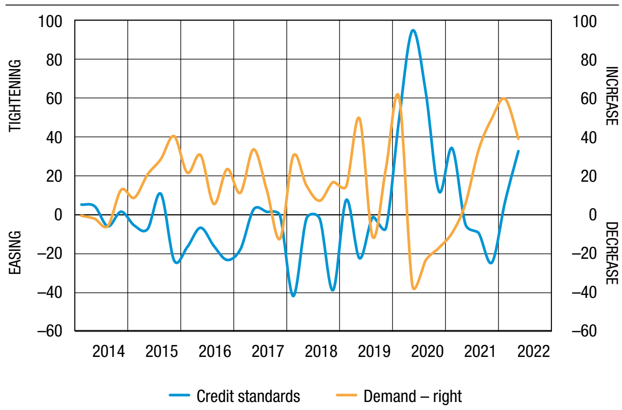
The decrease in the funding costs of the Croatian banking system in conditions of the exceptionally expansionary monetary policy and record high surplus liquidity contributed to the maintenance of the favourable financing conditions of the private sector. The national reference rate[3] (Figure 7.8), which is most often used in household loan contracts as a parameter for determining the level of the variable component of variable interest rate on loans, continued to decrease slightly in the first half of the year. On the other hand, the six-month EURIBOR rose by 0.8 percentage points in the first

Figure 7.8 National reference rate (NRR)



Note: The rates shown are the rates for all natural and legal persons.
Sources: CNB and HUB.

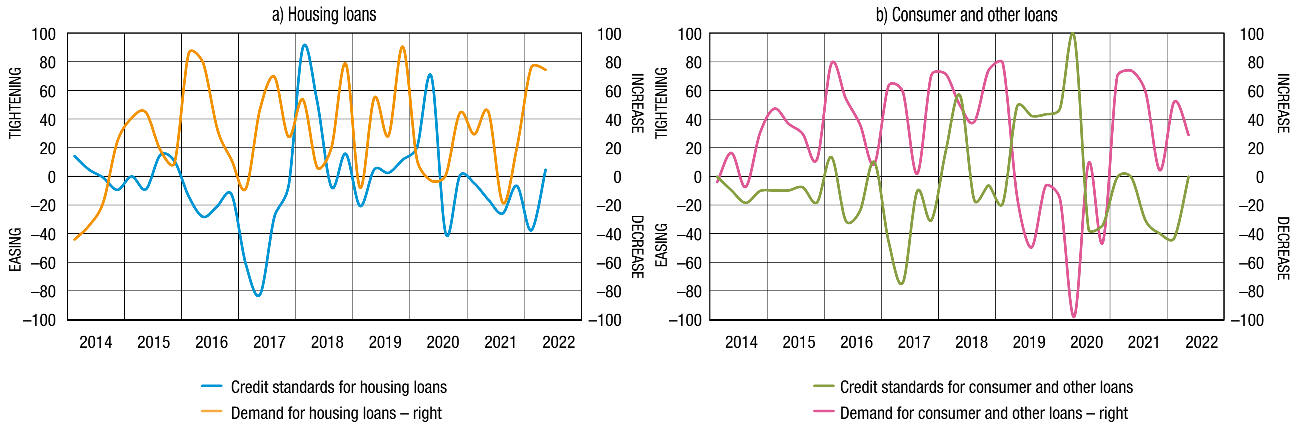
Figure 7.9 Credit standards and corporate demand for loans



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

3 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 variable interest rate on loans, in accordance with Article 11a of the Consumer Credit Act (pursuant to the Act on Amendments to the Consumer Credit Act, OG 143/2013).

Figure 7.10 Credit standards and household demand for loans



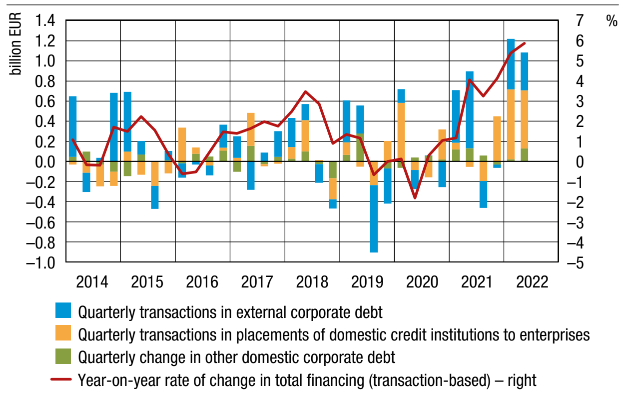
Note: Data show the net percentage of banks weighted by the share in total household loans.
Source: CNB.

half of the year, reaching 0.3%, the highest level since 2014.

According to the bank lending survey, the loosening of the credit standards for corporate loans seen throughout most of 2021 came to an end in the first half of 2022. There was a strong demand for loans, although its growth diminished in the second quarter (Figure 7.9). The tightening of credit standards in the first half of the year was mainly affected by the negative expectations related to overall economic trends as well as the worsened outlook of industry or the individual corporation. The most important drivers of rising demand for loans in the first half of the year were corporate needs for financing inventories and working capital, whereas the intensity of demand related to fixed capital formation financing decreased noticeably in the second quarter.

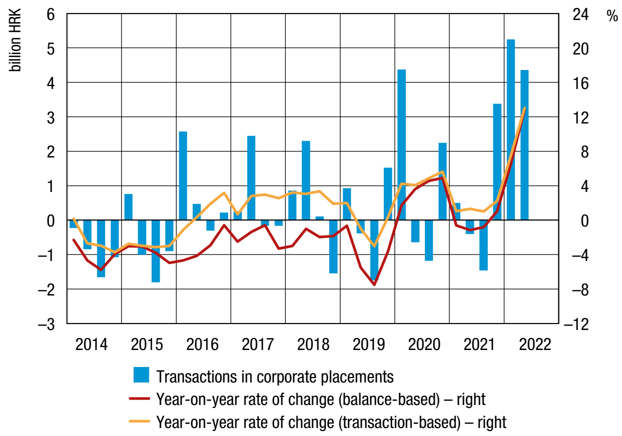
As regards households, the easing of credit standards seen in previous periods came to a halt in the second quarter (Figure 7.10). According to bank responses, the loosening of credit standards came to an end in the second quarter mostly due to worsened expectations related to overall economic trends. Demand for housing loans increased noticeably in the first quarter, holding steady in the second quarter as well. On the other hand, the demand for consumer and other loans slowed down in the second quarter. A strong demand for housing lending in the first half of the year was driven by a favourable real estate market outlook and the subsidy programme. Faltering demand for consumer loans in the second quarter was influenced by a less pronounced consumption of durable consumer goods and a drop in consumer confidence.

Figure 7.11 Corporate financing



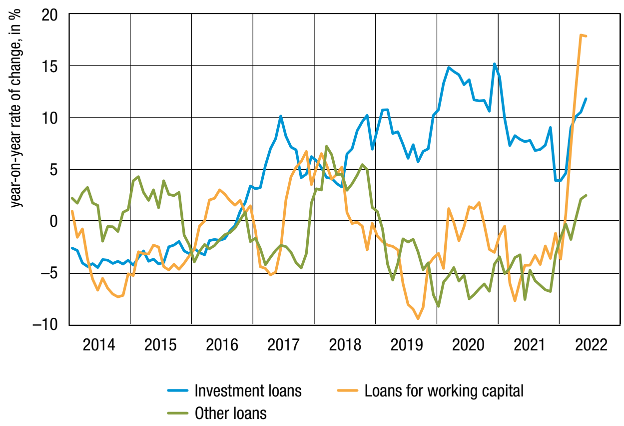
Notes: Other domestic financing includes borrowing from domestic leasing companies, the CBRD and HAMAG-BICRO. External debt excludes the effect of debt-equity swaps. All changes were calculated on the basis of transactions (except for leasing companies).
Sources: HAMAG-BICRO, HANFA, CNB and CNB calculations.

Figure 7.12 Corporate domestic placements of credit institutions



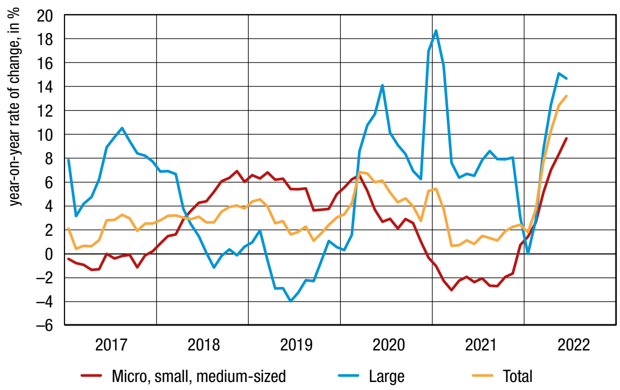
Source: CNB.

Figure 7.13 Growth in corporate loans by purpose
transaction-based



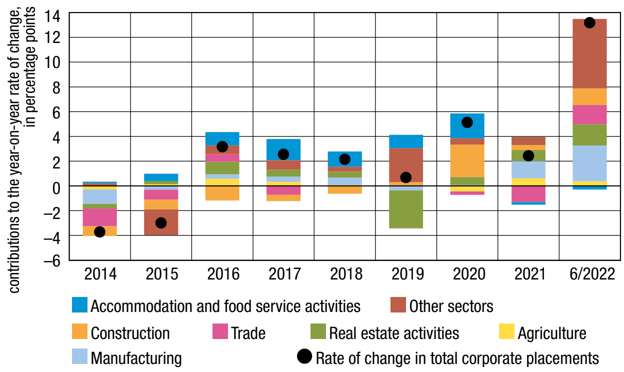
Source: CNB.

Figure 7.14 Growth in corporate placements by size
transaction-based



Note: The data were adjusted for the assessment of the effect of activated government guarantees for loans to particular shipyards and the decrease in the claims on the Agrokor Group linked to the operational implementation of the settlement.
Source: CNB.

Figure 7.15 Growth in corporate placements by activity
transaction-based

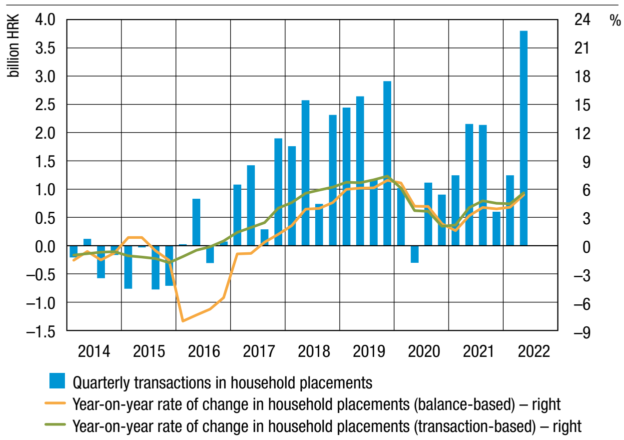


Note: In October 2019, a large corporation switched from Section L (Real estate activities) to Section E (Water supply, sewerage, waste management and remediation activities). This is why in 2019 a sharp decrease in placements was recorded in Real estate activities, and a substantial rise was seen in Other sectors, which include Water supply activity.
Source: CNB.

Total corporate financing trended up strongly in the first half of 2022, by EUR 2.3bn (Figure 7.11), with the largest increase seen in borrowing from domestic credit institutions. As a result, the growth in total corporate financing picked up to 5.9% (transaction-based) on an annual basis, the highest growth rate since 2009. All types of financing gathered momentum on an annual level.

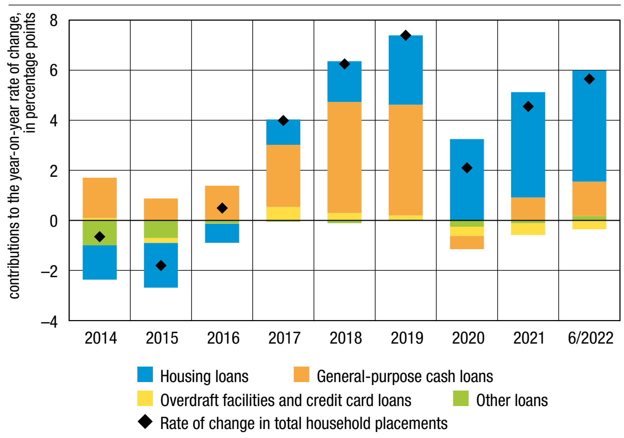
Corporate debt to domestic credit institutions in the first half of the year increased by HRK 9.6bn or 10.7%. The annual growth in domestic placements picked up to 13.0% (transaction-based, Figure 7.12) in June. Corporate needs for financing of current operations shot up amid rising costs, so that the annual increase in working capital loans went up from –1.2% in late 2021 to almost 18% in June (Figure 7.13). The annual growth in investment loans also accelerated from the previous year, reaching 11.8% in June. With regard to the structure of financing in terms of enterprise size, the annual increase in borrowing by large enterprises was the most pronounced, having reached 14.7% in

Figure 7.16 Household placements



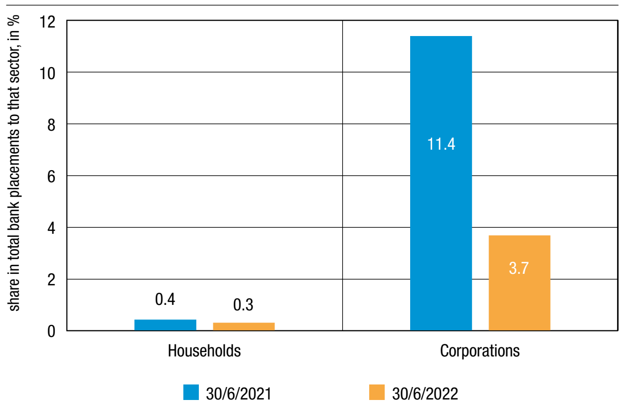
Source: CNB.

Figure 7.17 Growth in household placements by loan type
transaction-based



Source: CNB.

Figure 7.18 Placements under payment deferral or restructuring measures



Note: Since June 2021, data on approved loan payment deferral or restructuring applications have been collected according to a new methodology, but this has not led to significant deviations from the data collected by applying the old methodology.
Source: CNB.

June (Figure 7.14), while lending to micro, small and medium-sized enterprises grew at a slower pace.

Broken down by activities, almost all activities recorded annual growth in placements in June (Figure 7.15). The sharpest increase was seen in manufacturing and other activities, especially in electricity, gas and steam supply, as well as professional, scientific and technical activities.

The growth rate of household placements continued to accelerate slightly, but has not yet reached that seen in the pre-pandemic year 2019. The annual growth rate went up from 4.5% in 2021 to 5.6% in June (transaction-based, Figure 7.16). Almost four-fifths of the annual increase in household placements in June related to housing loans (Figure 7.17), the annual growth rate of which picked up to 9.5% in the first half of 2022, spurred also by the government subsidy programme. The annual growth in general-purpose cash loans continued to recover mildly and reached 3.6% in June, yet remaining much lower than the 11.5% seen in 2019.

Total amount of bank placements covered by payment deferral or restructuring measures was significantly lower at the end of June 2022 than in mid-2021, which is largely attributable to the expiry of granted moratoria. At end-June, 3.7% of bank placements to corporates and only 0.3% of placements to households were covered by the measures (Figure 7.18).

8 Foreign capital flows

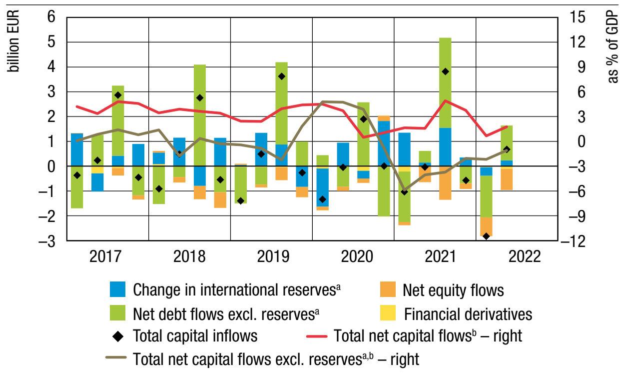
Net capital inflows grew sharply, by EUR 2.0bn. This refers in particular to inflows of new direct equity investments in Croatia, which mostly took place in the real estate sector and the automobile industry. Net debt liabilities of domestic sectors went up only slightly in the first half of 2022. Thus, at the end of June 2022, gross external debt stood at EUR 47.0bn, or 75.2% of GDP, down by 1.7 percentage points from the end of 2021. Net external debt stood at EUR 3.6bn, or 5.8% of GDP, up 1.0 percentage point from the end of 2021. The increase in net equity and net debt liabilities resulted in a deterioration in the international investment position in absolute terms, while the relative indicator improved owing to nominal GDP growth.

The financial account of the balance of payments, changes in gross international reserves and liabilities of the CNB excluded, saw a strong net capital inflow of EUR 2.0bn in the first six months of 2022. The bulk of net capital inflows was related to the rise in net equity liabilities of domestic sectors, with a much weaker growth in net debt liabilities. At the same time, international reserves declined mildly, so that the total net inflow of capital was slightly larger, at EUR 2.2bn (Figure 8.1).

The net inflow from equity investments in the first half of 2022 (EUR 1.6bn) resulted from a large increase in liabilities coupled with a marginal decrease in equity assets of domestic sectors. This refers in particular to inflows of new direct equity investments in Croatia, which were noticeably larger than in the same period of the year before, and mostly took place in the real estate sector and the automobile industry (Figure 8.2). To a smaller extent, this was also driven by reinvested earnings of domestic business entities in non-resident ownership, reflecting the rise in current profitability in a large number of activities. By contrast, investments of domestic institutional investors in foreign shares and equity holdings decreased.

Net debt liabilities of domestic sectors (excluding the change in the gross international reserves and liabilities of the CNB) went up only slightly (by EUR 0.3bn) in the first half of 2022 as the surge in foreign debt liabilities of domestic sectors was largely accompanied by a rise in foreign debt claims. The greatest deterioration was observed in the net debt position of other domestic sectors, in particular non-financial corporations, which increased their net liabilities to affiliated creditors and liabilities under short-term trade credits. Banks' net debt

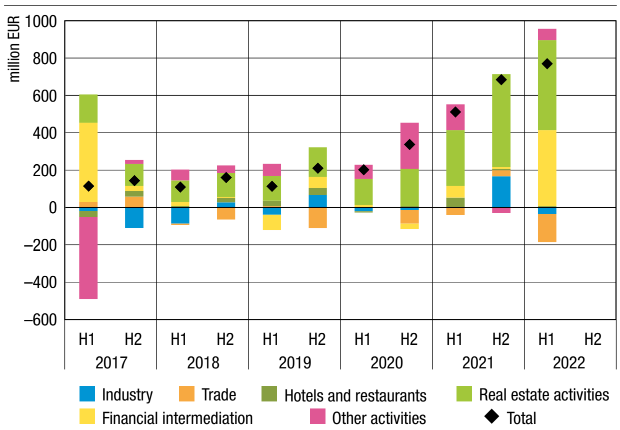
Figure 8.1 Flows in the financial account of the balance of payments



[a] Changes in gross international reserves net of CNB foreign liabilities.
[b] Sum of the previous four quarters.
Notes: Net flows are 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.

also grew slightly, but the assets of banks in TARGET2[4] managed by the central bank grew even more. By contrast, the net debt position of the government improved due to a perceptible fall in foreign liabilities based on long-term debt securities, as a result of transactions in the secondary market. At the same time, the international reserves (gross reserves minus CNB liabilities) decreased slightly as the outflows based on the foreign exchange intervention of March were mostly offset by the increase in government deposits in the account with the CNB in the second quarter of 2022.

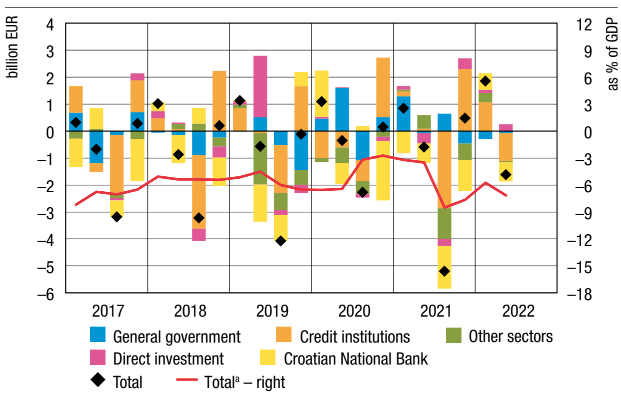
Figure 8.2 Foreign direct equity investment in Croatia by activities



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

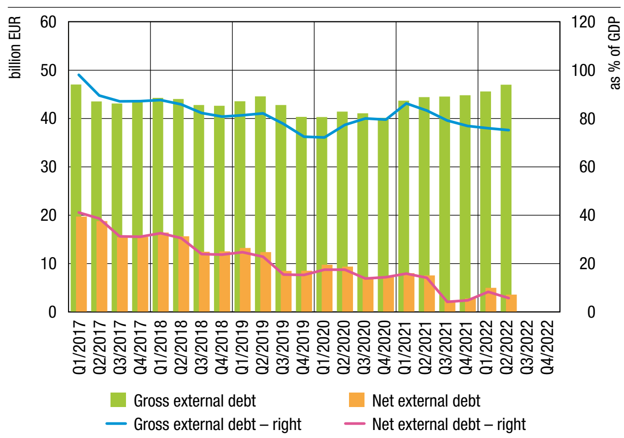
Despite the growth in domestic sectors' debt liabilities in an absolute amount, owing to the nominal GDP growth, the relative indicator of gross external debt improved in the first six months of 2022. Thus, at the end of June 2022, gross external debt stood at EUR 47.0bn, or 75.2% of GDP, down by 1.7 percentage points from the end of 2021 (Figure 8.4). By contrast, the relative indicator of net external debt grew in the first half of 2022 as the fall in net debt liabilities in the second quarter of 2022 was insufficient to offset the usual seasonal growth in net debt in the first three months of 2022. The mild increase in net liabilities of domestic sectors (transaction-based) was accompanied with the unfavourable effect of price, exchange rate and other adjustments. Net external debt stood at EUR 3.6bn at the end of the first half of 2022, or 5.8% of GDP, up 1.0 percentage point from the end of 2021.

Figure 8.3 Net external debt transactions by sectors



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

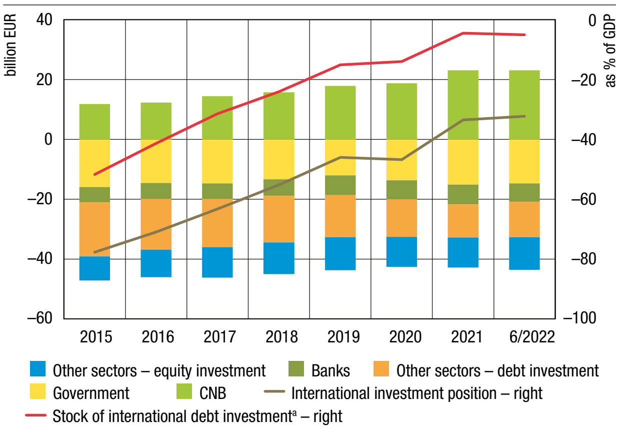
Figure 8.4 Stock of gross and net external debt



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

4 Banks' funds within the TARGET2 system account for central bank's foreign assets, but they are not part of international reserves.

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.

The increase in net equity and net debt liabilities resulted in a deterioration in the international investment position in absolute terms, while the relative indicator improved owing to nominal GDP growth. As a result, the net international investment position at the end of June 2022 stood at –32.3% of GDP, whereas at the end of 2021 it came to –33.5% of GDP (Figure 8.5).

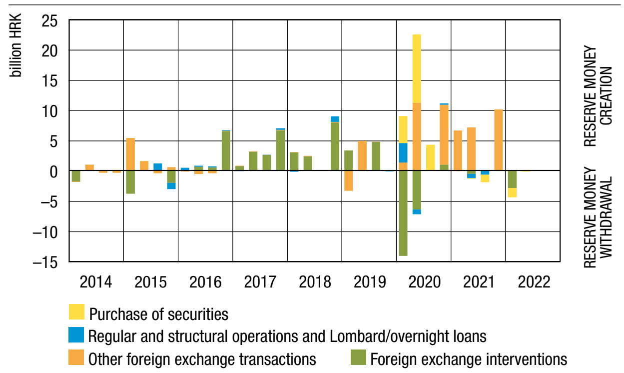
9 Monetary policy

The reversal of monetary policies triggered a substantial tightening of global financing conditions. The intensity of the pressures in the foreign exchange market was relatively limited as market expectations were further anchored by Croatia's participation in the Exchange Rate Mechanism and the expected introduction of the euro.

The CNB placed a total of HRK 770m on three occasions. The average daily surplus kuna liquidity remained very high in the first half of 2022. The exchange rate of the kuna against the euro was relatively stable owing to foreign exchange interventions of the CNB. Compared to the central rate, in the period from Croatia's entry to the European Exchange Rate Mechanism to the end of June 2022, the average exchange rate moved within a very narrow range of –1.0% to +0.7%. Following a surge in 2021, monetary aggregates grew at somewhat lower, but still relatively high, rates in the first half of 2022.

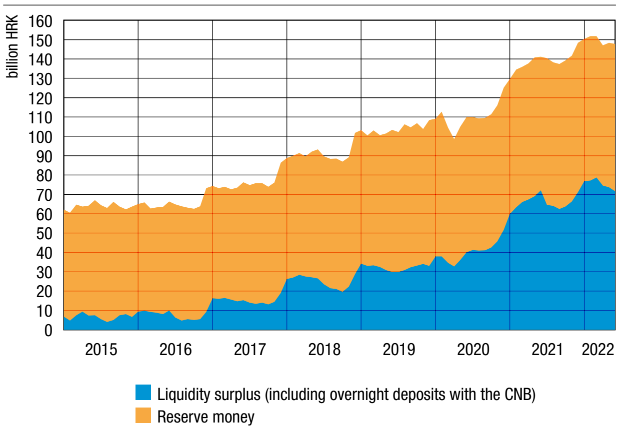
The first half of 2022 was marked by mounting inflationary pressures and expectations of a faster and sharper tightening of the monetary policies of many central banks. The expected reversal of monetary policies, backed by the first steps taken in that direction and announcements regarding future actions, spurred a substantial tightening of global financial conditions. In this context, the exchange rate of the kuna against the euro remained stable, while monetary system liquidity held steady at a very high level. Though the rise in geopolitical tensions spurred by the Russian aggression against Ukraine created some pressures in the foreign exchange market in March, their intensity was relatively limited as market expectations were further anchored by Croatia's participation in the European Exchange Rate Mechanism (ERM II) and the expected introduction of the euro. Market expectations were also calmed by the fast resolution of Sberbank d.d., which faced significant deposit outflows as a result of the reputational impact of sanctions against Russia. This is why the CNB intervened in the foreign exchange market on three occasions in March, selling a total of EUR 385m worth of foreign exchange to the banks, with one intervention taking place outside of auction. The CNB continued to purchase foreign exchange from the Ministry of Finance, albeit at a much slower pace than in the first half of 2021, purchasing only EUR 13.4m net from the MoF from the beginning of the year to

Figure 9.1 Flows of reserve money (M0) creation



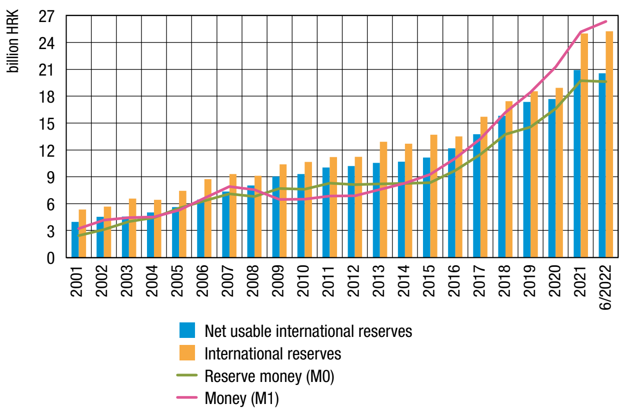
Notes: The Lombard facility cancelled on 28 September 2017 was replaced by the overnight facility. Other foreign exchange transactions include the purchase of foreign exchange from and the sale of foreign exchange to the MoF and the EC and foreign currency swaps with banks. The positive values refer to the purchase of foreign exchange.
Source: CNB.

Figure 9.2 Bank liquidity and reserve money



Source: CNB.

Figure 9.3 International reserves of the CNB and monetary aggregates



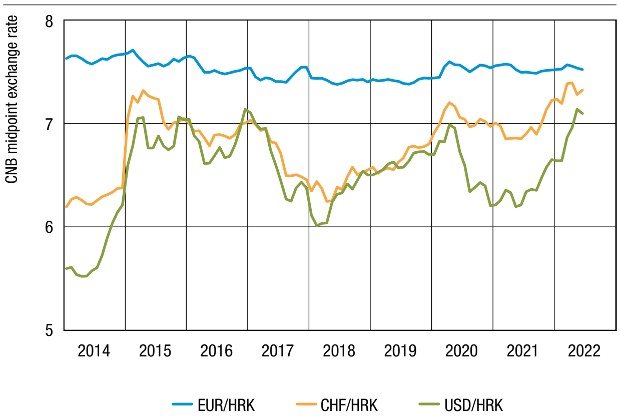
Note: Net usable international reserves are defined as international reserves net of CNB foreign liabilities, reserve requirements in f/c, government foreign currency deposits and off-balance sheet liabilities (swaps).
Source: CNB.

end-June. If total foreign exchange transactions are observed, the CNB sold net EUR 371.6m in that period, withdrawing a total of HRK 2.8bn in reserve money (Figure 9.1).

As regards kuna operations, the CNB continued to conduct regular weekly operations at a fixed rate of 0.05%, with banks showing interest in short-term kuna funds through this instrument in March, when the CNB placed a total of HRK 770m to them on three occasions. On the other hand, no structural operations were used to create additional kuna liquidity, and their stock dropped to HRK 3.0bn, down by HRK 60m from the end of the previous year due to early repayments. No purchases of government bonds took place in the first six months of 2022. However, certain bonds having fallen due, the stock of total subscribed bonds of the Republic of Croatia decreased by HRK 1.6bn from the end of 2021.

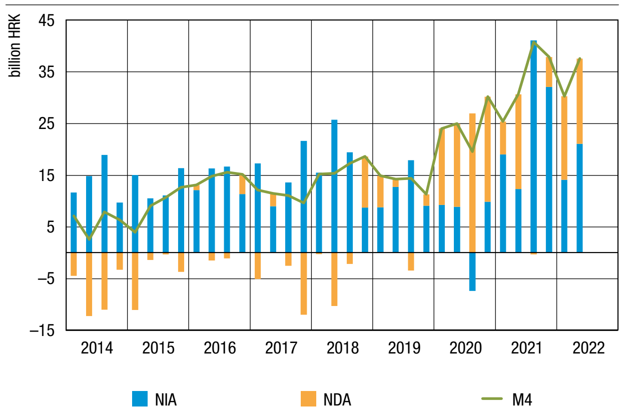
The average daily surplus kuna liquidity remained very high in the first half of 2022. Having reached a record high in March (HRK 78.7bn), it started to fall, coming to

Figure 9.4 Nominal exchange rates of the kuna against selected currencies



Source: CNB.

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



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

HRK 71.6bn in June, only slightly more than in last December (Figure 9.2). Banks' free reserves diminished, mostly as a result of the sale of foreign exchange to banks and the increase in government kuna deposits with the CNB.

A higher level of repo agreements and rising government foreign exchange deposits with the CNB contributed the most to the increase in international reserves in the first six months of 2022. Gross international reserves were EUR 25.2bn at the end of June (Figure 9.3), up by EUR 0.2bn (0.9%) from the end of 2021. Net usable reserves decreased by EUR 0.4bn (1.7%) in the same period. Both gross and net reserves continued to be higher than reserve money (M0).

The kuna/euro exchange rate was stable in the first half of 2022 owing to foreign exchange interventions of the CNB. In the first quarter, the exchange rate came under strong depreciation pressures, stemming from unfavourable geopolitical events, but it started to appreciate in April, ahead of the summer tourist season, and continued to do so to the end of June, when it stood at EUR/HRK 7.53, up by 0.1% from the end of 2021. The exchange rate of the kuna against the euro rose by 0.5% from the end of June 2021 to the end of June 2022, while the average exchange rate from the beginning of January to end-June 2022 stood at EUR/HRK 7.54, down 0.1% from the average exchange rate in the same period of the previous year (Figure 9.4). In relation to the central rate,[5] in the period from Croatia's entry to the European Exchange Rate Mechanism to the end of June 2022, the average exchange rate moved within a very narrow range of –1.0% to +0.7%. The exchange rate of the kuna against the US dollar and the Swiss franc was noticeably higher at the end of June 2022 than at the end of June 2021, reflecting the weakening of the euro against these two currencies on global financial markets.

Following a surge in 2021, monetary aggregates grew at somewhat lower, but still relatively high, rates in the first half of 2022. The annual growth rate in total liquid assets (M4) decelerated slightly, from 10.4% at the end of 2021 to 9.9% (transaction-based) at the end of June 2022. The annual increase in net domestic assets (NDA) accelerated (driven by the growth in placements to domestic sectors), while the rise in net foreign assets (NFA) decelerated in that period (Figure 9.5).

5 Croatia entered the Exchange Rate Mechanism in July 2020, with the central rate of the kuna being set at 1 euro = 7.5345 and the standard fluctuation band at ±15% around this rate.

10 Public finance

In the first half of 2022, the consolidated general government ran a surplus of HRK 2.0bn, which is an improvement of HRK 11bn from the deficit of HRK 9bn in the previous year. The deficit was revised upwards in May, to HRK 13.4bn. The strong increase in revenues from indirect taxes was a reflection of the recovery of nominal personal consumption and tourist activity as well as of changes in price levels. The decrease in total expenditures was mostly driven by the sharp fall in expenditures on subsidies. Interest expenditures dropped as well, whereas expenditures for employee compensations rose annually, partly due to the increase in the wage calculation base for civil servants and government employees.

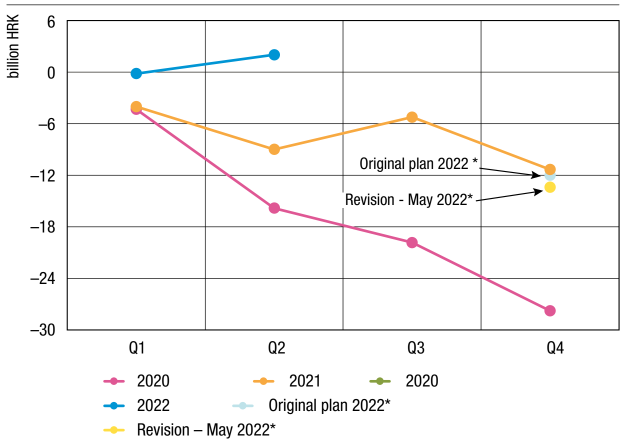
In the first half of 2022, the consolidated general government ran a surplus of HRK 2.0bn, which is an improvement of HRK 11bn from the deficit of HRK 9bn in the same period of the previous year. Observed on a quarterly basis, the first quarter of 2022 witnessed a deficit of HRK 0.2bn, which was an improvement of HRK 3.8bn on an annual basis, with favourable fiscal trends continuing into the second quarter, which saw a surplus of HRK 2.2bn, an improvement of HRK 7.2bn on an annual basis.

As regards the budget plans for 2022, the government's original plan projected a consolidated general government deficit of HRK 12.0bn, while the budget revision of May increased the deficit to HRK 13.4bn in view of the uncertain and potentially unfavourable effect of economic activity on fiscal movements.

In April 2022, the government adopted a package of measures worth HRK 4.8bn (1.1% of GDP) aimed at mitigating the negative effects of inflationary pressures on citizens' living standards and businesses. According to the available data, the estimated direct impact of the package of measures on the government budget in 2022 amounts to 1.0% of GDP as HRK 0.46bn (0.1% of GDP) went for the revenue loss of HEP, which is not part of the general government.

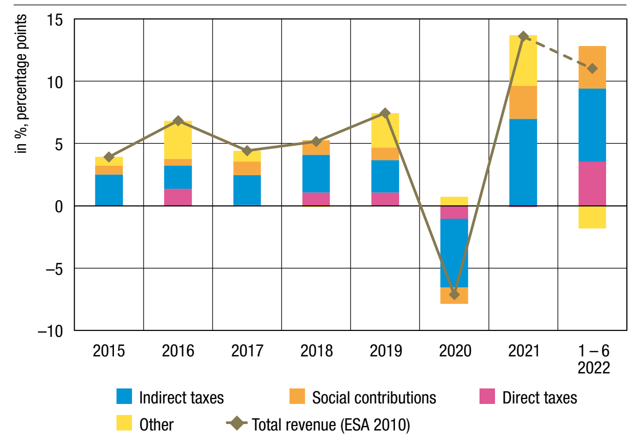
As for the revenue side of the budget (ESA 2010), total revenues were as much as 11.0% higher in the first half of 2022 than in the same period of the preceding year. The annual growth of total revenues was mostly driven by the strong increase in revenues from indirect taxes, which was the reflection of the recovery of nominal personal consumption and tourist activity as well as changes in price levels. The trends in this revenue category were also influenced by the government's anti-inflation package in effect from 1 April 2022, which reduced the VAT rate on

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



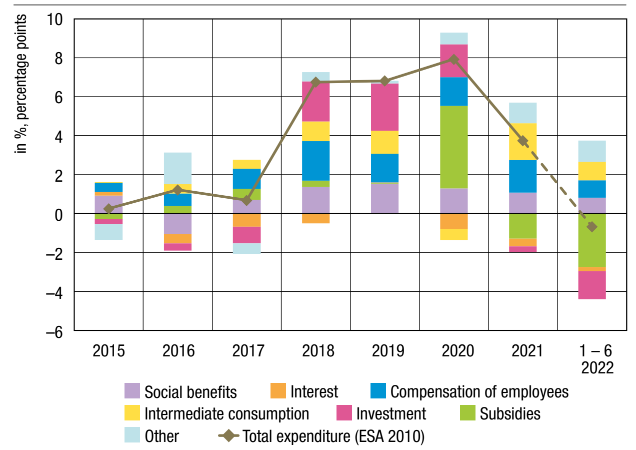
Sources: Eurostat and MoF (CNB calculations).

Figure 10.2 Consolidated general government revenue (ESA 2010)
year-on-year rate of change and contributions



Source: Eurostat (CNB calculations).

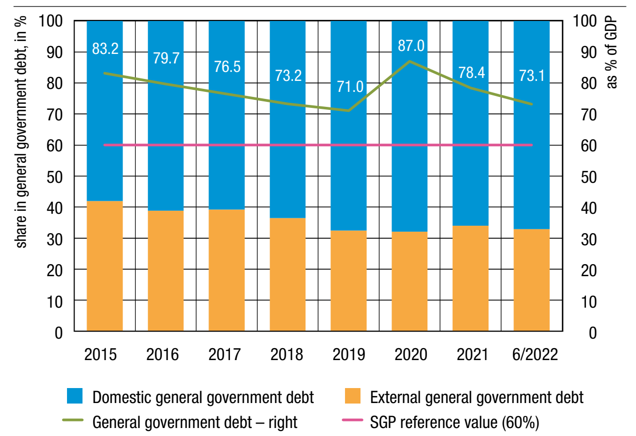
Figure 10.3 Consolidated general government expenditure (ESA 2010)
year-on-year rate of change and contributions



Source: Eurostat (CNB calculations).

some products and services, as well as excise duties on fuel by imposing ceilings on the retail prices of refined petroleum products. Furthermore, total revenues were given a boost by the rise in revenues from direct taxes, which was the outcome of positive trends in the labour market and better performance of enterprises. Revenues from social contributions also made a positive contribution to the movement of total revenues, mirroring favourable developments in the labour market, i.e. the increase in employment and wages. The category of other revenues made a negative contribution to developments in total revenues, most likely as a result of slower withdrawals of EU funds on an annual level.

Figure 10.4 General government debt
end-period stock



Note: Nominal GDP for the last four available quarters was used to calculate the relative indicator as at the end of June 2022.
Source: CNB.

The expenditure side of the consolidated general government budget (ESA 2010) saw a marginal decrease (of –0.7%) in the first half of 2022 from the same period of the previous year. The decrease in total expenditures was mostly driven by the sharp fall in expenditures on subsidies, which was largely due to the discontinuation of job preservation grants to employers in view of the better epidemiological situation and economic recovery. The annual fall in investment activity, that is, capital expenditures, also gave a downward momentum to total expenditures, which was attributable to the slower implementation of projects financed from EU funds. Expenditures on interest also decreased owing to the continuance of relatively favourable financing conditions in the capital market. By contrast, expenditures for intermediate consumption went up, reflecting in part higher energy costs and costs associated with the accommodation of refugees from Ukraine. Expenditures for employee compensations also saw annual growth, resulting mostly from the increase in the wage calculation base of 4% from 1 May 2022 for civil servants and government employees. Expenditures for social benefits also grew noticeably in the first half of 2022, mirroring, in part, increased expenditures for pensions, that is, the impact of indexation, and the one-off energy supplement to pensions envisaged in the April anti-inflation package of measures of the Croatian government.

The consolidated general government debt stood at HRK 343.7bn at the end of June 2022, a decrease of HRK 65m from the end of 2021. In the same period, the public debt-to-GDP ratio dropped from 78.4% at the end of 2021 to 73.1%, reflecting the growth in nominal GDP.

In early February, the government issued in the domestic market EUR 1bn worth of bonds with a currency clause falling due in 2030, with a yield to maturity of 1.39% and an annual interest rate of 1.25%. The funds raised were used to refinance EUR 500m worth of bonds with a currency clause due on 5 February 2022 and HRK 3bn worth of bonds due on 7 February 2022, while the remaining amount was earmarked to finance budget needs. In April, the government issued in the international capital market EUR 1.25bn worth of eurobonds falling due in 2032 with a yield to maturity of 2.98% and an annual coupon interest rate of 2.88%. The funds thus raised were used in May to refinance the matured eurobond worth nominally EUR 1.25bn.

11 International reserves management

In the first half of 2022, CNB foreign currency portfolios performed positively owing to a number of investment decisions to reduce exposure to interest rate risk. The growth in international reserves in the first half of 2022 was mostly fuelled by inflows of foreign exchange in the account of the Ministry of Finance and a higher level of repo transactions. These factors have no effect on developments in net reserves, which decreased mostly on account of interventions involving the sale of foreign exchange. Income from investment in the first half of 2022 amounted to EUR 96.9m or HRK 730.9m.

International reserves rose slightly in the first half of 2022. Notwithstanding adverse market conditions resulting from a surge in yields in the first half of 2022, CNB foreign currency portfolios performed positively owing to a number of investment decisions to reduce exposure to interest rate risk. Liquidity and safety of investment, the main objectives of international reserves management, were successfully accomplished.

The CNB manages international reserves in two ways: in line with its own guidelines or in accordance with the assumed obligations, 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, which is 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.

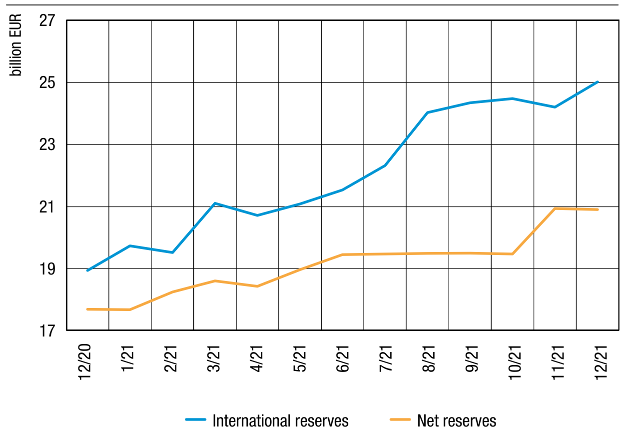
11.1 Structure of and developments in international reserves

On 30 June 2022, international reserves amounted to EUR 25,243.0m, up by EUR 221.8m or 0.9% from the end of 2021 when they stood at EUR 25,021.2m. Net reserves dropped by EUR 361.8m or 1.7% during that period, having fallen from EUR 20,910.3m to EUR 20,548.5m.

The growth in international reserves in the first half of 2022 was mostly fuelled by inflows of foreign exchange in the account of the Ministry of Finance and a higher level of repo transactions. These factors have no effect on developments in net reserves, which decreased mostly on account of interventions involving the sale of foreign exchange.

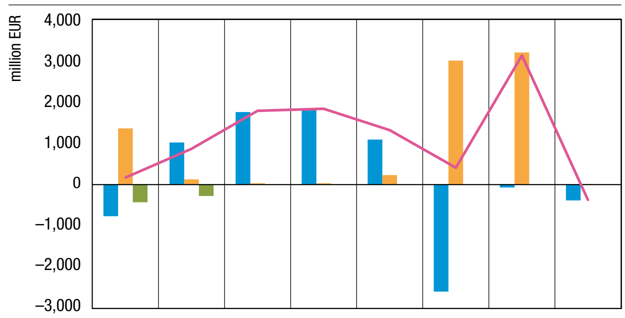
Securities of governments and government institutions, foreign cash and reverse repo agreements accounted for the largest share in the structure of international reserves investment at the end of the first half of 2022. A portion of international reserves invested in ESG investment went up from 1.2% at end-2021 to 3.9% at the end of June 2022.

Figure 11.1 Monthly changes in total and net international reserves in the first half of 2022
end of period



Source: CNB.

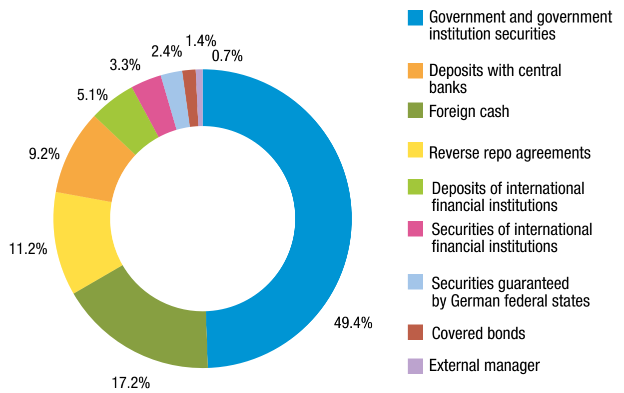
Figure 11.2 Foreign exchange interventions of the CNB with the banks, the MoF and the EC
in net amounts



	2015	2016	2017	2018	2019	2020	2021	6/2022
Banks	−767.2	1,018.8	1,757.0	1,808.9	1,088.9	−2,595.6	−70.0	−385.0
MoF	1,364.0	125.6	30.6	30.4	228.1	3,004.0	3,201.7	13.4
EC	−428.9	−277.8	–	–	–	–	–	–
Total	167.9	866.6	1,787.6	1,839.3	1,316.9	408.4	3,131.7	−371.6

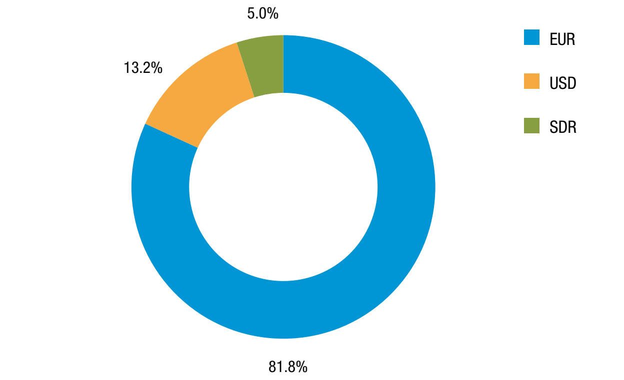
Note: Positive values refer to the purchase and negative to the sale of foreign exchange by the CNB.
Source: CNB.

Figure 11.3 Structure of international reserves investment
as at 30 June 2022



Source: CNB.

Figure 11.4 Currency structure of total international reserves
as at 30 June 2022



Source: CNB.

The CNB invests funds in instruments 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 Fitch Ratings) and on an internally-developed creditworthiness assessment model.

At the end of the first half of 2022, approximately 62% of international reserves were invested in instruments within the two highest credit rating categories, BIS instruments and foreign cash in the CNB vault.

The euro dominates the currency structure of international reserves. The share of the euro fell slightly in the first half of 2022, from 84.3% at the end of 2021 to 81.8%, as a result of the sales of the euro in foreign exchange interventions and the weakening of the euro against the US dollar. On the other hand, the share of the US dollar went up from 10.7% to 13.2%, while the share of SDRs in international reserves grew marginally, from 4.9% to 5.0%.

11.2 Financial markets and international reserves management results in the first half of 2022

Financial markets in the first half of 2022 were dominantly influenced by geopolitical developments triggered by the outbreak of the war in Ukraine, while high inflation and the beginning of the tightening of monetary policies of major central banks occasioned a rise in interest rates. The Fed, like the majority of central banks, started to lift its benchmark interest rates, while the ECB announced that it would do so in the second half of the year. Both these central banks discontinued their securities repurchase programmes. In addition to strong volatility and persistent uncertainty, the first half of 2022 was marked by a surge in yields on government bonds (drop in bond prices), while euro yields almost came out of negative territory after a period of several years. The share of bonds of euro area member states with negative yields dropped to only 5% towards the end of June 2022, and related only to bonds maturing in less than six months.

The yield curve for US bonds of maturities up to ten years rose by the end of June from the end of 2021 by a high 186 basis points on average, with the sharpest growth seen for maturities between 6 months to three years, primarily reflecting the beginning of the rise in the Fed's key interest rates.

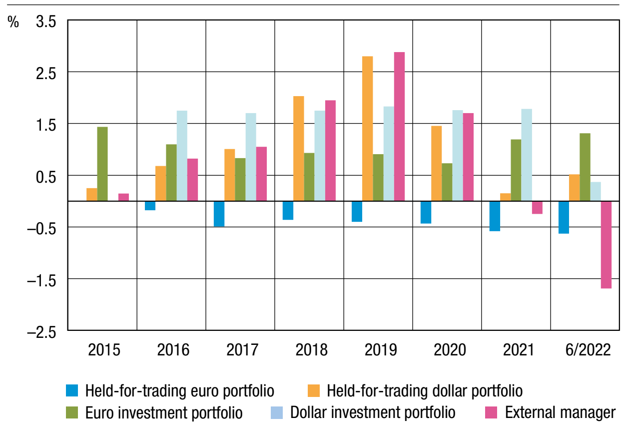
Equity markets performed very poorly, while the US dollar appreciated sharply against the euro. Market developments were much less influenced by the pandemic than in the previous two years.

Income from investment in the first half of 2022 amounted to EUR 96.9m or HRK 730.9m.

In the first six months of 2022, the annual rate of return on the entire euro portfolio of net reserves was 0.33%, while the rate of return on the entire US dollar portfolio totalled 0.27%. In the first half of 2022, the annual rate of return on the US dollar funds entrusted for management to an international financial institution was –1.69%.

The held-for trading portfolios, which are used for maintaining foreign exchange liquidity, accounted for some 32% of net reserves. Investment portfolios account for about 46% of net reserves.

Figure 11.5 Annual rates of return of the CNB foreign currency portfolios from 2015 to the end of the first half of 2022



Source: CNB.

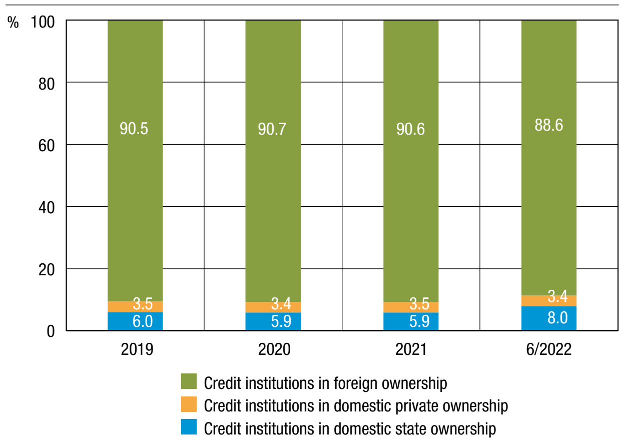
12 Business operations of credit institutions

The business performance of credit institutions in the first half of 2022 was better than in the same period in the previous year, owing to the less burdensome credit loss costs and the growth in non-interest income. The assets of credit institutions continued to increase, mostly due to the rise in received deposits, which was used predominantly to enhance lending activity.

The strong capitalisation and high liquidity of credit institutions supported stable and smooth operations of the banking system amid continued uncertainty. The assets of credit institutions continued to increase in the first half of 2022, mostly due to the rise in received deposits, which was used predominantly to enhance lending activity. The years-long upward trend in the quality of total exposure persisted, largely due to the impact of the fall in non-performing loans to non-financial corporations. The business performance of credit institutions in the first half of 2022 was better than in the same period in the previous year, owing to the less burdensome credit loss costs and the growth in non-interest income.

At the end of the first half of 2022, there were 21 credit institutions operating in the Republic of Croatia: 20 banks and one housing savings bank. From the end of 2021, the number of credit institutions fell by two as a result of a merger of two housing savings banks with their parent banks.[6] In addition, there was one branch of an EU credit institution operating in the country, while more than 200 institutions from the EU and the European Economic Area had notified the CNB of their intentions regarding the direct provision of mutually recognised services.[7] With the decrease in the number of housing savings banks, the share of banks in total banking system assets rose further, to 99.6% of total assets of credit institutions. The slight decrease in the assets of credit institutions in the majority ownership of foreign shareholders, to 88.6%, and the growth in the assets of domestic state-owned banks, to 8.0%, were mostly related to the change in ownership of Nova hrvatska banka d.d.

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

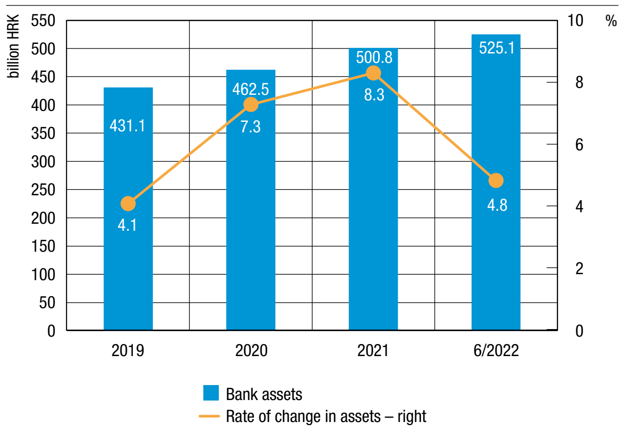


Source: CNB.

6 Raiffeisen stambena štedionica d.d. merged with Raiffeisenbank Austria d.d. on 2 May 2022, while PBZ stambena štedionica d.d. merged with Privredna banka Zagreb d.d. on 15 June 2022.

7 Updated information on credit institutions operating in the territory of the Republic of Croatia may be found here.

Figure 12.2 Assets of credit institutions



Source: CNB.

Resolution proceedings against Sberbank d.d. were opened on 1 March 2022 and ended on 13 April 2022 and Hrvatska poštanska banka became its new owner. The bank started to operate on 14 April 2022 under the name of Nova hrvatska banka d.d.

Following the Russian invasion on Ukraine, the European Union and the United States of America adopted a sanctions package that has also had a quick and significant effect on the operations of Sberbank d.d. Due to a rapid liquidity deterioration, the European Central Bank (ECB), which directly supervises this bank, announced on 28 February, that Sberbank d.d. was failing or likely to fail.

In accordance with its mandate, the ECB notified the Single Resolution Board (SRB), the central resolution authority within the Banking Union, of this assessment. The SRB determined that the bank was failing or likely to fail and adopted the decision on a moratorium on the operations of Sberbank d.d., based on which the CNB also adopted its decision.

The decision on the resolution of Sberbank d.d. by sale was adopted to ensure financial stability in the Republic of Croatia, avoid economic disruptions and protect the public interest and the clients of this bank.

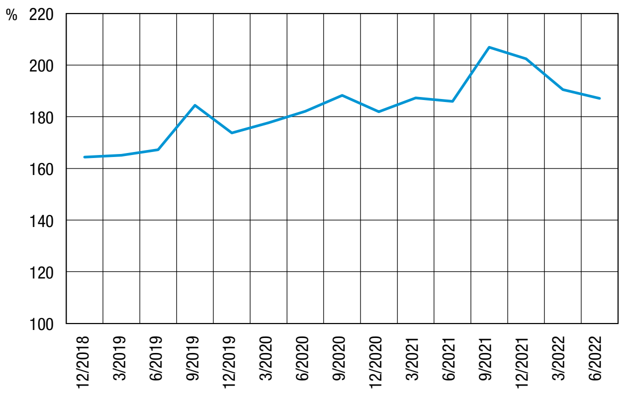
The assets of credit institutions rose by HRK 24.2bn (4.8%) in the first half of 2022, standing at a record high of HRK 525.1bn. The increase in received deposits (HRK 26.0bn or 6.2%), primarily those of households and non-financial corporations, is the biggest source of asset growth.

Credit institutions used the bulk of the asset growth to increase loans and advances (net) by HRK 22.5bn (7.4%).[8] The sharpest increase was seen in loans to non-financial corporations (HRK 9.9bn or 12.4%), particularly those engaged in trade, energy supply and construction. Household loans continued to grow (by HRK 5.1bn or 3.8%), driven by further growth of housing loans, supported by credit institutions' participation in the government housing loans subsidy programme, as well as the mild rise in general-purpose cash loans.

When compared with the growth in loans and advances, changes in other major assets items were much smaller. Banks' investment in securities fell marginally, while the sharp increase in cash, which lasted for the past two years, almost came to a halt in the first half of 2022. However, cash remained at a high 21.7% of total assets and continued to have a favourable impact on most key performance indicators of credit

8 Loans and advances are debt instruments held by the credit institution that are not securities. They include loans, deposits and advances.

Figure 12.3 Liquidity coverage ratio (LCR)



Source: CNB.

institutions. This was especially reflected in the high level of the liquidity coverage ratio, which stood at 187.1%, much above the prescribed minimum of 100%, with all credit institutions meeting the prescribed minimum liquidity requirements.

The years-long trend of improvement in the quality of assets persisted owing to a fall in non-performing loans and the impact of new loans. The non-performing loans (NPL) ratio fell from 4.3% at the end of 2021 to 3.8% at the end of the first half of 2022. Despite the positive trend, the quality of loans at the system level remained below the EU average (1.8%).[9] In preceding years, the improvement in overall credit quality was predominantly due to a sale of non-performing receivables. However, this contribution was almost absent in the first half of 2022 as the NPL ratio decreased mostly owing to repayments and improvement in the quality of credit exposures and their reclassification as performing exposures. Some credit institutions continue to face high NPL ratios and six of them have an NPL ratio above 10%.

The developments in total NPLs were largely influenced by their decline in the non-financial corporate sector, in which the NPL ratio fell from 9.9% to 7.8%. Improved loan quality was noticeable in loans to all major activities in that sector. The loan quality in the household sector improved as well, with the share of NPLs falling from 6.6% to 6.1%. In addition to the rise in loans to households, the value of this ratio was mostly affected by the ongoing improvement in the quality of housing loans, where the NPL ratio stood at 3.1%

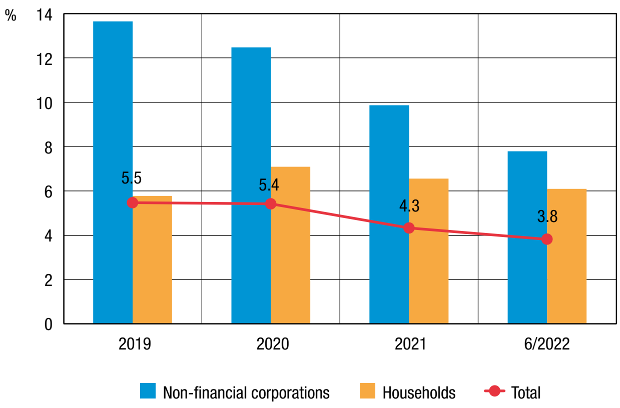
The coverage of NPLs by impairment remained very high (65.1%) and much above the average NPL coverage within the EU banking system (43.8%).

In contrast with the favourable trends in the non-performing share of the credit portfolio, credit risk associated with performing loans is still higher than before the pandemic and has yet to show signs of improvement. More specifically, performing loans in value impairment stage 2 accounted for 13.1% of total loans and advances at the end of the first half of 2022.[10] The share of stage 2 loans, which started to rise under the influence of the pandemic, remained high and even drifted up in the first half of 2022. This indicates the recognition of increased credit risk and heightened caution of credit institutions in its assessment relative to the pre-crisis period.

9 Data on the values of key performance indicators of the EU banking system may be found here.

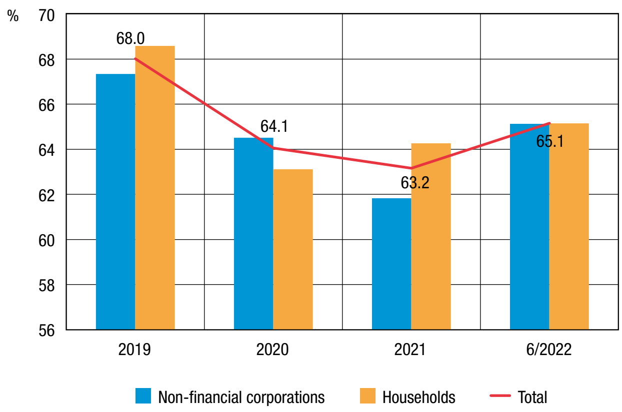
10 Each instrument that is subject to the calculation of expected credit loss, which includes all debt instruments measured at amortised cost and at fair value through other comprehensive income, is classified in one of the three stages of value impairment. Instrument is classified in stage 2 if there is a significant increase in credit risk (although still not in default), where the expected loss is calculated for the entire lifetime of the instrument.

Figure 12.4 Share of non-performing loans in total credit institution loans



Source: CNB.

Figure 12.5 Coverage of non-performing loans by impairment

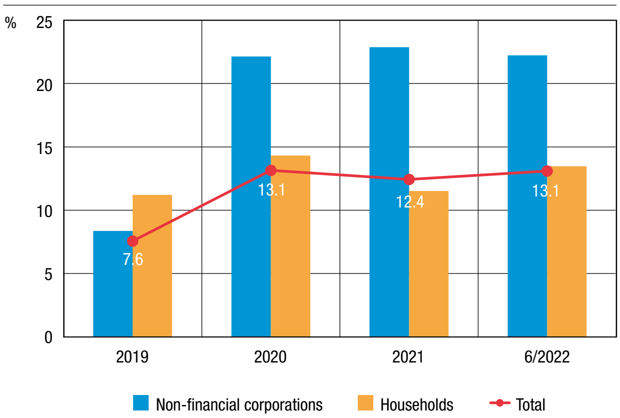


Source: CNB.

At the end of the first half of 2022, credit institutions operated at a profit that totalled HRK 3.1bn. Profit rose by HRK 0.5bn (19.3%) from the same period in 2021, largely due to income from the reversal of impairment for credit losses and the increase in net operating income. With increased profit, profitability indicators also increased – the return on assets (ROA) rose to 1.2% and the return on equity (ROE) to 9.5%. The reversal of impairment for credit losses, in particular for non-performing loans to non-financial corporations, generated a profit for credit institutions, while expenses on impairments for household exposures were much lower than in the same period of 2021.

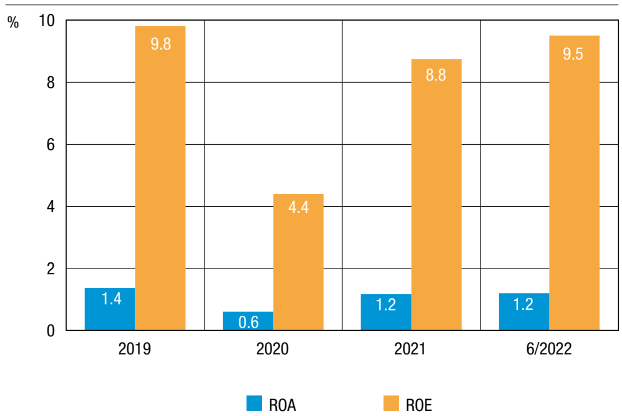
Total net operating income grew by 2.9%, due entirely to the growth in non-interest income, while interest income, the main source of income, continued to decline. Net income from fees and commissions grew the most (18.6%), with its share reaching a record high of 25.3% of total net income. This was also due to the smaller share of net interest income, which dropped to 61.2% of total net income. Interest income fell by

Figure 12.6 Share of loans in value impairment stage 2 in total credit institution loans



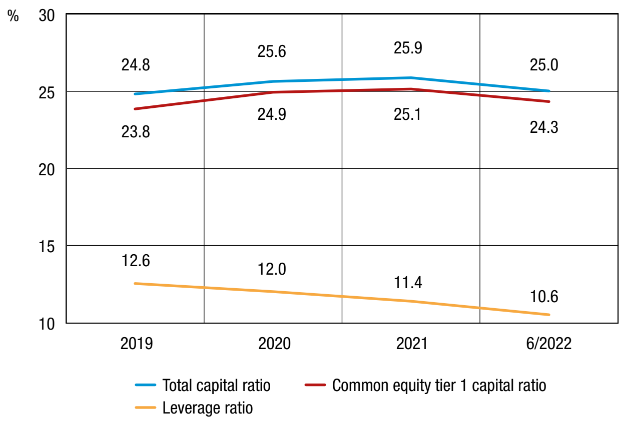
Source: CNB.

Figure 12.7 Bank return on assets (ROA) and return on equity (ROE)



Source: CNB.

Figure 12.8 Key indicators of credit institution capitalisation



Source: CNB.

3.2% from almost all instruments and sectors. Interest income from general-purpose cash loans decreased the most, while the rise in housing loans did not lead to an increase in interest income on these loans. Interest expenses, primarily expenses on household deposits with agreed maturities, also continued to trend downwards. The higher general operating costs triggered a deterioration in cost effectiveness, with the cost-to-income ratio rising and standing at 53.3%. Both this and the profitability indicator continued to be under the key influence of leading banks.

The very high values of key indicators of banking system capitalisation that were recorded in 2021 due to the effects of regulatory adjustments and the macroprudential measures taken to mitigate the effects of the pandemic had dropped marginally by the end of the first half of 2022. The total capital ratio went down from 25.9% to 25.0% as a result of the fall in own funds (HRK 2.3bn or 3.6%), which was mostly due to the disappearance of the accumulated other comprehensive income from the capital of credit institutions. More specifically, the growth of interest rates and the fall in the prices of securities in the portfolio measured at fair value through other comprehensive income resulted in an unrealised loss and ultimately a decrease in total capital. The maintenance of high capitalisation was aided by a decrease in total risk exposure, which was driven by increased channelling of exposures into low risk items. This resulted in a further fall in the value of the average credit risk weight, from 41.8% to 40.0%. All credit institutions reported a total capital ratio above the prescribed minimum of 8% and ten of them, which accounted for 83.8% of the total system assets, boasted a total capital ratio of above 20%. The total capital ratio is still among the highest in EU member states and much above the EU average (19.00%).

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
EC – European Commission
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
ROA	– return on assets
ROE	– return on 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

HNB

HNB

ISSN 1848-7505