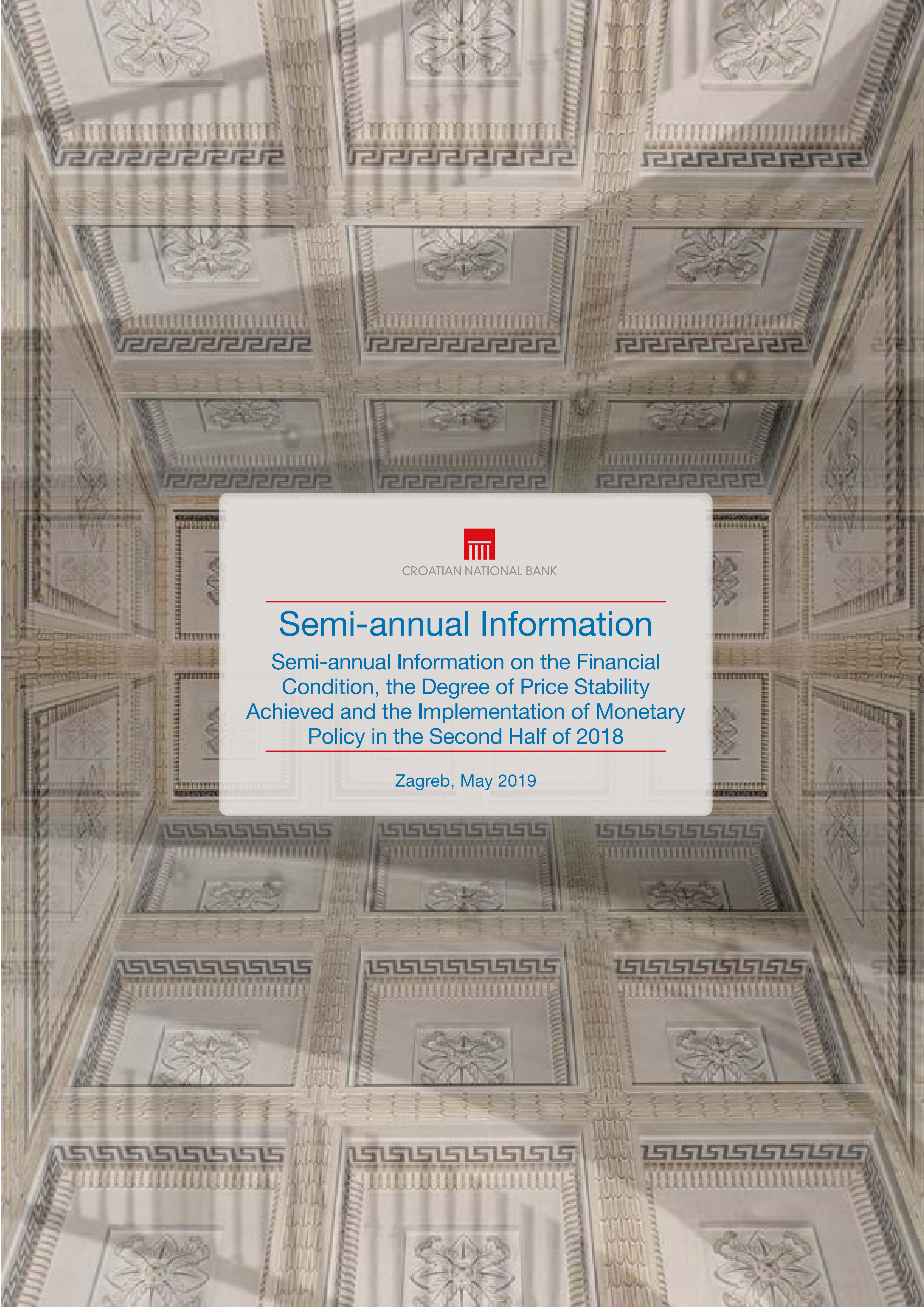

CROATIAN NATIONAL BANK

Semi-annual Information

Semi-annual Information on the Financial Condition, the Degree of Price Stability Achieved and the Implementation of Monetary Policy in the Second Half of 2018

Zagreb, May 2019

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Contents

1 Summary

Economic activity grew by 2.6% in the second half of 2018 from the same period in 2017 but slowed down towards the end of year. The real GDP growth was mainly driven by rising personal consumption, which reflects the continuation of favourable developments in the labour market, increased borrowing and high consumer confidence. A positive contribution also came from exports of goods and services, although their growth dynamics slowed down markedly from the first half of year. During the second half of 2018, and notably at the end of the year, total investment activity intensified. Government consumption was another positive contributor to economic growth. Strong domestic demand resulted in high growth of imports, with the contribution of net exports to the increase in real GDP remaining negative.

Favourable labour market trends continued. The broad-based rise in employment continued, with the largest contribution to total increase of employment coming from private sector service activities. At the same time, unemployment continued to decrease, with the seasonally adjusted registered unemployment rate reaching 9.3% of the labour force in the second half of 2018. Wages continued to drift up – as a result, the average gross wage was 4.4% higher in the second half of 2018 than in the same period of 2017. Real net wages grew less rapidly (3.9%) due to the annual growth of the consumer price index.

Consumer price inflation went down in the second half of the year from 2.4% in June to 0.8% in December 2018, due mainly to the slowdown in the annual growth rate in energy prices and, to a smaller extent, to the decrease in the annual rate of change in the prices of non-processed food and industrial goods. In contrast, core inflation accelerated slightly, from 0.7% in June to 1.0% in December 2018 due to a larger contribution of processed food prices (attributable mainly to the rise in the producer prices of tobacco products and excise duties in December) and market-based service prices.

The surplus in the current and capital account grew slightly in the second half of 2018 from the same period in 2017, as a result of a further increase in net exports of services and an improvement in the sum balance in the secondary income account and the capital account. However, the widening of the foreign trade deficit and unfavourable trends in the primary income account had an opposite effect. The financial account of the balance of payments continued to be marked by net capital outflows due to the decrease in net foreign debt liabilities and the rise in net inflows of equity investments. On the other hand, the relative indicators of external debt and the international investment position improved steadily.

The CNB monetary policy remained expansionary in the second half of 2018, supporting the high liquidity in the monetary system and maintaining the stability of the nominal kuna/euro exchange rate. The increase in liquidity was spurred predominantly by the purchase of foreign exchange from banks, which alleviated appreciation pressures on the domestic currency and added to gross international reserves. In such a setting, the several-year improving trend in domestic financing conditions continued, while the easing of credit standards and the growth in demand for loans resulted in the steady growth of placements to domestic sectors.

International reserves of the CNB recorded the second largest annual growth in absolute terms in 2018. The factors behind the strong annual increase in reserves included a significant purchase of foreign currency from banks, ensuring the stability of the domestic currency exchange rate. A satisfactory level of earnings from the investment of international reserves was generated in the environment of a prolonged period of negative euro interest rates. At the same time, the key mandate in international reserves management – safety and liquidity – was successfully fulfilled.

Bank assets and profitability trended up in 2018 and the capitalisation of the banking sector remained high. Mainly as the outcome of stronger lending to households, the rise in loans made a significant contributions to the growth in total assets of 4.4%. Bank profits grew on account of smaller credit risk expenses, with lower expenses related to the Agrokor Group having a key impact. Bank earnings in 2017 were heavily burdened by expenses related to credit risk, arising from operating difficulties in the Group. With these expenses trending downward in 2018, the return on average assets (ROAA) and the return on average equity (ROAE) recovered, increasing to 1.4% and 8.6% respectively.

With regard to the credit risk exposure, the share of non-performing loans continued to trend downwards, amounting to 9.8% at the end of 2018, with the sale of claims having a key effect on such developments. Total capital ratio decreased to 22.9% on account of heightened business activities of banks and the rise in credit risk exposure. Although lower, total capital ratio remained high, and even if all exposures were fully irrecoverable, it would still amount to a high of 19.9%.

After a deficit of about HRK 0.7bn (ESA 2010) in the first half of the year, the second half of 2018 saw a general government surplus of HRK 1.4bn, which was considerably lower than the surplus of HRK 5.2bn in the same period of 2017, due to a much faster growth in total expenditures (12.1%) relative to total revenues (7.0%). The public debt-to-GDP ratio stood at 74.6% at the end of December 2018, down by 1.7 percentage points from June 2018.

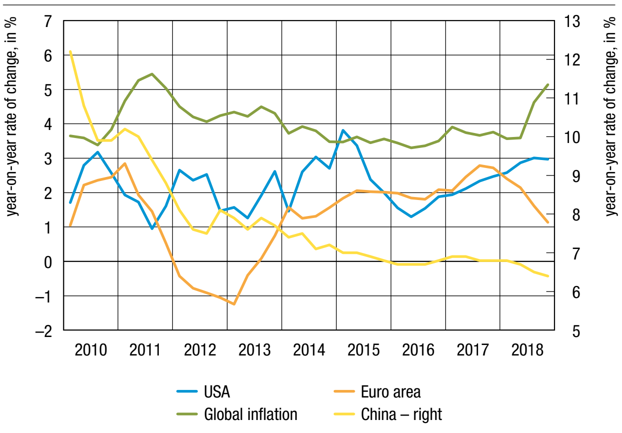
2 Global developments

Global economic growth slowed down markedly in the second half of 2018, in particular among developed countries, accompanied by a slump in global trade. The slowdown in economic activity was particularly evident in euro area countries, particularly in Germany, this trend spilling over to other European markets. The major emerging market economies also saw a noticeably slower growth, especially China, in part also due to increased trade tensions with the USA. The crisis in some Latin American and European emerging market economies deepened further. Global inflation trended up in the second half of 2018, mainly in the crisis-hit emerging market economies, and remained subdued in the majority of developed countries. Notwithstanding the eased monetary policies prevailing in most of the large economies, global financing conditions began to deteriorate on account of intensified risks and uncertainties.

In contrast to most other large developed economies, the US economy continued to grow at a high annual rate of 3.0% in the second half of 2018. This was mostly due to strong personal consumption, which continued to be the main driver of economic activity. The US labour market remained highly dynamic, with a very low unemployment rate. A significant contribution to the rise also came from private sector investments, owing to tax disburdening, with the contribution of government consumption being somewhat stronger than in previous periods. By contrast, the contribution of net exports of goods and services remained negative. Against this background, domestic inflationary pressures mounted, so that inflation actually exceeded the Fed's target level, reaching 2.4% on average in the second half of 2018.

As to the euro area, following a rise in real GDP of 2.3% in the first half of 2018, the economic growth slowed down to 1.4% in the second half of the year, this trend being widespread across the member states. The strongest individual contribution to slower growth was made by the largest members – Germany, Italy and France, but the relative slowdown was mostly felt in the countries that had had above-average growth in previous periods, such as Ireland. Such trends in the euro area were mostly driven by external factors, in particular rising global uncertainty, which adversely affected the export sector, and individual domestic factors in some countries. Specifically, the German economic activity was adversely impacted by factors related to the adjustment of the automobile industry to new environmental rules, while in France economic activity was impacted by numerous protests by the "yellow vest" movement. The Italian economy was exposed in the reference period to heightened uncertainty due to the disagreement with EU institutions on the fiscal policy, which in turn contributed to the deterioration of the economic sentiment and financing conditions.

Figure 2.1 Economic growth in selected markets and global inflation



Sources: Eurostat, BEA, NBS and IMF.

2.1 Croatia's main trading partners

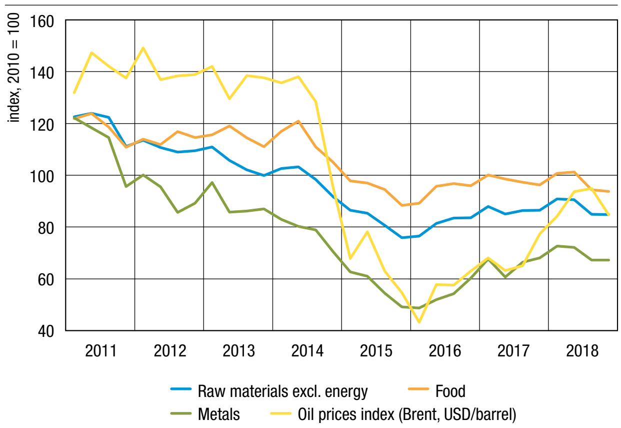
Most of Croatia's major trading partners, particularly those from the euro area, saw slower growth in the second half of 2018. This mostly refers to Italy, which was in recession in the second half of 2018. In addition, on a broader European level, economic activity was significantly affected by the weakening of the German economy, whose annual growth halved from 2.0% in the first half of the year to 0.9%. Austria's economic growth decelerated, the same trend, albeit somewhat weaker, being observed also in Slovenia.

As regards trading partners in the SE region, most of them (Serbia and Bosnia and Herzegovina included) continued to record a mild economic slowdown in the second half of 2018 from the first half of the year. Nevertheless, they remained the trading partners of Croatia that had the most dynamic economic growth.

2.2 Prices, exchange rates and financing conditions

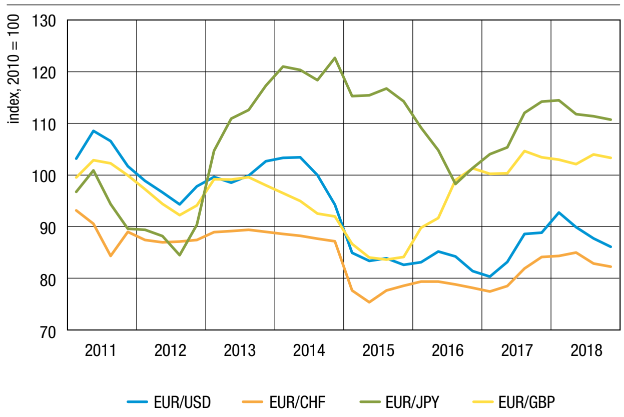
Global raw material prices decreased in the second half of 2018. The trends in the average price of Brent crude oil in the global market were highly volatile. After heightened concerns over the global economic outlook and the intensification of protectionist trade measures, the price of oil decreased from USD 79 at the end of June to about USD 70 in mid-August. The price of oil continued to rise again in the second half of August, mostly driven by the expectations of a possibly weaker oil supply in the world market due to the forthcoming US sanctions imposed against Iran's oil exports, the decline in oil production in Venezuela and unstable crude oil supplies from Libya. The price of crude oil reached USD 86 early in October; following this month, the growth trend was halted and crude oil prices had fallen to USD 53 by the end of 2018. The drop in the price of oil was driven by the increase in production and stockpiles in the USA and higher production by the other largest oil producers. In addition, the drop in Iranian exports following the imposition of US sanctions was smaller than expected. At the same time, expectations of decelerated growth prevailed on the demand side due to intensified trade tensions and indications of global growth slowdown. Non-energy raw material prices, including the prices of agricultural

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



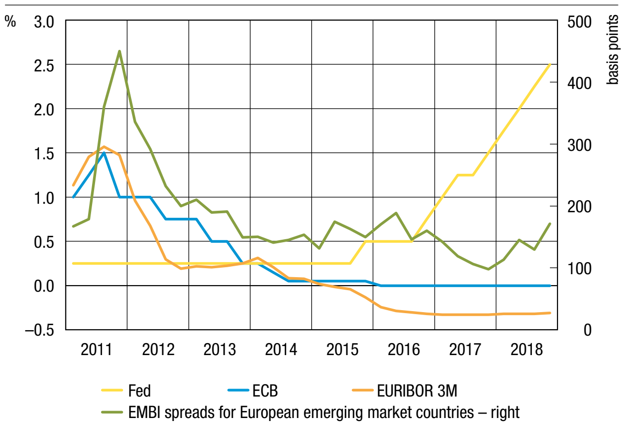
Sources: IMF and Bloomberg.

Figure 2.4 Exchange rates of individual currencies against the euro



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

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



Source: Blomberg.

raw materials, foods products and metals also edged down in the second half of 2018.

In the second half of 2018, divergence in the monetary policies of the US and the euro area widened even further. The Fed raised its benchmark interest rate by a total of 0.5 percentage points on two occasions in that period. By contrast, the ECB left its benchmark interest rate unchanged, but reduced its bond purchase programme to EUR 30bn a month in the third quarter and to EUR 15bn a month in the fourth quarter and then wound down the programme.

Financing conditions for European emerging market countries deteriorated further during the second half of 2018. The EMBI index for European emerging markets increased by about 30 percentage points in the reference period from the end of 2017. The intense uncertainty in financial markets was fuelled by heightened trade and geopolitical tensions as well as by concerns regarding the economic situation in Turkey.

In the second half of 2018, the euro weakened against the major currencies on the global foreign exchange market, except against the pound sterling, which was adversely affected by uncertainties regarding Brexit. Hence, the exchange rate of the US dollar against the euro fell to EUR/USD 1.15 at the end of 2018, down by 1.5% from the end of the first half. The US dollar was supported by optimism driven by favourable developments in the US economy and higher demand for the relatively safe US assets, since investors are showing generally lower risk-appetite. Political uncertainty in Italy, which caused concerns with regard to the sustainability of public finance, and adverse economic indicators in the euro area contributed to the weakening of the euro against the US dollar. At the same time, a drop in the risk appetite resulted in the appreciation of the Swiss franc against the euro. The EUR/CHF exchange rate stood at 1.13 at the end of 2018, down by 3% compared with the end of June.

3 Aggregate supply and demand

The annual growth of real GDP stood at 2.6% in the second half of 2018, slowing down slightly compared with the performance in the first six months. Personal consumption continued to contribute the most to economic growth on an annual basis, this contribution being slightly weaker than in the first half of 2018. The rise in economic activity was also driven by the exports of goods and services, the dynamics of this GDP component slowing down in the second half of the year. Concurrently, investment activity intensified, and government consumption made a somewhat stronger positive contribution to the real GDP growth.

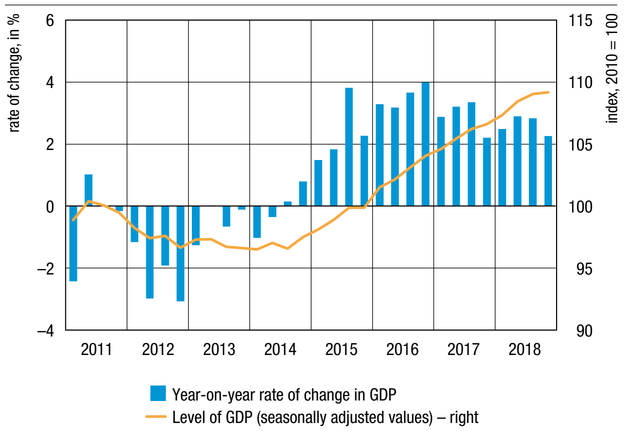
In the second half of 2018, gross value added (GVA) moved with similar dynamics as in the first half of the year, increasing annually by 2.1%. The increase was primarily due to GVA growth in trade, transportation and storage, and accommodation and food service activities. GVA also recorded annual growth in all other categories, with the exception of industry.

3.1 Aggregate demand

The average annual growth rate of the real exports of goods and services in the second half of 2018 was at a level similar to that recorded in the first half of 2018 (2.8%). However, total exports continuously trended downward on the quarterly level.

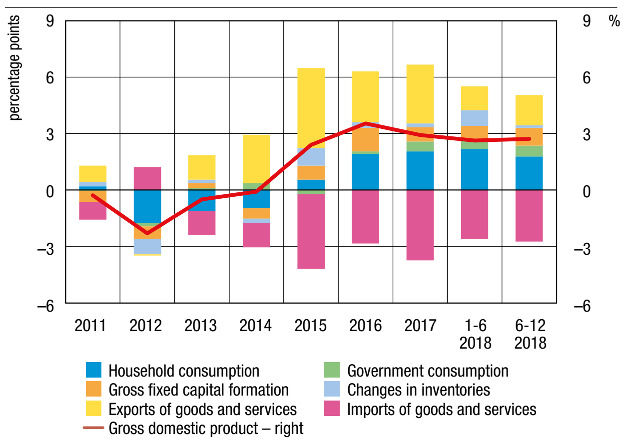
The annual growth of goods exports slowed down to 5.2% in the third quarter of 2018, and nearly held steady at the end of the year (0.3%) due to a strong quarterly fall. Moreover, the nominal data on the trade in goods show a rise in goods exports in the second half of 2018 in all main industrial groupings, except non-durable consumer goods and exports of

Figure 3.1 Gross domestic product
real values



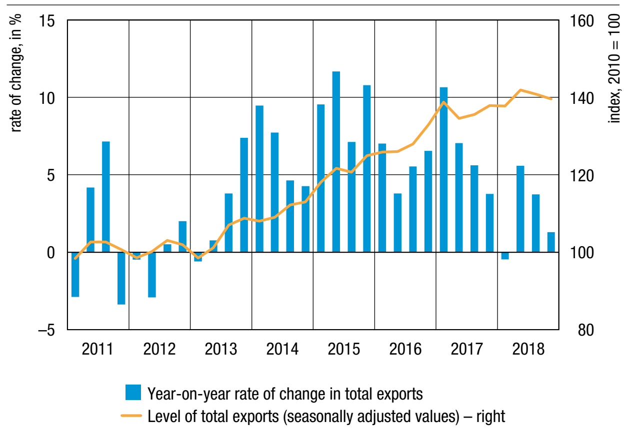
Source: CBS (seasonally adjusted by the CNB).

Figure 3.2 GDP rate of change
contributions by components



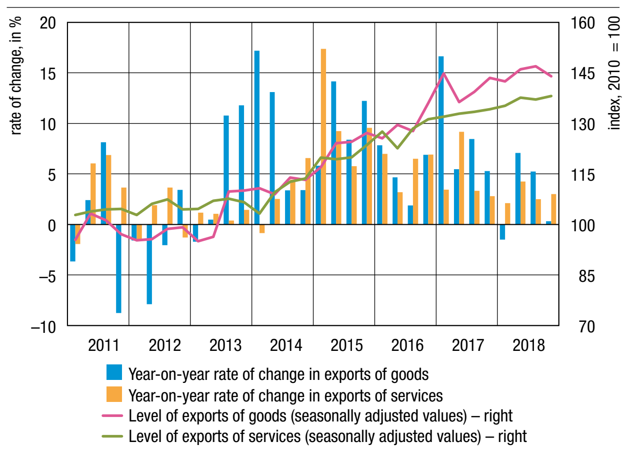
Source: CBS.

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).

energy. With regard to the exports of services, a slightly weaker performance in the third quarter of 2018 resulted in a lower annual growth rate in the second half of 2018 than in the same period in 2017. As a result, total exports grew by 2.8% in 2018, compared with the growth of 6.4% in 2017.

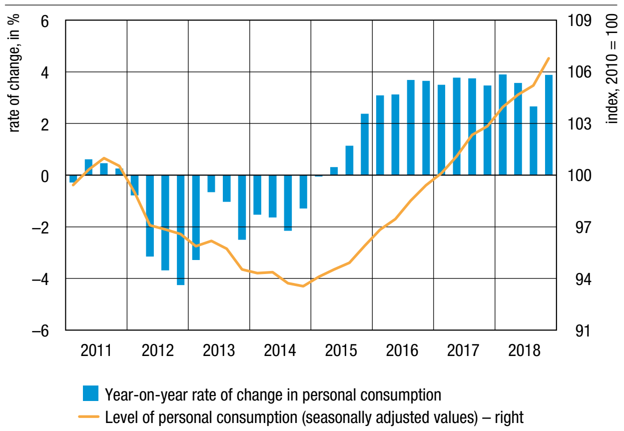
Personal consumption continued to increase in the second half of 2018, showing a noticeable upturn at the end of the year. However, its average annual growth rate decreased slightly, to 3.3% from 3.7% in the first half of the year. The rise in household consumption reflected the continued favourable trends in the labour market, accompanied by the growth of employment, while the unemployment rate continued to decrease. In addition, wages also continued to grow. Positive contributions to the growth of personal consumption also included increased borrowing and further rise in consumer confidence which grew at a steady pace towards the year-end. If analysed at the level of the whole of the year, personal consumption grew by 3.5%, making the most significant contribution to growth in total economic activity.

The growth of gross fixed capital formation picked up in the second half of 2018 to 4.9% from 3.3% in the six months previously. The annual growth of capital investments picked up substantially in the fourth quarter of 2018, to 6.1% from the 3.7% recorded in the third quarter, primarily as a consequence of the growth in general government investments. As a result, investment activity increased by 4.1% in 2018, from 3.8% in 2017.

The annual increase in government consumption accelerated to 3.1% in the July-December period of 2018, from 2.6% the first six months of the same year, which may be attributed to the continued growth in the number of employed persons in public and government services and increased growth of intermediate consumption. In the whole year, government consumption increased by 2.9% and thus made a positive contribution to total growth of economic activity.

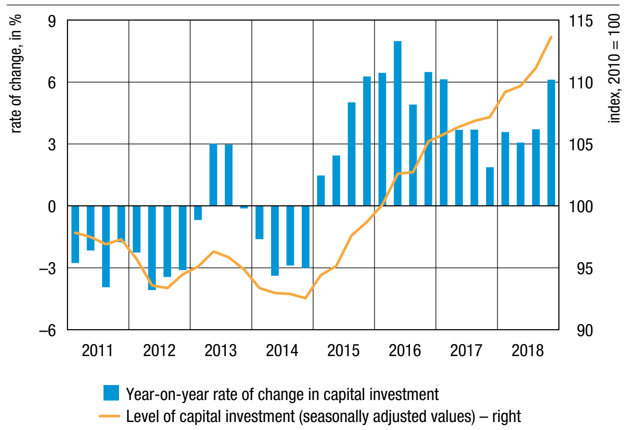
The annual growth in imports of goods and services accelerated to 5.8% in the second half of 2018, from 5.1% in the first six months. Their faster growth primarily reflects a significant increase in goods imports in the second half of the year, mainly brought about by stronger domestic demand.

Figure 3.5 Personal consumption
real values



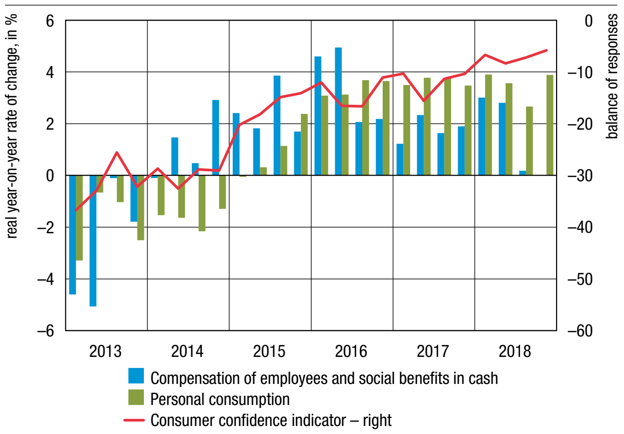
Source: CBS (seasonally adjusted by the CNB).

Figure 3.7 Gross fixed capital formation
real values



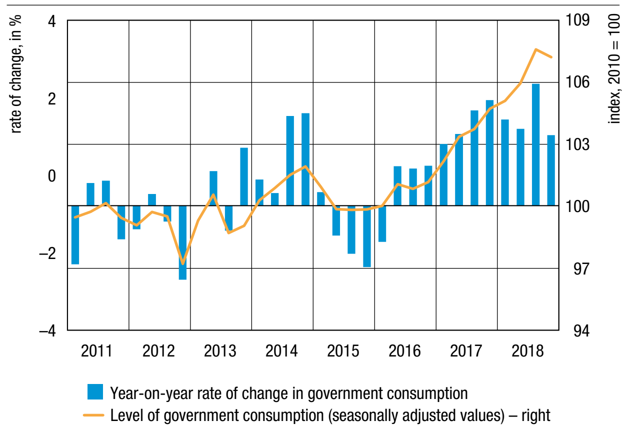
Source: CBS (seasonally adjusted by the CNB).

Figure 3.6 Determinants of personal consumption
real values and index



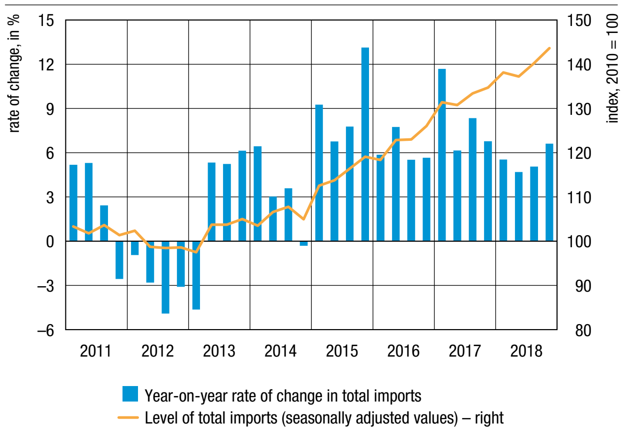
Note: Real values of compensation of employees and social benefits in cash were calculated by deflating nominal values using the personal consumption deflator.
Sources: CBS, Ipsos and CNB.

Figure 3.8 Government consumption
real values



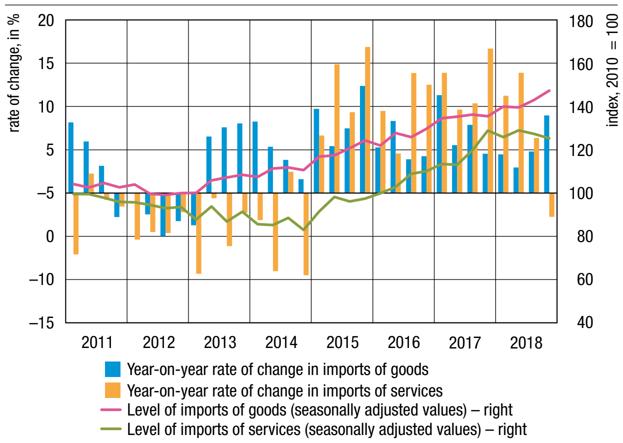
Source: CBS (seasonally adjusted by the CNB).

Figure 3.9 Imports of goods and services
real values



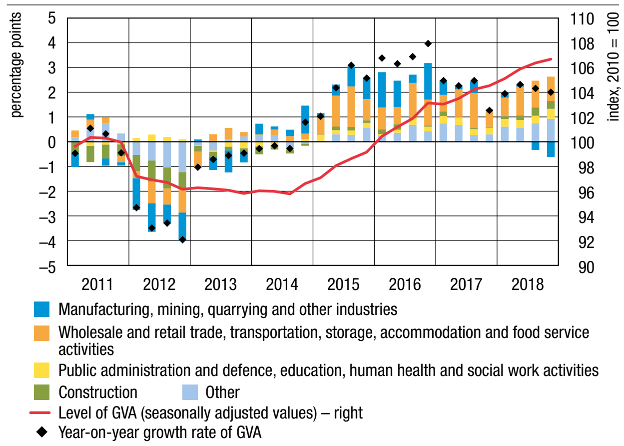
Source: CBS (seasonally adjusted by the CNB).

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).

The nominal data on trade in goods show the rise in imports in all main industrial groupings in the reference period, lower annual growth being recorded in intermediate goods and non-durable consumer goods. The growth rate of total imports stood at 5.5% in 2018. Compared with 2017, it contributed significantly to the increase of the negative contribution of net exports to the real GDP growth.

3.2 Aggregate supply

From July to December 2018, GVA continued moving at a dynamics similar to that in the first half of the year, and recorded a growth of 2.1% due to the rise in all components, except industry. The largest contribution to GVA growth came from retail trade, transportation and tourism, reflecting a continued improvement in household purchasing power and favourable developments in tourism. Gross value added grew by 2.1% in 2018 or at the same rate as in 2017.

4 Labour market

4.1 Employment and unemployment

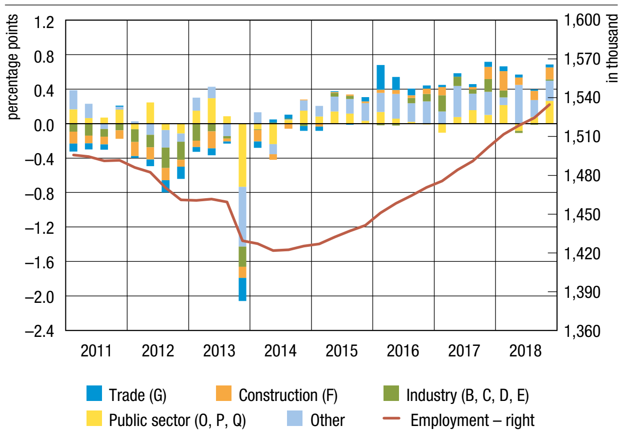
Positive trends in the labour market continued in the second half of 2018. As a result, the number of employed persons was 2.2% higher in the July-December period of 2018 than in the same period in 2017. The employment growth was broadly based, with the largest contribution to total increase of employment coming from private sector service activities.

The employment growth was also reflected in the movement in the number of unemployed persons, which continued to decrease in the second half of 2018. This fall was more pronounced than in the first six months of 2018 on account of higher employment based on work contracts than removal from the register for non-compliance with legal provisions, registration cancellation and failure to report regularly. As regards the annual dynamics, the average number of unemployed persons was 21.4% lower in the second half of 2018 than in the same period in 2017 (by about 38,000 persons).

In accordance with the above developments, the unemployment rate continued to decrease, hitting its record low. The average registered unemployment rate stood at 9.3% in the July-December period of 2018, down by 2.2% percentage points from the same period in 2017. The average ILO unemployment rate amounted to 8.1% in the July-December period of 2018, decreasing by 2.0 percentage points from the year before; the decrease in employment accelerated towards the end of the year after being stagnant in the third quarter of 2018.

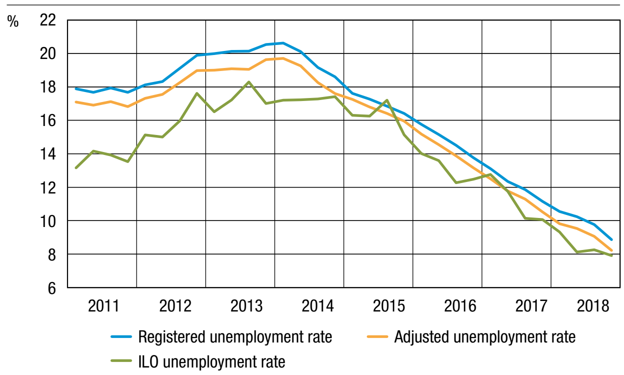
Furthermore, data from the Labour Force Survey show that the unemployment rate in the second half of 2018 remained at the level seen in the first six months (46.9%), mildly trending up on an annual basis. The participation rate (i.e. the share of labour force in the working age population) continued to trend

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



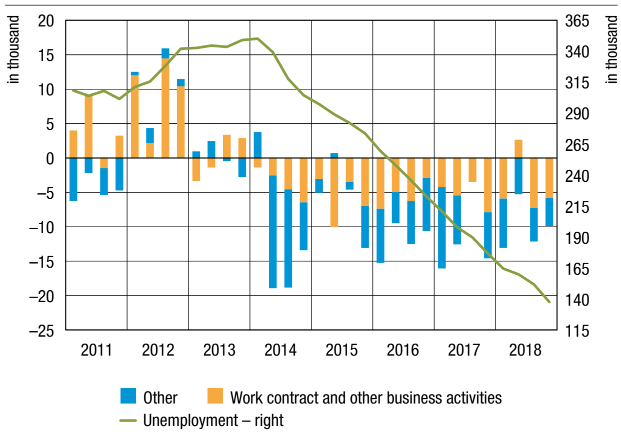
Source: CPII (seasonally adjusted by the CNB).

Figure 4.3 Unemployment rates
seasonally adjusted data



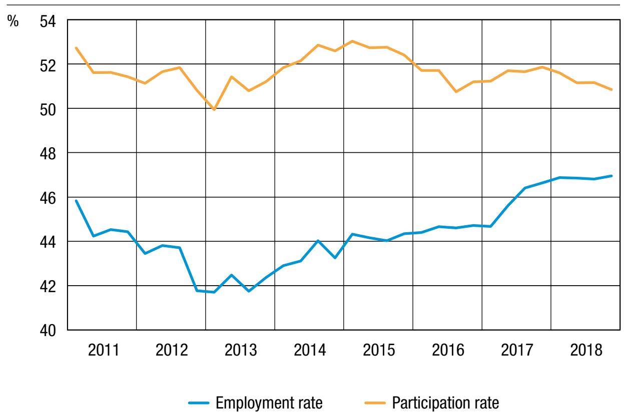
Notes: The adjusted unemployment rate is the CNB estimate and is calculated as the share of the number of registered unemployed persons in the working age population estimated as the sum of unemployed persons and persons insured with the CPII. Since January 2015, the calculation of the registered unemployment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

Figure 4.2 Total unemployment and net unemployment inflows
seasonally adjusted data



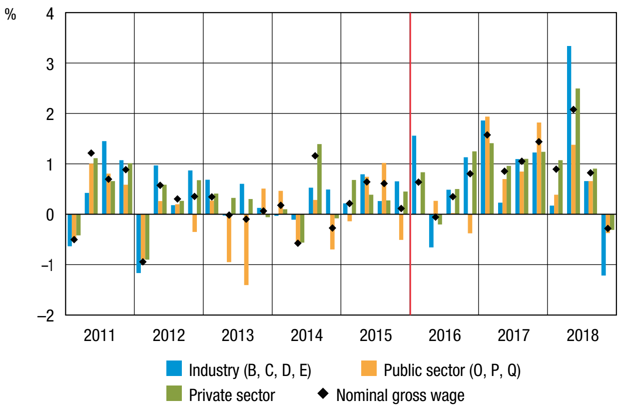
Source: CES (seasonally adjusted by the CNB).

Figure 4.4 Labour Force Survey
seasonally adjusted series



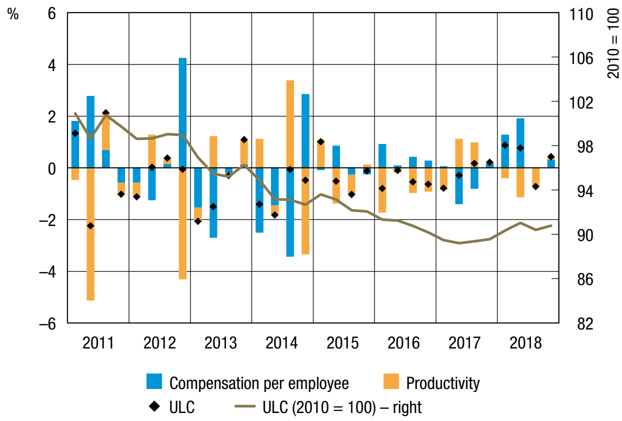
Source: CBS (seasonally adjusted by the CNB).

Figure 4.5 Average nominal gross wage by NCA activities
seasonally adjusted data, contributions to the quarterly rate of change



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

Figure 4.6 Compensation per employee, productivity and unit labour costs
seasonally adjusted data, quarterly rate of change and levels (2010 = 100)



Note: Productivity growth carries a negative sign.
Sources: CBS and Eurostat (seasonally adjusted by the CNB).

downward at a pace similar to that in the first half of 2018 and on average stood at 51.0%.

4.2 Wages and unit labour cost

Wages continued to trend upwards in the second half of 2018, although at a slower pace than in the first six months of 2018. If analysed on an annual basis, nominal gross and net wages picked up on average by 4.4% and 3.9% respectively in the second half of 2018. It is noteworthy that the wage growth dynamics was stronger in the private sector than in the public sector.

National accounts data indicate that employee compensation stagnated in the second half of 2018, after a sharp rise in the first two quarters. At the same time, the increase in labour productivity slowed down, with unit labour costs remaining mostly unchanged from the first six months of 2018. Unit labour costs were up by 1.3% from the second half of 2017.

5 Inflation

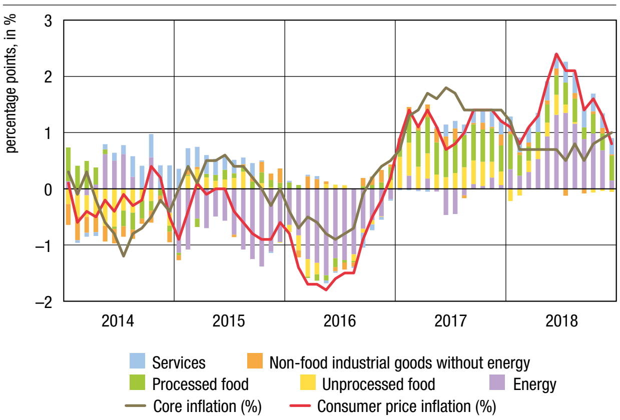
The average annual consumer price inflation increased to 1.5% in 2018 from 1.1% in 2017. Domestic inflationary pressures from the demand side were slightly higher in 2018, as suggested by a modest increase in positive output gap. By contrast, domestic cost pressures arising from the increase in unit labour costs strengthened considerably. After total consumer price inflation picked up in the first half of the year, mainly due to an increase in the annual rate of growth in energy prices (electricity and refined petroleum products), the second half of the year witnessed a slowdown in inflation from 2.4% in June 2018 to 0.8% in December 2018. This was mostly brought about by a slowdown in the annual growth rate in the prices of energy and, to a smaller extent, by the decrease in the annual rate of change in the prices of non-processed food and industrial goods.

The deceleration in the annual increase in energy prices was particularly pronounced at the end of 2018 due to a sharp decrease in the prices of crude oil in the global market that passed through to domestic retail prices of refined petroleum products. As a result, the average price of a barrel of Brent crude oil stood at USD 56 in December, down by 30% from October. This was to a large extent due to higher supply in November brought about by the increase in production in the USA and the other largest oil producers and by the expectations of the decrease in demand prevailing in December. Overall, the contribution of energy to inflation fell from 1.3 percentage points in the middle of the year, to only 0.2 percentage points at the of 2018. In non-processed food, the annual rate of growth in the prices of vegetables, fruit and meat decelerated substantially in the second half of the year, so that the contribution of this component to the overall inflation was slightly negative at the end of the year. The component of non-food industrial goods without energy has for quite some time provided only a small contribution to inflation, ranging between –0.1 and 0.1 percentage points in the second half of 2018.

Core inflation mildly accelerated, from 0.7% in June 2018 to 1.0% in December 2018, mainly as a result of a moderate growth in the contribution of the prices of processed food (including alcoholic beverages and tobacco) and market-based service prices. Faster annual growth in the prices of processed food in the second half of 2018 resulted predominantly from the faster annual increase in tobacco prices (attributable to the rise in the producer prices of tobacco products and excise duties in December). A moderate growth in the contribution of the prices of services to core inflation is a continuation of the trend observed since mid-2017. Such developments reflect, among other things, imported and domestic inflationary pressures, such as increases in the prices of refined petroleum products and unit labour costs. As a result, the second half of 2018 was marked by an accelerated growth in the prices of telephone services, passenger transport by air, catering services and insurance connected with transport.

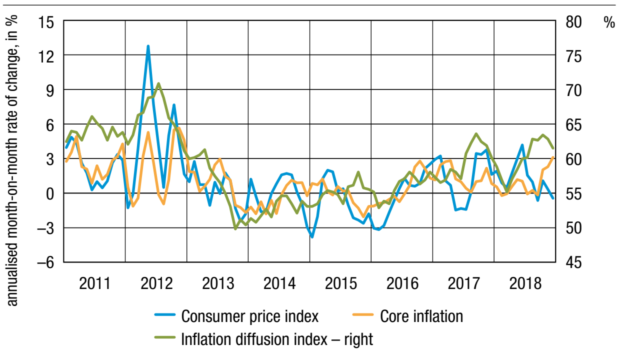
The implicit deflator of GDP went down from 2.1% in the

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



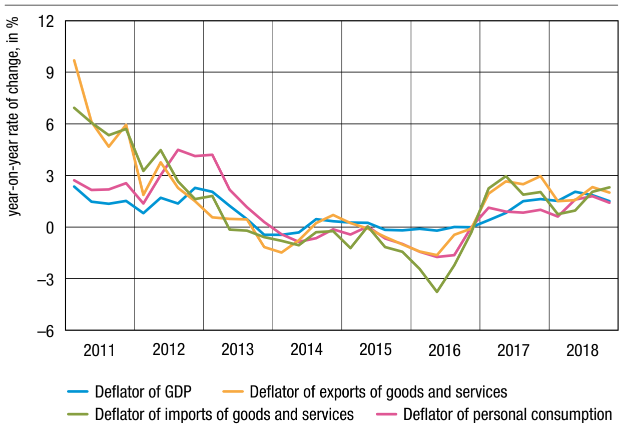
Notes: Core inflation does not include agricultural product prices, energy prices and administered prices. Processed food products include alcoholic beverages and tobacco.
Sources: CBS and CNB calculations.

Figure 5.2 Indicators of current inflation trends



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

Figure 5.3 Deflator of GDP and its individual components



Source: CBS.

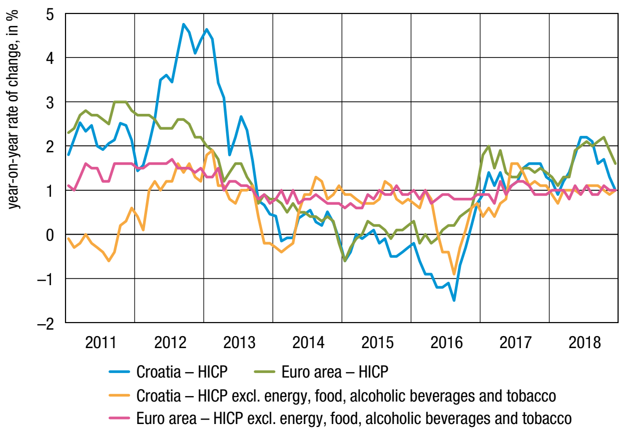
Table 5.1 Price indicators

year-on-year rate of change

	12/17	3/18	6/18	9/18	12/18
Consumer price index and its components					
Total index	1.2	1.1	2.4	1.4	0.8
Energy	0.4	1.8	7.9	5.3	0.9
Unprocessed food	2.6	2.1	3.8	–0.1	–0.6
Processed food	2.0	1.1	1.5	0.9	1.9
Non-food industrial goods without energy	0.8	0.3	0.5	–0.3	0.1
Services	1.0	1.0	1.0	1.4	1.1
Other price indicators					
Core inflation	1.4	0.7	0.7	0.5	1.0
Index of industrial producer prices on the domestic market	2.1	1.2	3.4	3.4	0.5
Index of industrial producer prices on the domestic market (excl. energy)	1.0	0.5	–0.1	–0.2	–0.3
Harmonised index of consumer prices	1.3	1.2	2.2	1.6	1.0
Harmonised index of consumer prices at constant tax rates	1.2	1.1	2.1	1.5	0.8

Sources: CBS and Eurostat.

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



Source: Eurostat.

second quarter to 1.5% in the fourth quarter of 2018. Trade conditions deteriorated in the second half of 2018 due to the accelerated annual growth in the deflator of imports of goods and services and somewhat less pronounced acceleration in the annual growth of the deflator of exports of goods and services.

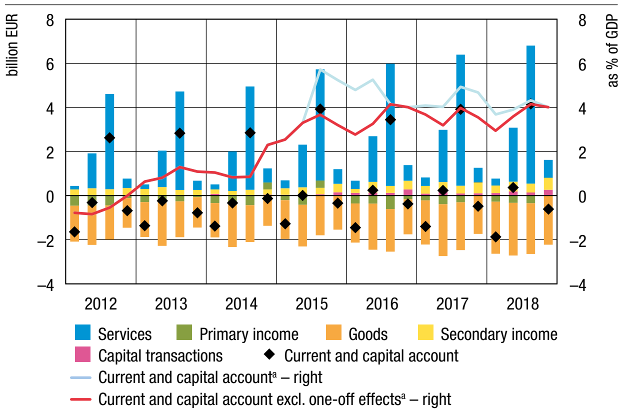
The annual inflation rate measured by the harmonised index of consumer prices (HICP) in the euro area fell from 2.0% in June to 1.6% in December 2018. This rise was mainly the result of trends seen in the prices of energy, primarily caused by the slowdown in the annual growth rate of refined petroleum products prices, from 14.7% in June to 5.9% in December. The contribution of food to inflation in the euro area also fell over the observed period. In contrast, core inflation, which excludes the prices of energy, food, alcoholic beverages and tobacco, edged up from 0.9% in June to 1.0% in December.

Croatia's annual inflation rate measured by the HICP went down from 2.2% in June to 1.0% in December 2018. The main reason for this was the slowdown in the annual growth in energy prices, primarily caused by the aforementioned decrease in refined petroleum products prices at the end of the year. As a result, inflation was 0.6 percentage points lower in Croatia in December than in the euro area. When observing the components, energy showed considerably lower annual growth in December (0.3% compared with 5.4% in the euro area), because the prices of natural gas, electricity and heating grew at higher annual rate in the euro area in December. Core inflation (measured by the HICP excluding energy, food, alcoholic beverages and tobacco prices) mildly accelerated in Croatia (from 0.9% in June to 1.0% in December), as it did in the euro area.

6 Current and capital account

The surplus in the current and capital account grew slightly in the second half of 2018 from the same period in 2017, as a result of a further increase in net exports of services and, to a lesser extent, of improvement in total balance in the secondary income account and the capital account. By contrast, stronger growth in imports than in exports of goods resulted in a noticeable widening of the trade deficit, which, paired with the rise of the deficit in the primary income account, largely offset positive developments in the current and capital account. In 2018 as a whole, the surplus in the current and capital account stood at 4.0% of GDP (4.7% of GDP in 2017). The decrease in the surplus reflects the impact of the impairment of claims on the Agrokor Group on bank profit, which, if excluded, would result in a surplus of 3.6% of GDP in 2017, compared with 4.2% of GDP in 2018.

Figure 6.1 Current and capital account balance and its structure



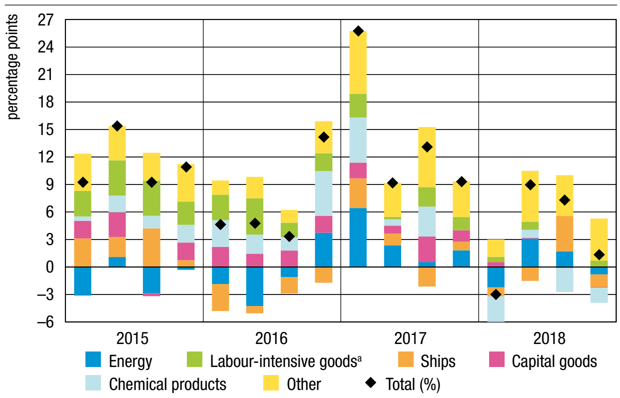
[a] Sum of the last four quarters.
Note: One-off effects include conversion of CHF-linked loans in 2015 and bank provisions for loans to the Agrokor Group in 2017 and 2018.
Source: CNB.

6.1 Foreign trade and competitiveness

The deficit in the international trade in goods was much larger in the second half of 2018 than in the same period of the previous year. According to the CBS data, the deficit widened mostly due to the rise in net imports of energy products (notably oil and refined petroleum products and to a lesser extent electricity and other energy products) and machinery (especially electrical machinery, apparatus and appliances) as well as due to the deterioration in the balance of trade in medical and pharmaceutical products. In addition, net imports of road vehicles increased. By contrast, adverse developments were counteracted by smaller net imports of miscellaneous food products and scientific and controlling instruments.

Notwithstanding the slight rise in goods exports in the second half from the first half of 2018, the annual growth rate of goods exports (3.8%) was significantly smaller than in the same period of 2017 (11.1%). The growth of total goods exports was mainly driven by higher exports of food products to Italy, other transport equipment (mostly ships) to Luxembourg

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

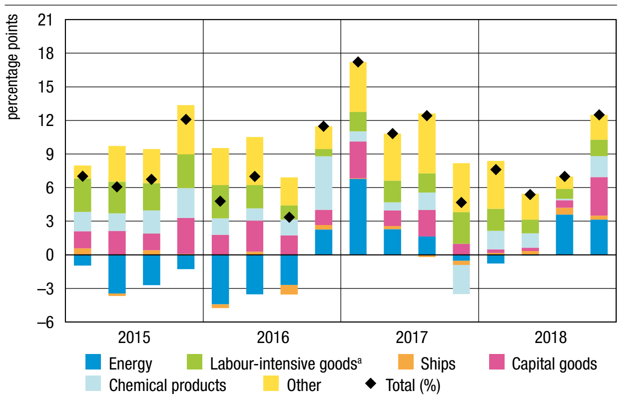


[a] Labour-intensive goods (according to the SITC) include: textile, wearing apparel, footwear, leather, paper, cork and wood, furniture, manufactures of metals and non-metallic mineral manufactures, prefabricated buildings and manufactured articles n.e.c.
Source: CBS.

and Finland and road vehicles to Slovenia and Germany. Exports of oil and refined petroleum products also increased significantly, with the contribution of energy products to the growth of total exports being offset by a concurrent strong fall in exports of electricity (to Bosnia and Herzegovina and Slovenia). Moreover, the largest adverse impact on export performance was produced by reduced exports of medical and pharmaceutical products to the USA and Belgium and power generating machinery and equipment to Bosnia and Herzegovina and the United Kingdom. Total exports of goods grew by 3.6% in 2018, that is, at a much slower rate than in 2017 (13.8%) on account of slower growth in foreign demand of Croatia's main trading partners and the volume of global trade.

In contrast to exports, the rise in the total imports of goods was slightly higher in the second half of 2018 than in the same period in 2017 (9.0% compared with 8.5%). The increase in

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



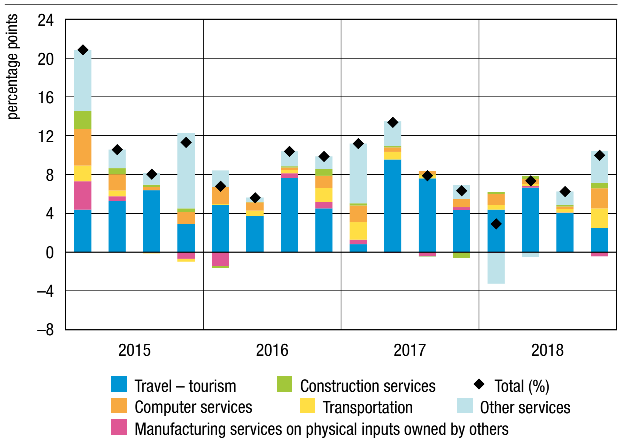
[a] Labour-intensive goods (according to the SITC) include: textile, wearing apparel, footwear, leather, paper, cork and wood, furniture, manufactures of metals and non-metallic mineral manufactures, prefabricated buildings and manufactured articles n.e.c.
Source: CBS.

imports was mostly due to the rise in imports of energy products, in particular oil and refined petroleum products from Iraq, Azerbaijan and Hungary, road vehicles from Slovenia and the Czech Republic, machinery (mainly electrical machinery, apparatus and appliances) from China and Italy and other transport equipment. On the back of the continued growth of personal consumption and investments, total imports of goods increased by 8.1% on an annual basis in 2018 or at a slower pace than in 2017 (11.1%).

Net exports of services continued to grow in the second half of 2018, largely owing to travel services. Revenues from tourism consumption of non-residents thus rose by 4.8% from the same period in 2017 and were accompanied by an increase in the number of arrivals and nights stayed by foreign tourists (4.3% and 2.2% respectively), primarily from Germany, the United Kingdom, Hungary and the USA. Despite continued growth, the growth dynamics of tourism revenue slowed down substantially from the 9.2% reported in the same period of the previous year, which can be attributed to increased competition in the Mediterranean market. In addition to tourism, strong growth in net exports of other services, notably telecommunication, computer and information services, as well as personal, cultural and recreational services, had favourable impact on developments in the international trade in services.

The price and cost competitiveness of Croatian exports, measured by the real effective kuna exchange rates, improved modestly in the second half of 2018, but this was not sufficient to offset the deterioration in the previous half of the year. The depreciation of the real effective exchange rates of the kuna deflated by consumer prices and producer prices in the second half of 2018 resulted from somewhat more favourable developments in domestic prices compared to the prices of Croatia's main trading partners. Concurrently, the movement of unit labour costs at the level of the whole economy was more favourable than abroad. As a result, the real effective exchange rate of the kuna deflated by unit labour costs in the total economy also depreciated. Developments in the nominal effective exchange rate of the kuna in the second half of the year was only partly offset by the relatively favourable impact of domestic prices and costs as the kuna strengthened slightly against the basket of currencies.

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



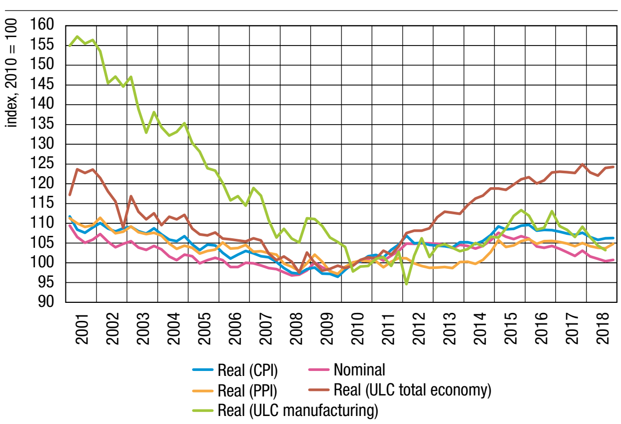
Source: CNB.

6.2 Income and transactions with the EU

The balance of investment income deteriorated in the second half of 2018 from the same period in 2017 due to a noticeable increase in expenditures on direct equity investment brought about by the improvement in the business results of domestic enterprises in non-resident ownership, primarily enterprises in real estate and telecommunication activities. At the same, unfavourable trends in investment income were partly mitigated by better business performance of foreign enterprises in resident ownership and lower interest expenditures on the external debt of domestic sectors.

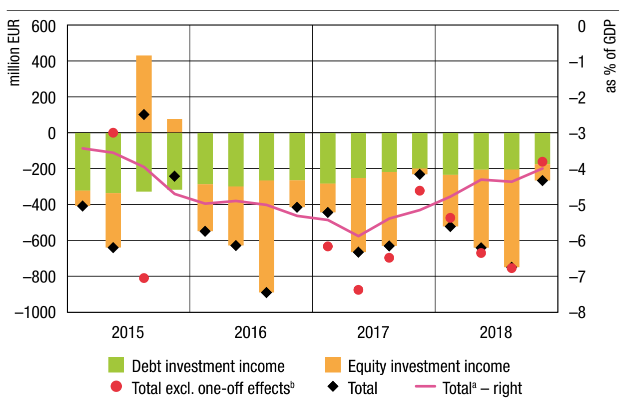
The second half of 2018 witnessed a sharp increase in net revenues arising from transactions with the EU budget compared with the same period in 2017 due to intensified use of EU funds and only slightly higher payments to the EU budget. With regard to the use of EU funds, the amount of allocated

Figure 6.5 Nominal and real effective exchange rates of the kuna



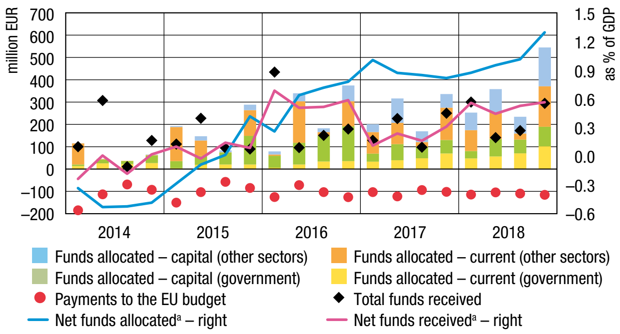
Notes: The unit labour cost is calculated as the ratio between compensation per employee and labour productivity (defined as GDP per person employed). A fall in the index indicates an effective appreciation of the kuna.
Source: CNB.

Figure 6.6 Investment income



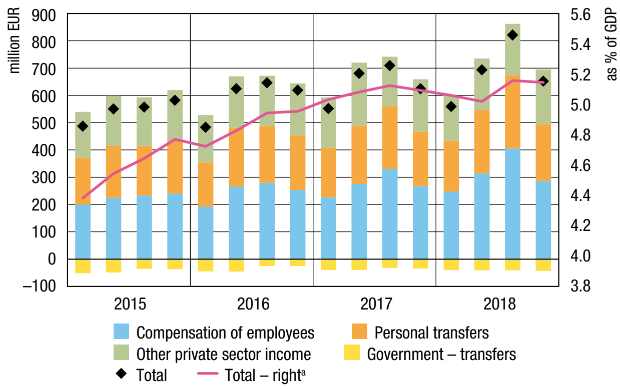
[a] Sum of the last four quarters, excluding one-off effects. [b] One-off effects include the conversion of CHF-linked loans in 2015 and bank provisions for loans to the Agrokor Group in 2017 and 2018.
Source: CNB.

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.

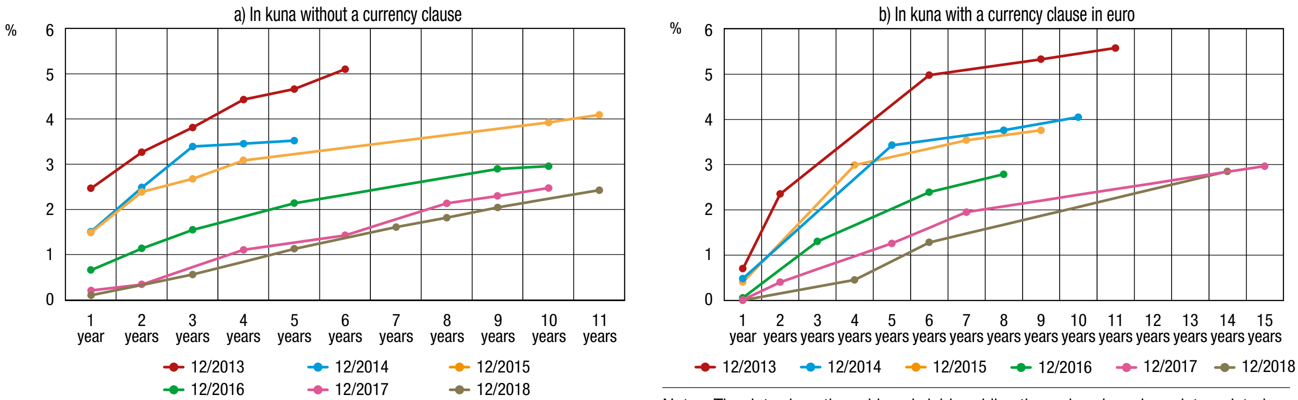
capital funds showed the largest increase (notably as regards other sectors), with the growth also being observed in the amount of allocated current funds. If analysed at the level of the whole of the year, the surplus of funds utilised from EU funds over payments to the EU budget increased to 1.8% of GDP in 2018 from 1.2% of GDP in 2017. Other income, which excludes transactions with the EU budget, was also marked by favourable trends, brought about by a noticeable growth in revenues from compensation of persons temporarily employed abroad and, to a smaller extent, the increase in revenues from personal transfers from abroad.

7 Private sector financing

The several-year trend of improvement in the financing conditions of domestic sectors mostly continued in the second half of 2018. The costs of short-term government borrowing remained at the lowest level ever recorded. The interest rate on one-year kuna T-bills has remained unchanged since February 2018, standing at 0.09% in December. In the same month, the interest rate on one-year euro T-bills held steady at 0.00%, a level first recorded in May 2018. With regard to long-term borrowing costs, early in July 2018 the government issued the second tranche of the five-year kuna bond worth HRK 5.5bn with a yield at issue of 1.22% and a new eleven-year bond worth HRK 5.0bn with a yield at issue of 2.58%, or on the most favourable terms of financing so far. Improving financing conditions are also suggested by the yield curve for kuna bonds without a currency clause (Figure 7.1a) and notably by the yield curve for kuna bonds with a currency clause in euro which edged down noticeably from the end of 2017 (Figure 7.1b).

During the second half of 2018, the average cost of government borrowing on the foreign market, estimated on the basis of the EMBI index for Croatia and the yield on the German government bond, remained at the level of the average of the first half of the year, standing at 2.4% (Figure 7.3), while during December it was up by 0.3 percentage points from the end of the previous year. The credit default swap (CDS) was almost unchanged at the end of December from the end of 2017, standing at 96 basis points. As regards rating agencies' perception of Croatian risk, after two agencies upgraded Croatia's credit rating from 'BB' to 'BB+' (one notch below investment grade) in the first quarter of 2018, Fitch changed the outlook from stable to positive in July, while Standard & Poor's followed suit in September. Moody's rating and outlook have

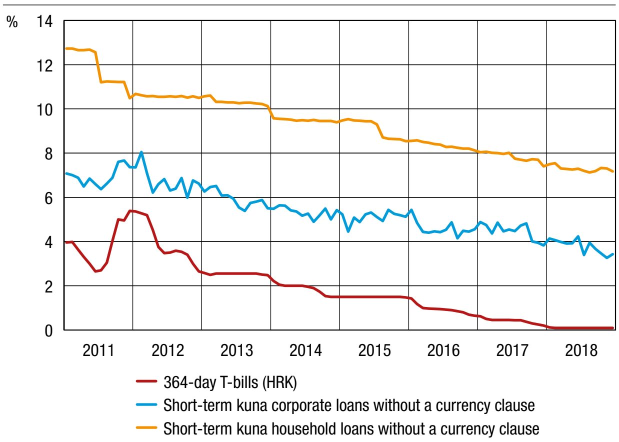
Figure 7.1 Yield-to-maturity on RC bonds



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

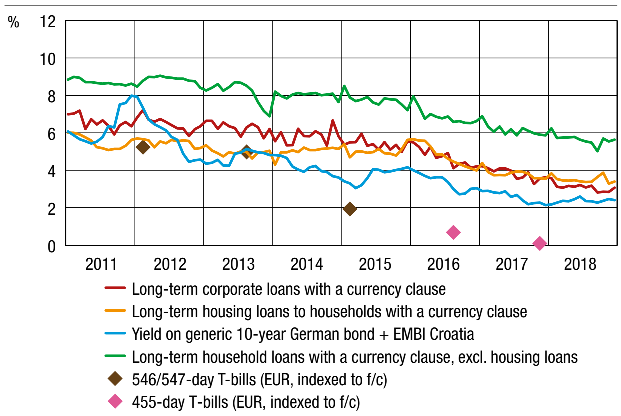
Notes: The dots show the achieved yields, while other values have been interpolated. Data for one-year yield refer to the achieved interest rate on one-year T-bills with a currency clause in euro. Data for the end of 2016 refer to November, while data for the end of 2017 refer to October.
Source: CNB.

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



Sources: MoF and CNB.

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



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

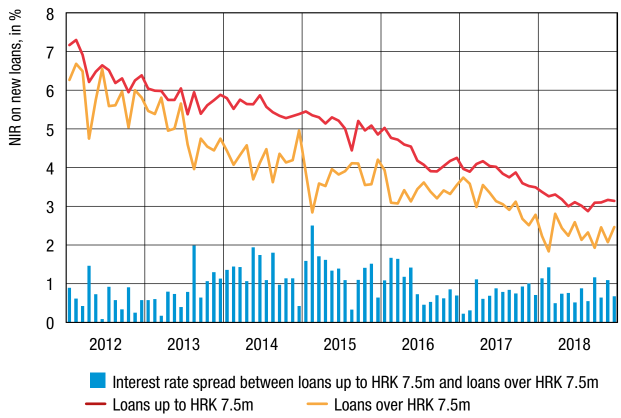
been unchanged since March 2017 at 'Ba2', i.e. two notches below investment grade with stable outlook.

The costs of corporate financing continued to fall. When compared with the average of the first six months of 2018, the average interest rate on short-term kuna loans without a currency clause fell by 0.5 percentage points in the second half of the year, and held steady below 4% (Figure 7.2). At the same time, the average interest rate on long-term corporate loans with a currency clause decreased by 0.2 percentage points (Figure 7.3) and stood below 3% for the first time in some months in the second half of 2018. The favourable movements of corporate financing costs in the second half of the year were also reflected in the decrease in interest rates relative to loan amount (Figure 7.4). Interest rates on loans above HRK 7.5m were considerably lower and more volatile, since such loans are used by a smaller number of large companies with more collateral and better access to alternative financing.

The interest rates on household loans on average also continued a downward trend. The average interest rate on long-term loans with a currency clause, excluding housing loans, fell notably in the second half of 2018, down by 0.3 percentage points from the first half of 2018. Average interest rates decreased moderately in short-term kuna financing, but the costs of financing in long-term housing loans with a currency clause showed on average no change from the first half of the year (Figures 7.2 and 7.3).

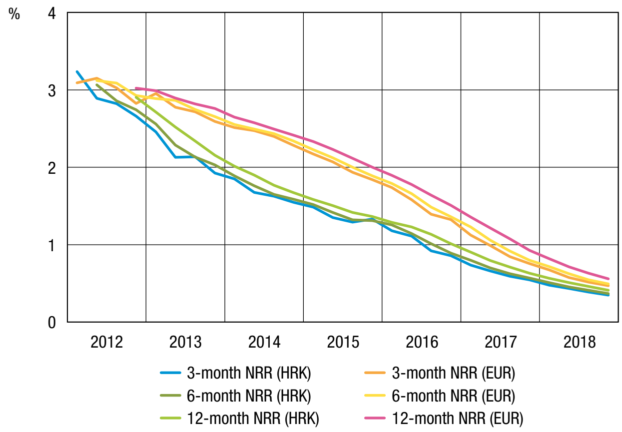
The continued several-year trend of more favourable conditions for corporate and household financing was due to the very high liquidity in domestic and international financial markets and the continued fall in the costs of funding sources of the Croatian banking system, with EURIBOR still in negative territory (Figure 2.3), while the national reference rate (NRR)[1]

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



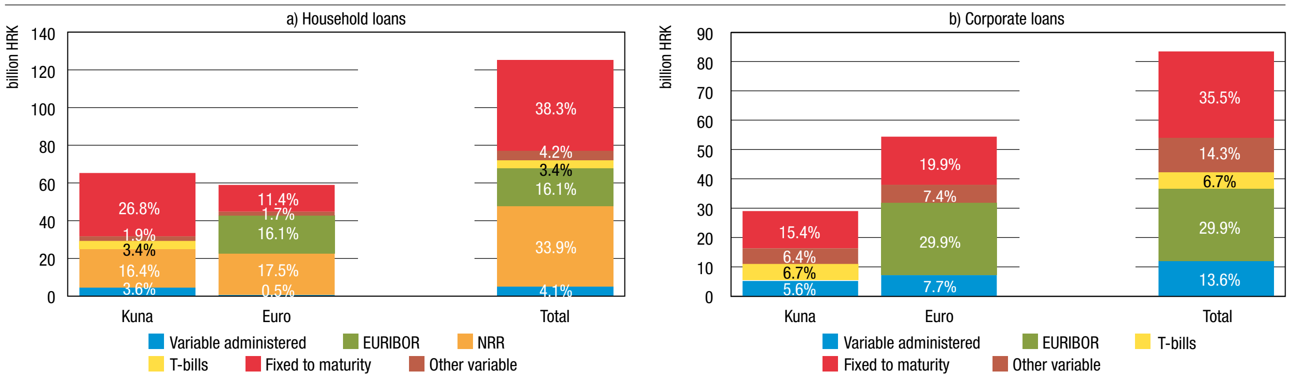
Source: CNB.

Figure 7.5 National reference rate (NRR)



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

Figure 7.6 Structure of interest rates
December 2018

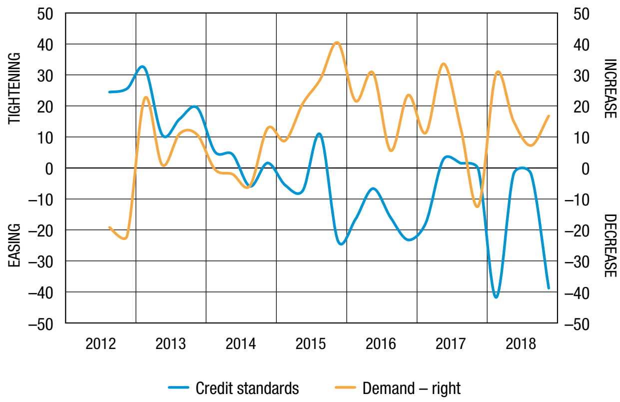


Notes: Percentages show shares in total household loans. Loans currently undergoing initial interest rate fixing are included in a category in accordance with the relevant parameter that will be applicable following the expiry of the fixing period.
Source: CNB.

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

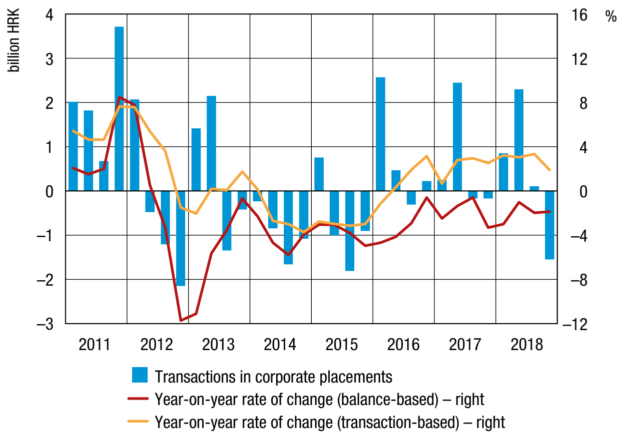
1 The national reference rate (NRR) is the average interest rate paid on deposits by the banking sector. It is used as one of the benchmark interest rates for determining the level of the variable component of the variable interest rate on loans, in accordance with Article 11a of the Credit Consumer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

Figure 7.7 Credit standards and corporate demand for loans



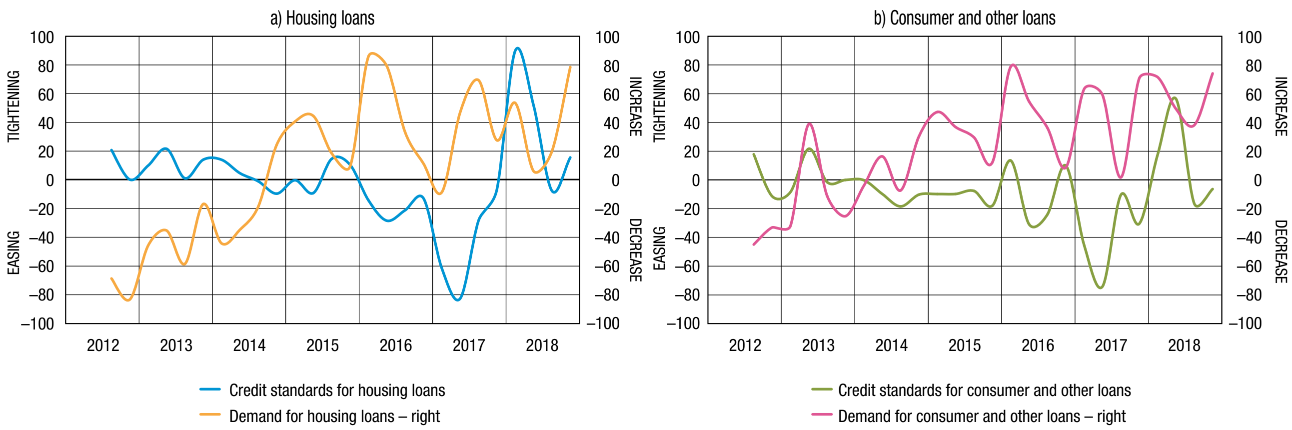
Note: Data show the net percentage of banks weighted by the share in total corporate loans.
Source: CNB.

Figure 7.10 Corporate domestic placements of credit institutions



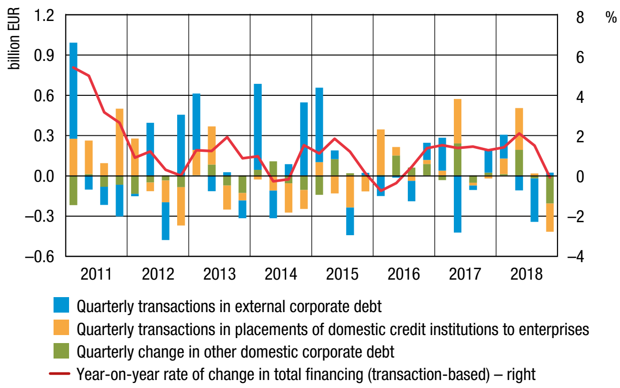
Source: CNB.

Figure 7.8 Credit standards and household demand for loans



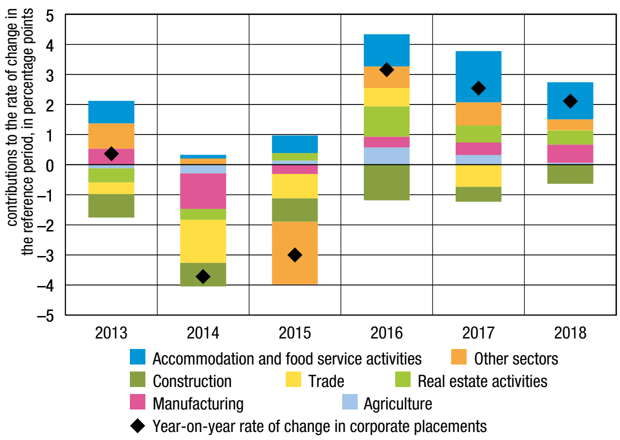
Note: Data show the net percentage of banks weighted by the share in total household loans.
Source: CNB.

Figure 7.9 Corporate financing



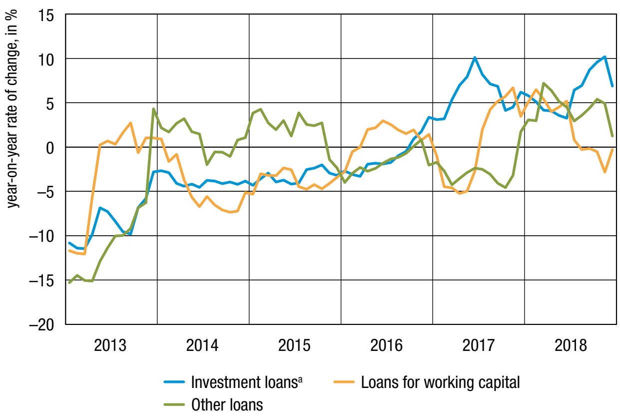
Notes: Other domestic financing includes borrowing from domestic leasing companies and the CBRD. External debt excludes the effect of debt-to-equity transactions. All changes were calculated according to transactions (except for other domestic debt).
Sources: HANFA, CNB and CNB calculations.

Figure 7.11 Growth of corporate placements by activity
transaction-based



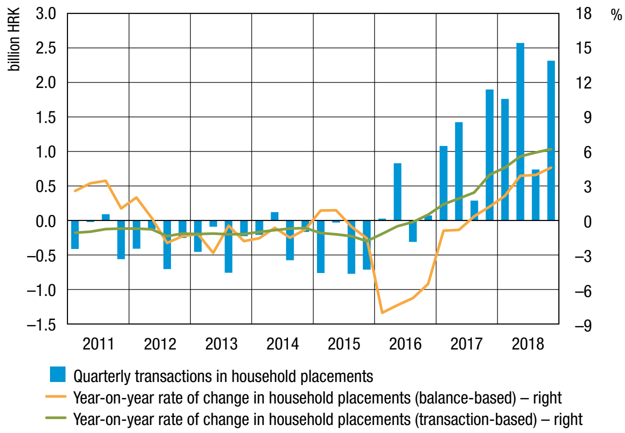
Source: CNB.

Figure 7.12 Growth in corporate loans by purpose
transaction-based



[a] Includes investment, construction, agriculture and tourism loans as well as shares in syndicated loans.
Source: CNB.

Figure 7.13 Household placements



Source: CNB.

continued to trend downwards (Figure 7.5).

As regards the structure of interest rates, at the end of December, loans with a fixed-to-maturity interest rate (38.8%, Figure 7.6a) were the most represented, followed by loans tied to the NRR and the EURIBOR. Loans granted at an interest rate fixed in a period shorter than maturity accounted for 14.0% of household loans, of which two thirds referred to fixing longer than three years. As regards corporate loans, the largest portion of loans had a fixed-to-maturity interest rate (35.5%, Figure 7.6b), while EURIBOR was the second most represented according to the currency structure in which the euro is predominant. When compared with the end of 2017, the shares of the fixed-to-maturity interest rate increased the most, i.e. by 4.6 percentage points in household loans and 3.3 percentage points in corporate loans.

According to the results of the bank lending survey, credit standards for corporate loans eased in the second and the third quarter of 2018, albeit at a much lower intensity than in the fourth quarter of 2018 (Figure 7.7). If a slight tightening in the second and the third quarter of 2017 is excluded, the developments in 2018 are a continuation of a three-year long trend of the easing of credit standards for corporate lending. In the second half of 2018, the easing of standards was on average mostly driven by the positive expectations with regard to overall economic developments, bank liquidity and competition among banks. The results of the second round of the Survey on the access to finance of enterprises also indicate an improvement in financial conditions, although for some groups of enterprises obstacles in the access to finance are still pronounced (see Box 1 Characteristics of small and medium-sized enterprises in the access to finance – Survey findings). Apart from the decline in the last quarter of 2017, corporate demand for loans continued its several-year growth trend in 2018. The most important drivers of rising demand for loans in the second half of 2018 were still enterprises' needs to finance inventories and working capital as well as investments, and to a lesser extent, debt restructuring.

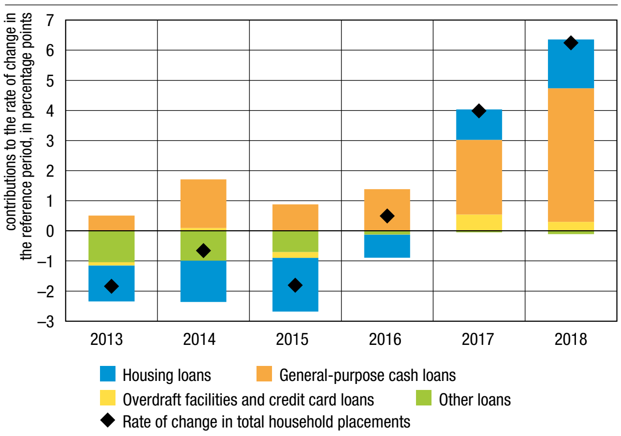
As regards credit standards for household loans, they mostly eased in the second half of 2018 (Figure 7.8), due to competition among banks, positive expectations regarding general economic developments and the reduced effect of legislative changes. The considerable tightening of credit standards for household loans in the first half of the year was particularly the consequence of the application of the new Foreclosure Act and the Decision on the additional criteria for the assessment of consumer creditworthiness and on the procedure of collection of arrears and voluntary foreclosure which had an unfavourable effect on the creditworthiness of part of the household sector. In addition, the growth in demand for housing, consumer and other loans continued and now it has been ongoing for the more than four years, except the decrease in demand for housing loans in early 2017. The boost to demand for both types of loans in the second half of 2018 was still strongly driven by consumer confidence. The demand for housing loans was additionally stimulated by favourable circumstances in the real estate market, while the consumption of durable consumer goods spurred growth in demand for consumer and other types of household loans.

The total debt of non-financial corporations[2] decreased in the second half of 2018, with all sources of financing showing a decline, which in case of domestic financing largely reflected the activation of government guarantees for loans to shipyards (Figure 7.9). As regards the annual dynamics, total corporate debt decreased slightly, by 0.1% in 2018 (transaction-based), due to a considerable deleveraging abroad and a modest decrease in other domestic debt, while corporate financing from domestic credit institutions rose.

Domestic credit institutions' placements to non-financial corporations rose by HRK 1.7bn (1.9%) in 2018 (transaction-based, Figure 7.10). As in 2017, the rise was entirely generated in the first half of 2018, while the period from July to December saw a decline in placements of HRK 1.4bn, brought about by their fall in the fourth quarter due to the activation of government guarantees for loans to shipyards. By contrast, the annual rate of change in corporate placements calculated on the basis of nominal values remained negative (–1.9% at the end of December), mostly due to the sale of irrecoverable placements and the strengthening of the kuna against the euro.

2 Non-financial corporations do not include public enterprises included in the general government sector.

Figure 7.14 Growth of household placements by loan type
transaction-based



Source: CNB.

In 2018, the rise in corporate placements was widespread across various activities, with the most significant contribution to growth coming from accommodation and food service activities, manufacturing and real estate activities (Figure 7.11). By contrast, the several-year trend of deleveraging in construction continued, picking up slightly from the previous years. As regards corporate loans by purpose, investment loans saw the sharpest rise in 2018, by almost 7% (transaction-based), while loans for working capital decreased slightly (Figure 7.12).

Household placements increased at an accelerated annual rate in 2018, reaching 6.2% (transaction-based, Figure 7.13). The rise in household lending was still driven by lower financing costs, growth in employment and rising consumer confidence. As regards the structure of loans, all major types of loans grew during 2018 (Figure 7.14), with general-purpose cash loans accounting for about 70% of the increase in that period (see Box 2 Intensified growth in general-purpose cash loans and potential risks to financial stability).

Box 1 Characteristics of small and medium-sized enterprises in the access to finance – Survey findings

The improvement of financing conditions, as reported by non-financial corporations in the second Survey on the access to financing of small and medium-sized enterprises (SMEs), is in line with the improved macroeconomic indicators and lower corporate debt. However, this favourable overall assessment combines diverse developments as regards the individual segments within the non-financial corporations sector. About 40% of SMEs do not use bank loans in their operations; over a half of such enterprises were unable to get a loan. The high share of small and especially young enterprises in this group confirms that obstacles in the way of access to finance still pose a problem.

The results of the first Survey on the access to finance of SMEs conducted in 2015 showed that SMEs in Croatia were unanimous in their view of the unfavourable institutional and business environment as the greatest hindrance to doing business, and two thirds of enterprises claimed that the access to finance impedes their business to a lesser or greater extent.

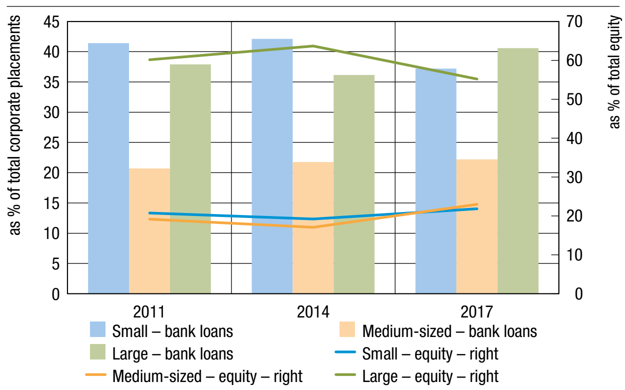
Two years later, in the second Survey, pressures on the labour market took the third place among the obstacles to doing business, immediately after the still leading business and institutional obstacles. Although during the second Survey enterprises emphasised improved accessibility and more diverse sources of financing, for some groups of enterprises, such as, for example, small and medium-sized and start-up enterprises, access to finance was still recognised as a problem, but in a comparison with the responses from the first wave of the Survey, there was no deterioration.

Financial characteristics of SMEs

SMEs account for over 99% of the total number of enterprises and generate more than a half of gross value added, employing about 70% of the total number of employed persons in non-financial corporations.

The corporate placements of banks account for slightly less than a half of the total placements of banks to the private sector, with 60% of corporate placements directed precisely to small and medium-sized enterprises, and the remaining 40% to large enterprises. By contrast, equity is concentrated in large enterprises (Figure 1).

Figure 1 Corporate placements of banks and equity according to the size of enterprises



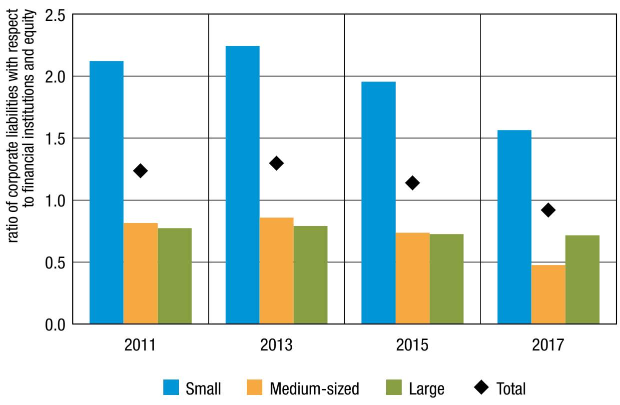
Note: On 31 December 2017, total corporate placements stood at HRK 90bn, i.e. HRK 33bn in small, HRK 20bn in medium-sized and HRK 37bn in large enterprises, and the total equity (capital and reserves) of the corporate sector stood at HRK 450bn, i.e. HRK 100bn in small, HRK 100bn in medium-sized and HRK 250bn in large enterprises.
Sources: FINA and CNB.

The sources of financing of SMEs became much more diverse in the previous two years, with a higher contribution of the absorption of EU funds. At the same time, the period was also marked by significant deleveraging by enterprises with respect to financial institutions (Figure 2). The improved access to finance is also recognised in the responses given by the enterprises participating in the Survey.

Access to finance – Survey responses

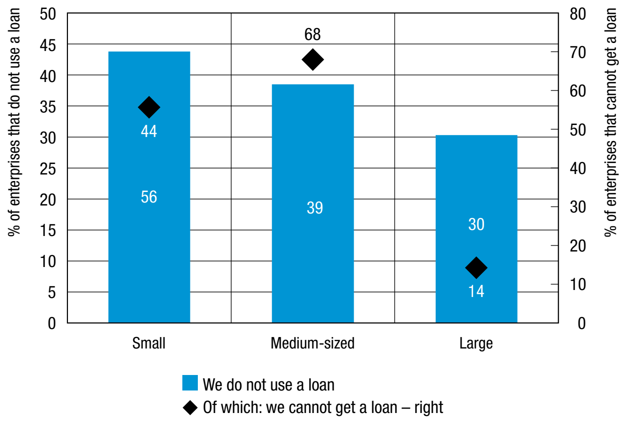
The decision to use internal or external funds depends on many factors. If a hypothetical economy with a perfect market is observed, internal (capital) and external (debt) sources of

Figure 2 Corporate deleveraging shown by the ratio of financial liabilities and equity, according to the size of enterprises



Note: The ratio of long-term and short-term financial liabilities with respect to banks and other financial institutions, securities issued and equity (debt-to-equity ratio).
Sources: FINA and CNB calculation.

Figure 3 The share of enterprises not using a loan, of which the share of enterprises that cannot get a loan



Note: Calculated using the procedure which takes account of Survey weights.
Source: Survey on the access to finance of SMEs, CNB and Ipsos, 2017.

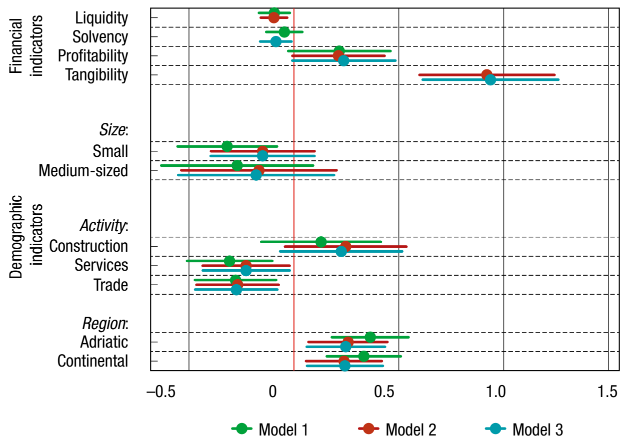
financing are perfect substitutes and "a firm's investment decisions are independent of its financial condition" (Fazzari et al., 1988).[3] In practice, however, such a hypothetical economy does not exist, and factors such as transaction costs, tax advantages, administrative obstacles, asymmetric information, etc., have as a consequence the imperfect substitutability of internal sources by external sources. As a result, the cost of borrowing may differ from the opportunity cost of internal finance. Therefore, financial constraints impact real variables, such as investments, working capital and the growth of the enterprise, in particular for enterprises with insufficient internal funds.

The enterprises that face financing constraints can be objectively defined through balance sheet items, for instance, as enterprises whose foreseen investments exceed the available financing. Another direction is enterprises' self-assessment through survey questions (Ferrando and Mulier, 2015[4]; Gomez, 2018[5]), in which enterprises respond on the importance of bank financing for their operations, on obstacles caused by problematic access to finance or the reasons because of which they could not or did not want to take a bank loan.

In the Survey on the access to finance of SMEs[6], enterprises replied to questions about the importance of loans as sources of financing for their operations, with the following responses to the questions offered: "we used a loan" (currently or previously) and "we have never used a loan nor is this source important for our operation". For about 40% of SMEs loans "are not important", while, as expected, only 30% of large enterprises claim that for them loans "are not important".

The fact that an enterprise does not use bank financing does not mean that the enterprise is facing financial constraints. On the contrary, such a financial structure may be the result of a

Figure 4 Ratios associated with the determinants of enterprises that do not use a bank loan in operation[7]



Notes: Calculated using the binary-choice model, which uses the Survey weights. Dependent variable: "loan is not important in our operation" = 1, while "we use a loan" = 0. The reference enterprise for the binary variable calculation (base): large, industry activity Zagreb region. The dot marks the point estimate of the ratio, and horizontal lines show the confidence interval. If zero (the red vertical in the figure) does not intersect the confidence interval, the ratio is statistically significant.
Model 1 = $\beta_0 + \beta_1 cash + \beta_2 solv + \beta_3 profit + dummy_{size,\ activity,\ region}$
Model 2 = $\beta_0 + \beta_1 cash + \beta_3 profit + \beta_4 tang + dummy_{size,\ activity,\ region}$
Model 3 = $\beta_0 + \beta_2 solv + \beta_3 profit + \beta_4 tang + dummy_{size,\ activity,\ region}$
Sources: Survey on the access to finance of SMEs, CNB and Ipsos, 2017, FINA and CNB calculation.

deliberate business decision. For this reason, enterprises were asked why they did not use a bank loan, with the offered response options: "we were not able to" and "we did not want to". If the enterprises that are not using loans are observed, over a

3 Fazzari, S. M., R. G. Hubbard, and B. C. Petersen (1988): *Financing Constraints and Corporate Investment*, Brookings Papers on Economic Activity, Vol. (1), pp. 141-195.
4 Ferrando, A., and K. Mulier (2015): *Firms' Financing Constraints: Do Perceptions Match the Actual Situation?*, Economic and Social Review, Vol. 46(1), pp. 87-117.
5 Gómez, M. G.-P. (2018): *Credit constraints, firm investment and growth: evidence from survey data*, No. 2126, European Central Bank, Working Paper Series.
6 For more details, see *Survey on the access to finance of SMEs – Survey findings*, Macroeconomic Developments and Outlook No. 3, 2017 and Bulletin No. 220, 2015.
7 Jann, B. (2014): *Plotting regression coefficients and other estimates in Stata*, Stata Journal Vol. 14(4), pp. 708-737; StataCorp (2017): *Stata Statistical Software*, Release 15.

half of small and two thirds of medium-sized enterprises were not able to get a loan. In the group of large enterprises, only 14% could not get a loan, of an otherwise small group of 30% of large enterprises that do not use loans (Figure 3).

Enterprises claimed that they could not get a loan for the following reasons (which are not mutually excluded): rejection of loan application, too long and/or too complex granting procedure, too high interest and/or fee, unacceptable collateral requirements and inadequate creditworthiness. The reasons for such a problematic access to finance can be systemic or specific to a certain enterprise.

The enterprises to which loans "are not important in operation" were analysed through the binary-choice model. The variables that explain the behaviour of these enterprises are the financial indicators of enterprises (cash ratio, solvency, profit-to-sales and tangibility[8] as a proxy variable for collateral), and their demographic characteristics (size, activity and region).[9]

Among the determinants of the enterprises to which "loans are not important in operation", in all of the combinations of indicators, the share of tangible assets in total assets and demographic characteristics are emphasised constantly and consistently. In addition, the statistical significance of the ratios associated with cash ratio and solvency indicates that banks direct their placements towards those enterprises they estimate to be most likely to be able to repay. Enterprises with a stable and predictable cash flow have access to loans, irrespective of the share of tangible assets in total assets.

The Survey responses additionally suggest that young enterprises are hit the strongest by financial constraints. Young enterprises are also most frequently small, with a small share of tangible assets and, as a rule, a not very sizeable cash flow. Although the age of the enterprise is not explicitly included in the model, such findings are in line with references (Haltiwanger, 2011[10]; Banerjee, 2014[11]).

In conclusion, the Survey responses confirm a generally improved access to finance. However, small and in particular young enterprises face tightened financing conditions relative to other enterprises, in an environment in which intangible assets[12] have an increasing importance for the business performance of enterprises. The problem of start-up enterprises that derives from their lack of collateral is part of a broader issue of the financial market development. This market is shallow, and partly even non-existent, precisely in those segments that should be directed towards the financing of such enterprises.

Box 2 Intensified growth in general-purpose cash loans and potential risks to financial stability

The growth of non-collateralised general-purpose cash loans intensified in 2018, notably those with longer maturities due to greater confidence of consumers and their propensity to consume durable goods. Although currency and interest rate risks for clients are less pronounced than in other forms of lending, relaxed credit standards relative to housing loans imply increased vulnerability of indebted households to potential shocks in the macroeconomic environment which, should it materialise, could generate major losses for banks and weaken future household consumption. In order to prevent excessive credit growth and additional accumulation of risks, the CNB adopted the Recommendation on actions in granting non-housing consumer loans.

Household sector borrowing began to recover in late 2016 (see Financial Stability No. 19, Chapter 3). The rise in employment and disposable income increased the borrowing potential, while credit growth (measured by transactions, i.e. by the difference between new lending and existing debt repayments) picked up to 6.24% on an annual basis (Figure 1.b) at the end of 2018. Although intensified household borrowing from credit institutions is partly a result of the recovery of housing loans, which had begun at the end of 2017 in parallel with the first government housing loans subsidy programme, the strongest impetus for the acceleration in total credit growth came from general-purpose cash loans. Their growth has been intensifying gradually since 2016, reaching 12.3% on an annual basis at end-December 2018, exclusively due to non-collateralised loans, which have been growing twice as fast as the average. The rise in these loans has also increased their share in total loans, potentially substituting for collateralised forms of lending (Figure 1.a).

A significant rise in non-housing loans was seen not only in Croatia but also in other EU countries over the past few years, mainly in Central and East European, most notably Slovakia and Slovenia (Figure 2.a). Interestingly, Croatia stands out among the mentioned countries with a somewhat higher share of non-housing lending (measured as the share in GDP) and a total amount of non-housing loans transactions exceeding 1% of GDP annually. At the same time, these countries are characterised by the high share of owner-occupier households, which implies a smaller demand for housing loans (Figure 2.b). By contrast, total credit growth in western European countries was spurred mainly by the rise in housing loans, which also set the trends of total lending in euro area countries (see ECB box on consumer credit growth).

The rise in general-purpose cash loans in Croatia may be associated with increasing household consumption. The bank lending survey suggests that the demand for consumer and other loans increased, driven by the recovery of consumer confidence and durable goods consumption. Responses from the Consumer Confidence Survey point to a similar conclusion, suggesting that consumers increasingly consider this to be an appropriate moment in which to purchase durable goods (Figure 3.a). It is also possible that general-purpose cash loans with longer maturities are also partly used as a substitute for car loans, which most credit institutions no longer offer, or even

8 Cash ratio = cash on hand/current liabilities; solvency = cash flow/total liabilities calculated as liabilities minus equity; profit-to-sales = (operating revenues – operating expenditures)/sales revenues; tangibility = share of tangible assets in total assets.

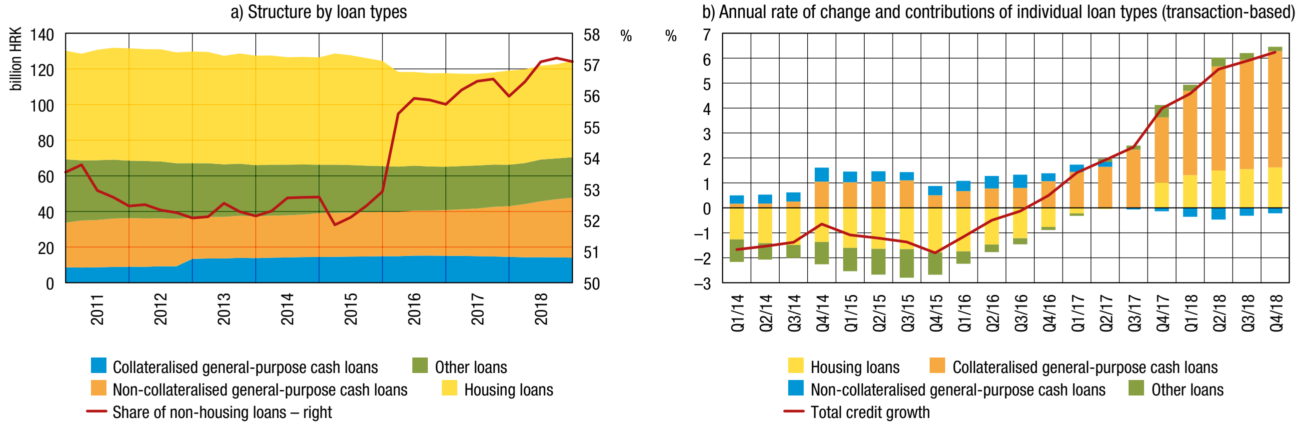
9 Size: total revenues ≥HRK 100.00 and (number of employees from 5 to 49 for small, 50 to 249 for medium-sized, ≥ 250 for large enterprises, and size according to the Accounting Act = 1, 2, 3); activity according to NACE: industry (B, C, D), construction (F), trade (G), services (H, I, J, L, M, P, Q, R, S); NUTS2: Adriatic, Continental excluding Zagreb and Zagreb.

10 Haltiwanger, J. (2011): *Firm Dynamics and Productivity Growth*, EIB Papers, Vol. 16(1), pp. 116-136.

11 Banerjee, R. (2014): *SMEs, financial constraints and growth*, BIS Working Paper, No. 475.

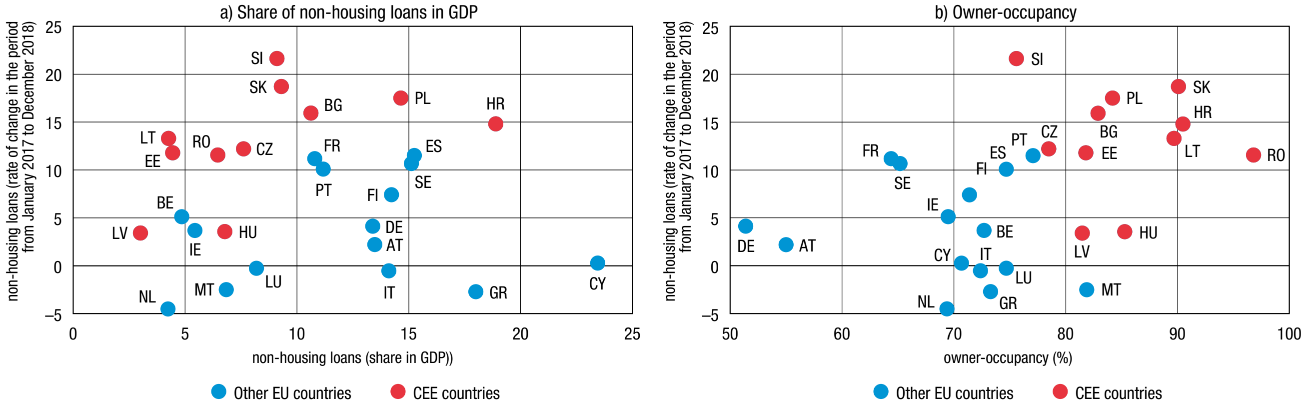
12 Intangibles = research and development, concessions, licences, goodwill, patents, etc.

Figure 1 Household debt to credit institutions



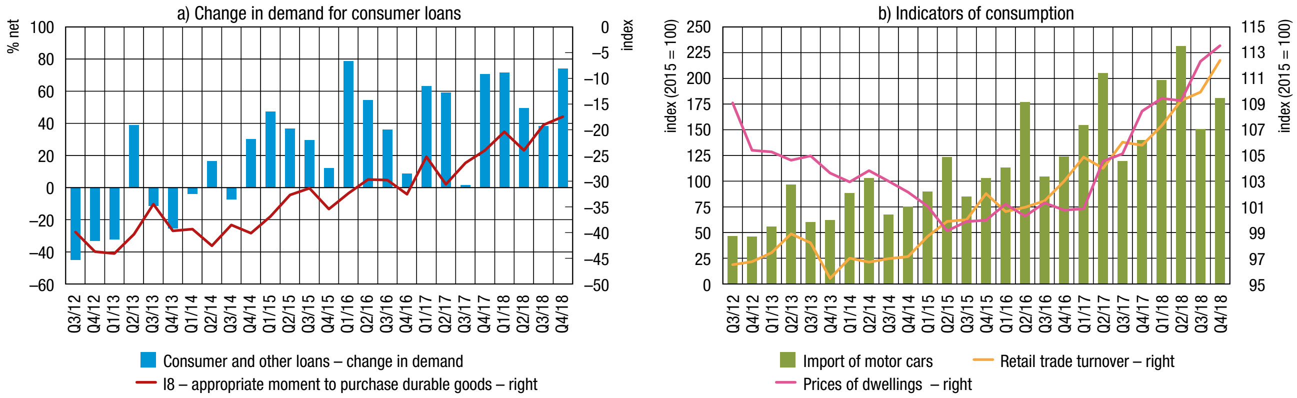
Source: CNB.

Figure 2 Trends in non-housing loans in EU countries, depending on:



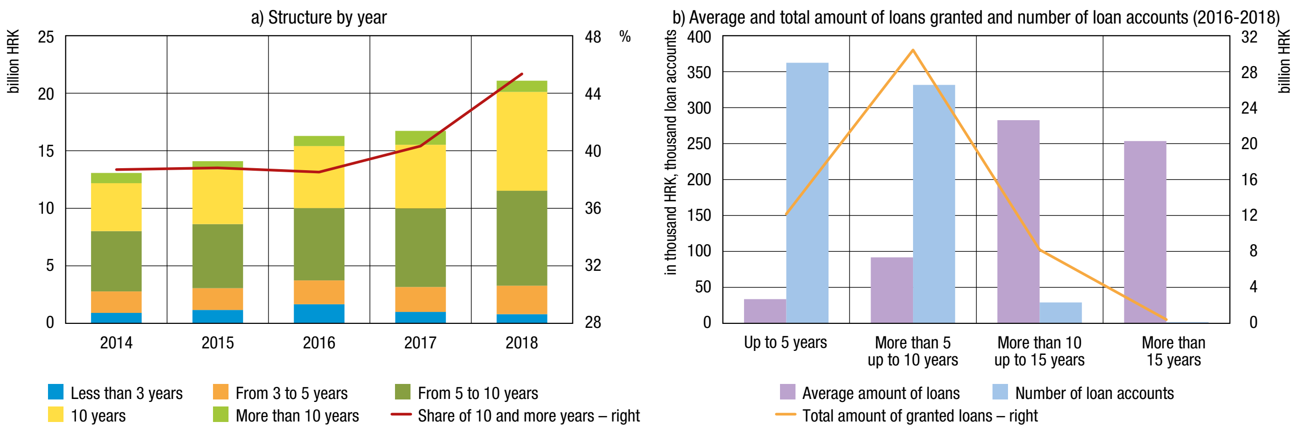
Notes: Due to differences in the classification of loans by purpose among EU countries, the figure shows non-housing loans. The data on owner-occupancy are obtained from EU-SILC 2017.
Sources: ECB and Eurostat.

Figure 3 Demand and indicators of consumption



Notes: The columns show the change in demand shown in the bank lending survey (for the determinants of demand, see survey question 15). A positive value indicates an increase and a negative value indicates a decrease in demand. The line shows the index of responses on the appropriateness of the purchase of durable goods for the household based on the data from the Consumer Confidence Survey (see survey question I8). Higher index values than those in the preceding period indicate growing consumer confidence.
Sources: CBS and CNB.

Figure 4 Characteristics of newly-granted general-purpose cash loans according to original maturity:



Sources: CNB and CNB survey on a sample of selected banks.

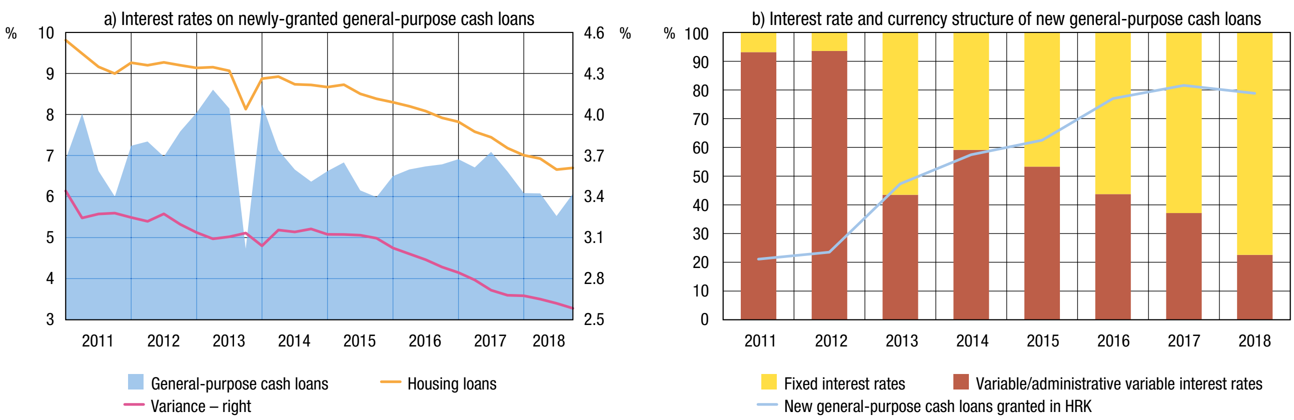
housing loans, in order to finance real estate purchase or renovation in a faster and simpler way (Figure 3.b).

The characteristics of newly-granted general-purpose cash loans may help in the identification of the main risks associated with this form of borrowing. As regards maturity, loans granted for a period of five years or more are dominant, although loans with an original maturity of ten years or more grew the most over the past two years (Figure 4.a). In addition, a survey conducted by the CNB on a sample of selected banks has shown that, on average, loans with longer initial maturities are granted for substantially higher amounts (Figure 4.b). Furthermore, even though they have generally been trending downwards, average interest rates on newly-granted cash loans are higher than those on other forms of lending. Compared with interest rates on housing loans, the second most frequent form of household lending, interest rates on cash loans are, on average, 3.5 percentage points higher (Figure 5.a), reflecting the risk premium calculated by the banks with regard to this riskier type of lending. On the other hand, currency and interest rate risks for clients are less pronounced than in other forms of lending (e.g. in housing loans) as newly-granted general-purpose cash loans are predominantly granted in kuna and at a fixed interest rate (Figure 5.b).

Furthermore, non-collateralised general-purpose cash loans are frequently granted within a very short period of time, sometimes without the client visiting the branch office, via mobile and online distribution channels. The simple manner in which such loans are granted, coupled with prolonged initial maturities and higher loan amounts, have increased the attractiveness of this form of borrowing. On the other hand, precisely due to the potentially higher degree of risk of such loans, credit institutions grant them with higher interest margins, enabling an immediate increase in profitability and the placement of surplus liquidity.

Since the growth in general-purpose cash loans was driven almost exclusively by non-collateralised loans, it may be considered to pose higher risks to credit institutions than the growth in housing and collateralised cash loans, as credit institutions cannot rely on a marketable instrument of collateral such as real estate or financial assets. The availability of promissory notes, guarantors and statements of approval for attachment of income mitigates risks associated with this form of lending only

Figure 5 Interest rates and currency structure



Note: Renegotiated agreements have been excluded from the calculation of average interest rates from the third quarter of 2014 onwards.
Source: CNB.

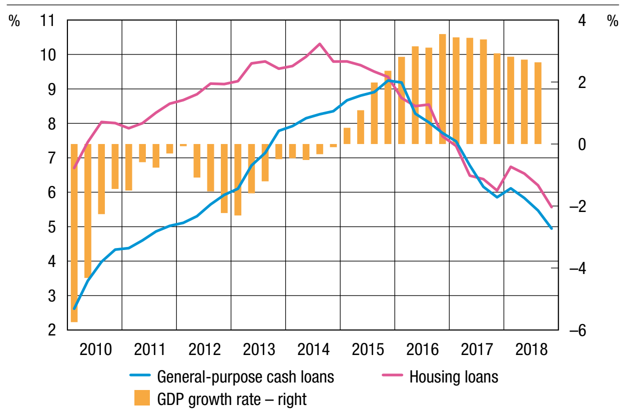
moderately. Systemic risks associated with this type of loan derive from the fact that, in the future, the number of households unable to meet the obligations arising from their loans may increase, causing greater losses to credit institutions than collateralised loans.

The second potential source of systemic risk is associated with the assessment of the creditworthiness of potential debtors. A survey conducted by the CNB on a sample of selected banks has shown that credit institutions in Croatia apply more relaxed standards when approving general-purpose cash loans than they do when approving housing loans. When calculating client creditworthiness and maximum repayment amounts, credit institutions do not apply a uniform methodology, as some of them take into account internally-defined minimum costs of living, while others do it indirectly, applying the maximum allowed debt service-to-income ratio. In addition, the determination of creditworthiness in the case of cash loans, particularly for clients with below-average income, is carried out according to more lenient standards than are those used for housing loans. The cost-of-living levels to be included in the assessment of creditworthiness for housing loans is set forth in the Decision on the additional criteria for the assessment of consumer creditworthiness and on the procedure of collection of arrears and voluntary foreclosure. Furthermore, the exchange of information and the issue of credit reports to the public, formerly carried out by the Croatian Registry of Credit Obligations (HROK), have been discontinued since the beginning of 2018, making impossible the inspection of a client's debt to other credit institutions and increasing the asymmetry of information in the loan market.

All of the above: the simple and fast manner in which loans are granted, the increase in the number of borrowers, the relaxed lending terms as well as the prolonged initial maturities could lead to an adverse selection of borrowers. For example, in a piece of research into consumer loans granted through an online service in the US, Hertzberg et al.[13] (2016) found that clients opting for loans with longer maturities were more likely to default. It seems that such clients are more exposed to income shocks and thus exhibit a higher degree of risk.

The absence of collateral and a possible adverse selection of clients when granting general-purpose cash loans may affect the stock of and developments in non-performing loans (NPLs). A comparison with housing loans shows that in Croatia, in times of growing employment and income (Figure 6) debtors managed to settle their obligations more easily, causing the share of NPLs to decline in both forms of lending. However, in the period characterised by unfavourable economic developments and intensified deleveraging, the fall in employment and household income led to difficulties in debt repayment and greater losses of banks arising from non-performing cash loans, as such loans are more difficult to recover than housing loans. The more relaxed assessment of creditworthiness and longer maturities increase the probability of default because they contribute to the increase in the share of clients that will sooner than others experience the negative consequences of economic shocks, while the absence of collateral may cause the losses of banks associated with NPLs to grow.

Figure 6 Share of non-performing loans and GDP growth rate



Note: The figure shows annualised GDP growth rates (calculated as the cumulative sums of GDP in the previous year divided by thus obtained annual GDP amounts at the end of the same quarter of the previous year).
Sources: Eurostat and CNB.

The growing exposure of banks to non-collateralised general-purpose cash loans constitutes a kind of accumulation of risks, which, should they materialise, could generate major losses for banks and weaken future household consumption. Optimistic expectations regarding debt servicing possibilities, which peak in economic upturns, contribute to the development of systemic risk, whose negative consequences can be felt only in the economic downturn. If the existing growth of general-purpose cash loans continues, it could soon become excessive. This required action on the part of the CNB which adopted the Recommendation on actions in granting non-housing consumer loans. Considering lower credit standards applied to cash loans than to housing loans, the Recommendation aims to harmonise the conditions for determining the creditworthiness as regards both types of loans with longer maturities. Hence, when granting non-housing consumer loans with original maturity equal to or longer than five years, credit institutions were recommended to apply the minimum costs of living that may not be less than the amount prescribed by the Foreclosure Act, governing the part of salary exempted from foreclosure. In addition, in line with the CNB supervisory powers, banks were requested to include potential losses arising from general-purpose cash loans in their internal assessments of capital requirements and to have in place clear mechanisms for bonus clawback in case of excessive losses stemming from such placements.

13 Hertzberg, A., A. Liberman, and D. Paravisini (2018): *Screening on Loan Terms: Evidence from Maturity Choice in Consumer Credit*, The Review of Financial Studies, Vol. 31, Issue 9, September, pp. 3532-3567.

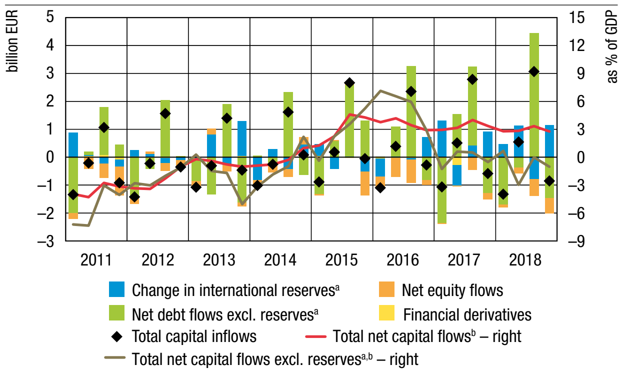
8 Foreign capital flows

The net capital outflow remained almost unchanged in the second half of 2018 from the same period of the previous year (EUR 2.2bn). However, if the change in gross international reserves and CNB liabilities is excluded, net foreign liabilities of domestic sectors fell significantly more than in the second half of 2017 (by EUR 1.8bn compared with EUR 0.9bn) due to stronger growth in net external debt liabilities, while the net inflow of equity investments increased. By contrast, the CNB's net foreign position improved considerably less than in the same period the year before.

The net inflow of equity investments reached EUR 1.1bn in the second half of 2018 as a result of a strong increase in liabilities (by EUR 1.3bn) accompanied by a mild increase in assets (by EUR 0.1bn). The sharp growth in liabilities was for the most part the result of the reinvestment of earnings of domestic business entities in non-resident ownership, which was larger than in the same period of 2017 on account of the better financial results of banks and non-financial corporations in non-resident ownership. The inflow of direct equity investments was also larger than in the same period of 2017, exclusively attributable to debt-to-equity transactions. If the above transactions are excluded, the inflow of direct equity investments remained relatively modest and was primarily seen in the real estate sector.

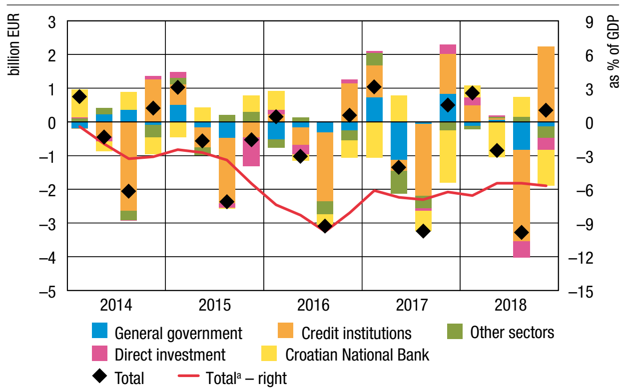
If the change in gross international reserves and CNB liabilities is excluded, the net outflow of debt capital stood at EUR 3.0bn in the second half of 2018. Net foreign position of other domestic sectors improved substantially due to a strong decrease in debt to affiliated creditors abroad that was only partly the result of the aforementioned debt-to-equity transactions. In addition, the net foreign position of the government improved distinctly on account of the repayment of international bonds

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



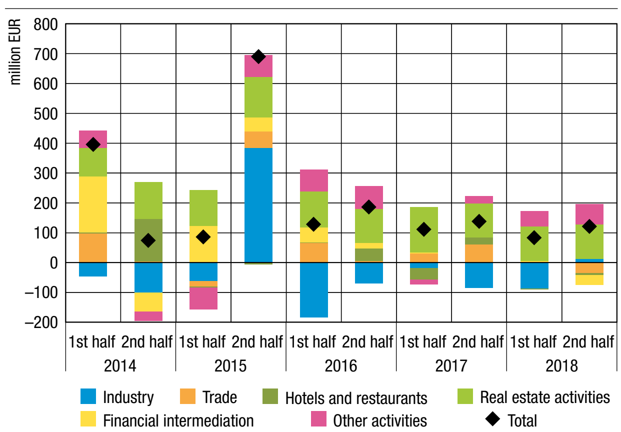
[a] Changes in gross international reserves net of CNB foreign liabilities.
[b] Sum of the previous four quarters.
Notes: Net flows mean the difference between changes in assets and liabilities. Equity flows comprise changes in foreign direct equity investments, reinvested earnings and portfolio equity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

Figure 8.3 Net external debt transactions by sectors



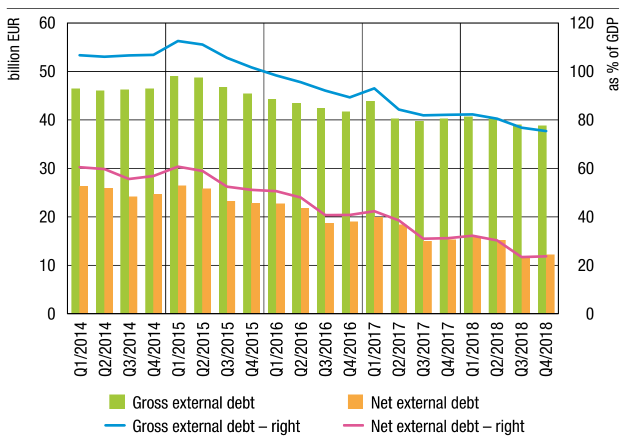
[a] Sum of the previous four quarters.
Notes: Transactions refer to the change in debt excl. cross-currency changes and other adjustments. Net external debt is calculated as the gross external debt stock net of foreign debt claims.
Source: CNB.

Figure 8.2 Foreign direct equity investment in Croatia by activities



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

Figure 8.4 Stock of gross and net external debt



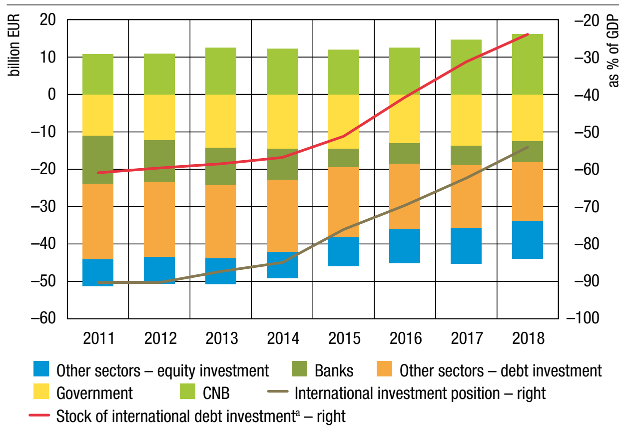
Note: Net external debt is calculated as the gross external debt stock net of foreign debt claims.
Source: CNB.

falling due in July. The repayment was financed from funds raised by the issuance of new bonds in June and temporarily deposited in an account with the central bank. Banks also improved their net foreign position, although much less than in the same period the year before. Moreover, the net foreign position of the central bank increased, albeit also much less than in the same period of 2017 as the increase in international reserves resulting from interventions in the foreign exchange market was offset by the withdrawal of government funds temporarily deposited in an account with the central bank.

The relative indicators of external debt improved steadily until the end of 2018 as a result of continued deleveraging and the growth of the nominal GDP. At end-2018, the gross external debt stock stood at EUR 38.8bn (75.4% of GDP), which is a decrease of 5.1 percentage points from the end of the first half of 2018. Concurrently, the decrease of the relative indicator of net external debt was somewhat more pronounced, mainly as a result of the rise in foreign assets in the second half of the year. By the end of December 2018, net external debt fell to EUR 12.2bn or 23.8% of GDP, a decrease of 6.6 percentage points from the end of the first half of the year.

The net international investment position improved in line with the decrease in net external debt, standing at –54.1% of GDP at end-2018 (–61.2% of GDP at end-June). In contrast to sharp decrease in debt, which positively contributed to the improvement of international investment position, the growth in net equity liabilities produced an opposite effect.

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.

9 Monetary policy

The CNB continued its expansionary monetary policy in the second half of 2018, maintaining the stability of the nominal kuna/euro exchange rate. Appreciation pressures on the kuna, prevailing at the beginning and in the middle of the year, strengthened again at the end of 2018. Hence, the CNB intervened vigorously in the foreign exchange market in December by purchasing a total of EUR 1.1bn from banks on three occasions. Over the entire year, the CNB purchased a net total of EUR 1.8bn from banks and EUR 30.4m from the Ministry of Finance. In all foreign exchange transactions in 2018, the CNB created a total of HRK 13.6bn (Figure 9.1).

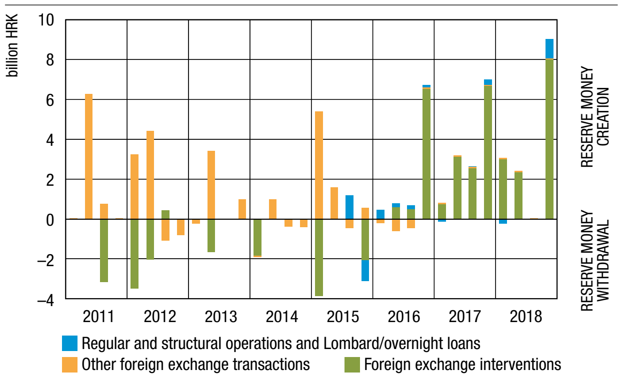
In addition, the CNB continued to conduct regular weekly operations at a fixed interest rate of 0.3%. However, in the conditions of large kuna liquidity surpluses in the monetary system, there was such little interest on the part of banks that the CNB did not place any funds at these auctions in 2018. However, the CNB held a structural operation in December, placing a total of HRK 1.4bn for a five-year term at a fixed interest rate of 1.2%. This was the first structural operation carried out after November 2017, and the sixth in total since the introduction of this instrument.

In 2018, the average surplus kuna liquidity reached HRK 24.9bn, up by HRK 9.7bn from the average surplus recorded in 2017 (Figure 9.2). The rise in kuna liquidity in the system primarily resulted from the creation of reserve money through the purchase of foreign exchange from banks. Against this background, the average weighted interest rate in the overnight interbank market amounted to 0.11% in 2018, almost the same as in 2017. In July, the interest rate dropped to 0.00% and transactions in the interbank market were absent in the rest of the year, as they were during most of 2018.

The kuna/euro exchange rate stood at EUR/HRK 7.42 at the end of December 2018, down by 1.3% from the end of December 2017, while the average exchange rate for 2018 was 0.6% lower than in the same period of 2017 (Figure 9.3). Appreciation pressures were associated with favourable balance of payments developments driven by growing exports and stronger inflows from EU funds, as well as with lower euroisation and the ongoing economic recovery, contributing to the reduction of fiscal risks and other macroeconomic imbalances. On the other hand, the exchange rate of the kuna against the US dollar and the Swiss franc was higher in late December than at the end of December 2017, reflecting the weakening of the euro against these two currencies on global financial markets.

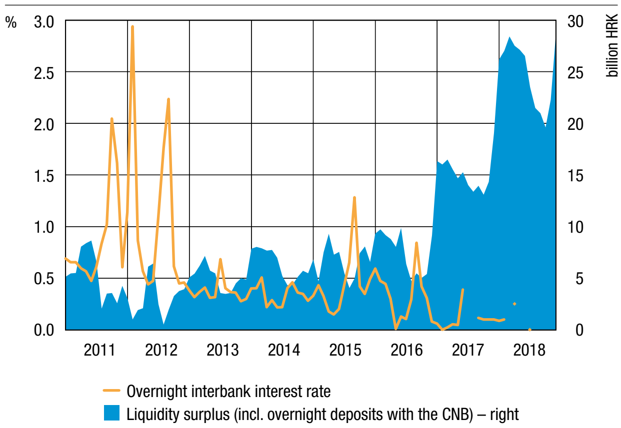
Gross international reserves went up by EUR 1.7bn or 11.0% in 2018, reaching EUR 17.4bn at the year's end (Figure 9.4). Net usable reserves also went up in the same period, by EUR 2.1bn, amounting to EUR 15.8bn at the end of December. The growth in reserves was mostly due to purchases of foreign currency from banks and, to a lesser extent, the strengthening of the US dollar against the euro, as a portion of international reserves is held in that currency. Gross international reserves remained at higher levels than money (M1) and

Figure 9.1 Flows of reserve money (M0) creation



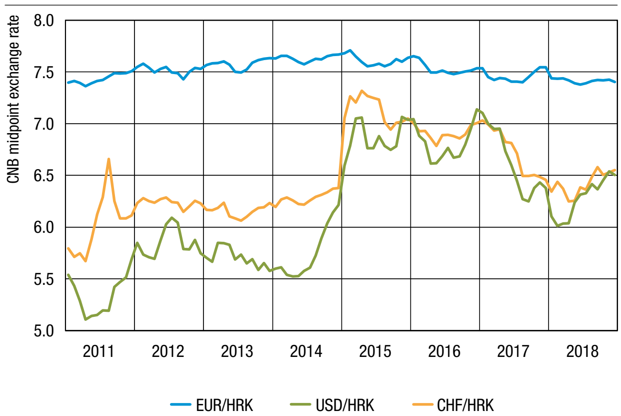
Notes: The possibility of using Lombard credits was abolished, while the possibility of using overnight credits was introduced on 28 September 2017. Other foreign exchange transactions include the purchase of foreign exchange from and the sale of foreign exchange to the MoF and the EC and foreign currency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

Figure 9.2 Bank liquidity and overnight interbank interest rate



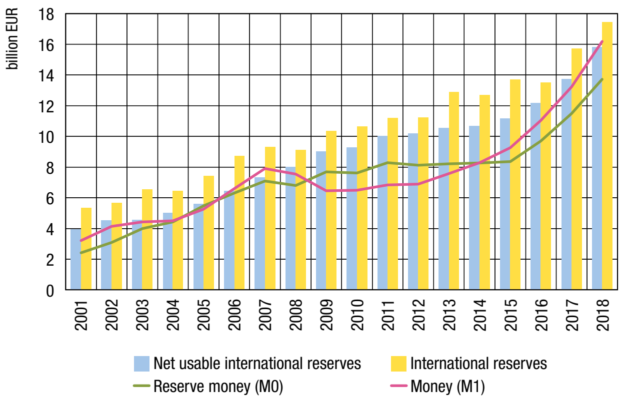
Source: CNB.

Figure 9.3 Nominal exchange rates of the kuna against selected currencies



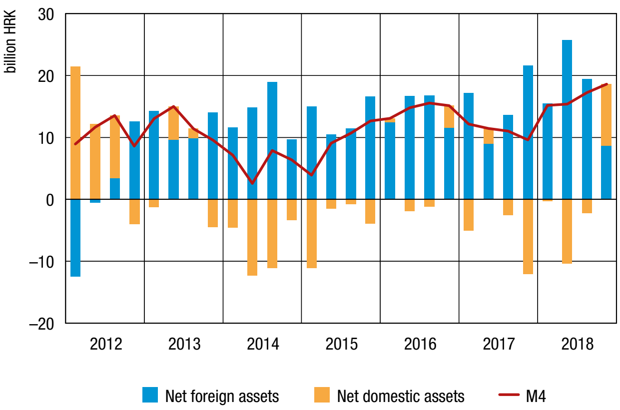
Source: CNB.

Figure 9.4 International reserves of the CNB and monetary aggregates



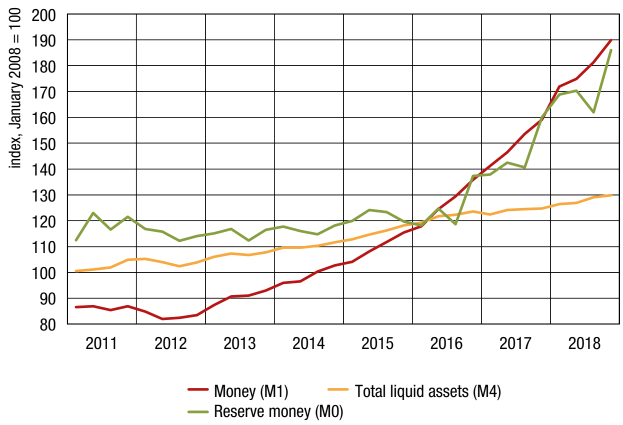
Note: Net usable international reserves are defined as international reserves net of the CNB foreign liabilities, reserve requirements in f/c, government foreign currency deposits and off-balance sheet liabilities (swaps).
Source: CNB.

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



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

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



Source: CNB.

reserve money (M0).

The growth of total liquid assets (M4) continued in the second half of 2018 as a result of the increase in net foreign assets of the CNB and the growth in net domestic assets, mostly driven by the upward trend in corporate and household placements and net placements to the central government (Figure 9.5).

The annual rate of the real growth in total liquid assets (M4) stood at 4.1% at end of December, while real money (M1) and reserve money (M0) grew annually by 19.4% and 16.3% respectively (Figure 9.6). The increase in M1 was mostly driven by the rise in kuna funds in transaction accounts in a setting of low interest rates on savings and time deposits, while the rise in M0 primarily reflected large kuna liquidity surpluses created in CNB foreign exchange transactions.

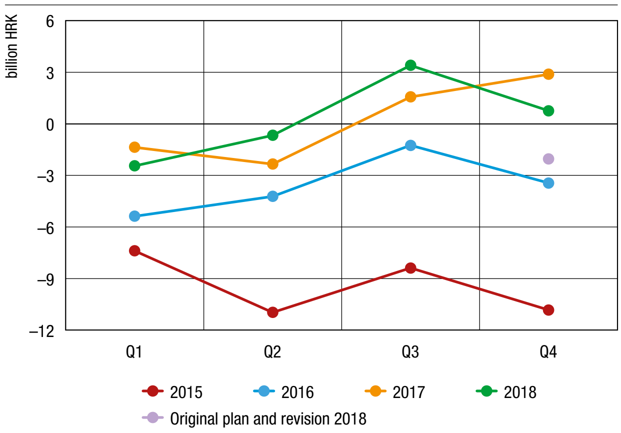
10 Public finance

Notwithstanding the materialisation of some of the negative risks which mainly included the activation of government guarantees issued to certain shipyards, relatively favourable fiscal developments continued in the second half of 2018. In the July-December period, the general government surplus (ESA 2010) reached HRK 1.4bn, reflecting a performance about HRK 3.8bn worse than in the same period of 2017. The decrease of the surplus reflects a much faster growth of total expenditures, which, due to the enforcement of guarantees, edged up by 12.1% from the second half of 2017, while total revenues grew by 7.0%. The general government surplus in 2018 as a whole stood at 0.2% of GDP, its overall annual performance being more favourable than in the general government budget revision from December 2018 which showed a deficit of 0.5%.

Decomposition of the change in the nominal general government balance shows that the decrease of the nominal surplus in 2018 as a whole was adversely affected by structural factors (mainly due to the growth of capital transfers driven by the activation of government guarantees). By contrast, a positive contribution to the change in the balance came from a further decrease in interest expenditures and, to a smaller extent, from the continuation of favourable cyclical developments in the economic activity.

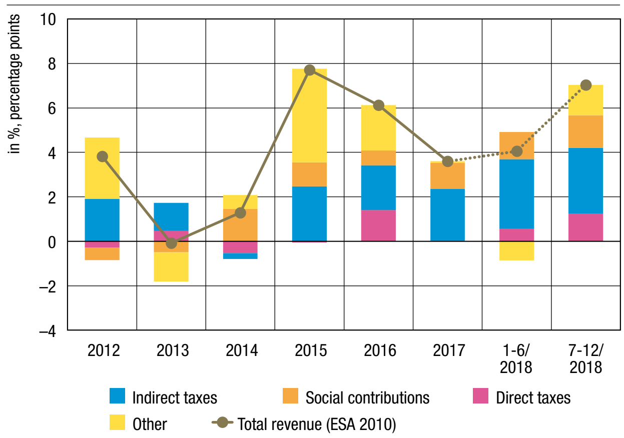
The annual increase in total revenues picked up from the 4.1% of the first half to 7.0% in the second half of 2018. Such developments primarily reflect a significant acceleration in the growth of direct taxes, which probably may be attributed to favourable trends in the labour market and better business results of economic entities. In addition, after falling on an annual basis in the first half of the year, other current revenues grew considerably in the second half of 2018 and thus made

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



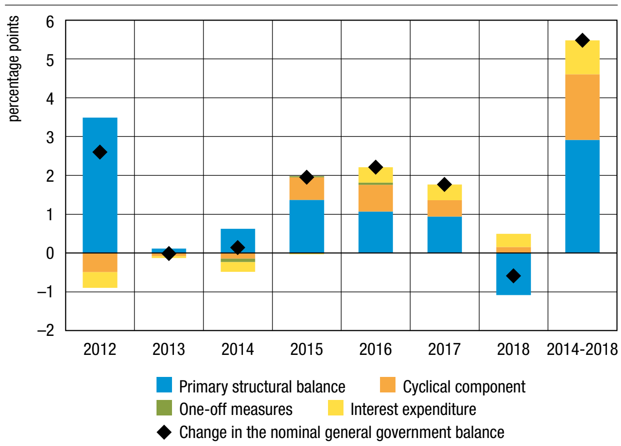
Sources: Eurostat and MoF (CNB calculations).

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



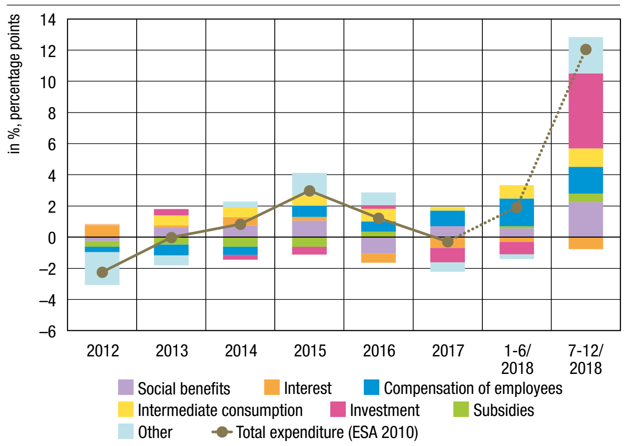
Source: Eurostat (CNB calculations).

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



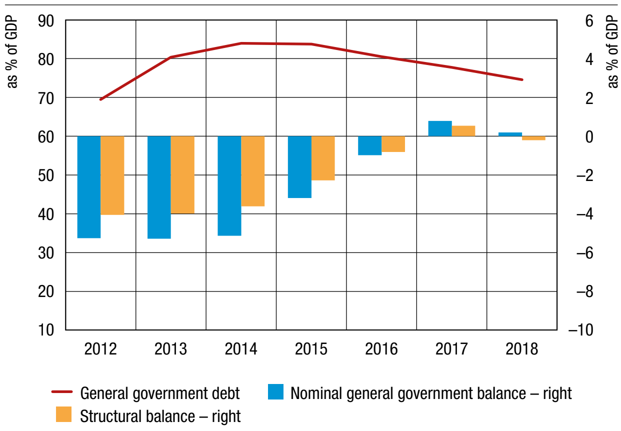
Source: CNB

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



Source: Eurostat (CNB calculations).

Figure 10.5 General government deficit and debt



Source: Eurostat (CNB calculations).

a positive contribution to total revenues. Revenues from indirect taxes grew on account of the continued growth of personal consumption and favourable developments in tourism. Favourable labour market trends also supported revenues from social contributions.

At the same time, general government expenditures increased by 12.1% on an annual level in the second half of 2018, after growing by 1.9% in the first six months. The growth of total expenditures was primarily driven by the rise in capital expenditures, up by as much as 73.5% annually in the second half of 2018 due to a sharp increase in expenditures for investments (80.3%) and capital transfers (60.5%). With expenditures for capital transfers strongly influenced by the enforcement of shipyard guarantees, the growth of expenditures for investments was probably stimulated by the stronger investment activity of the general government and public enterprises included in the general government sector. Moreover, in the second half of 2018, total expenditures grew also on account of the significant positive contribution of expenditures for social benefits, most likely under the influence of regular pension adjustments and additional expenditures due to the increased welfare for war veterans on the basis of the new Act from December 2017. Expenditures for subsidies also rose in the second half of 2018, this category being marked by a variable infra-annual dynamics of payments. Expenditures for employees and intermediary consumption grew at rates similar to those in the first half of 2018, while expenditures for interest fell on an annual basis on account of the improving financing conditions and lower financing needs of the general government.

Consolidated general government debt stood at HRK 284.7bn at the end of 2018 or 74.6% of GDP, a decrease of about HRK 0.26bn from the end of June 2018. This result would have been even more favourable had it not been for the enforcement of shipyard guarantees. It seems that the level of debt in the second half of 2018 was also influenced by significantly higher payments to end beneficiaries from EU funds in contrast to inflows from the EU budget, with the difference remunerated from national sources of funds. The public debt-to-GDP ratio went down by about 3.2 percentage points at the end of 2018 from the end of 2017, reflecting the relatively favourable budget outturn as well as economic growth and the strengthening of the kuna/euro exchange rate.

11 International reserves management

The upward trend in international reserves continued in 2018. In strategic and tactical terms, international reserves management adhered to the same principles as in the previous years, with special efforts put in to adjust the structure of net reserves to a prolonged period of low and negative interest rates in the financial market and to the inflows and maturities in the net reserves portfolios in the best possible way, all in line with the objectives of reserves management. The primary objective of international reserves management remained the same, namely to ensure a high level of liquidity and safety of international reserves and generate adequate levels of earnings.

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

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

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

11.1 Structure of and developments in international reserves

International reserves of the CNB stood at EUR 17,438.8m as at 31 December 2018, up by EUR 1,732.9m or 11.0% from the end of 2017 when they stood at EUR 15,705.9m. Over the same period, net reserves rose by EUR 2,084.8m, or 15.2%, from EUR 13,735.2m to EUR 15,820.0m.

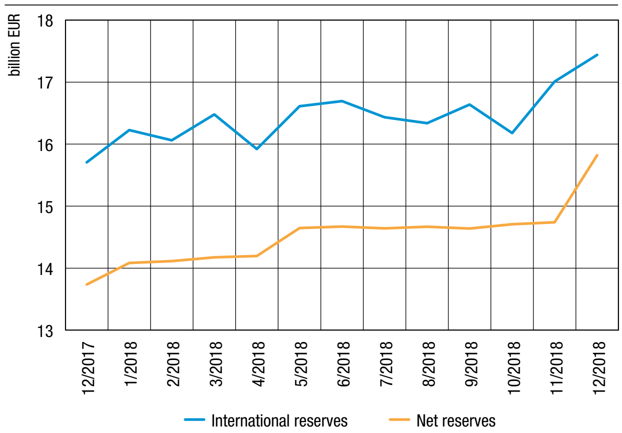
The increase in international reserves in 2018 was brought about by the substantial purchase of foreign exchange from banks, securing the stability of the domestic currency's exchange rate, earnings from reserves management and positive cross-currency changes caused primarily by the strengthening of the US dollar vis-a-vis the euro, which led to a rise in the value of the US dollar share of reserves in euro terms. Net purchases of foreign currency by the CNB amounted to EUR 1,839.3m in 2018, thus creating HRK 13.6bn. Almost the entire amount of foreign exchange transactions was accounted for by foreign currency purchases from banks (EUR 1,808.9m), while the remaining smaller share was accounted for by net purchases from the Ministry of Finance (EUR 30.4m).

Securities of governments and government institutions, reverse repo agreements and deposits with central banks accounted for the largest share in the structure of international reserves investment at the end of 2018.

The CNB invests funds with financial institutions and in countries with an investment grade rating; the assessment of creditworthiness is based on ratings issued by internationally recognised rating agencies (Moody's, Standard & Poor's and FitchRatings) and on an internally-developed creditworthiness assessment model.

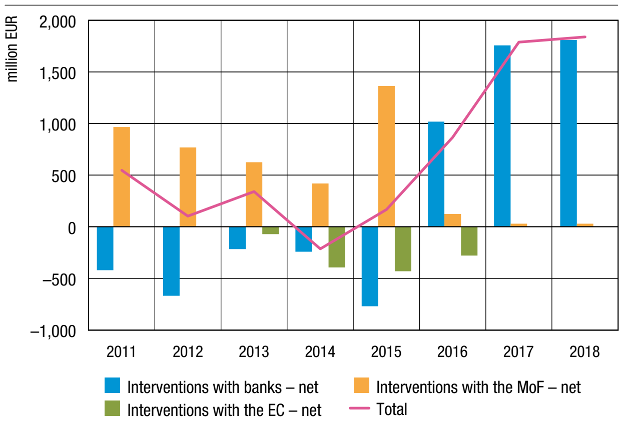
In its management of international reserves, the CNB is governed primarily by the principle of safety and applies restrictions on investments in individual financial institutions and countries and individual instruments, which serves to diversify credit risk. At the end of 2018, around one half of the CNB international reserves were invested in countries, banks and institutions within the two highest credit rating categories or invested in the BIS and the IMF or in foreign cash in the CNB

Figure 11.1 Monthly changes in international and net CNB reserves in 2018



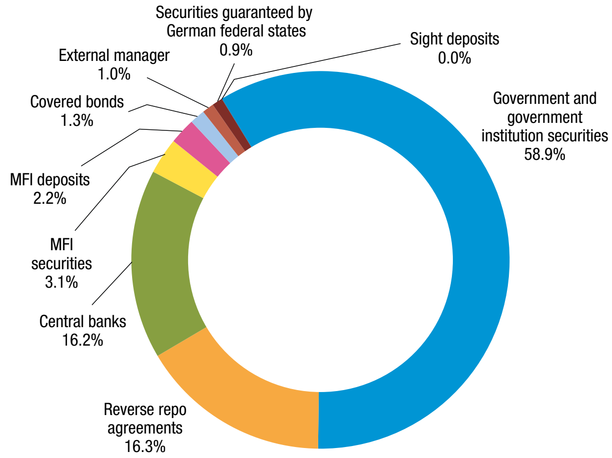
Source: CNB.

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



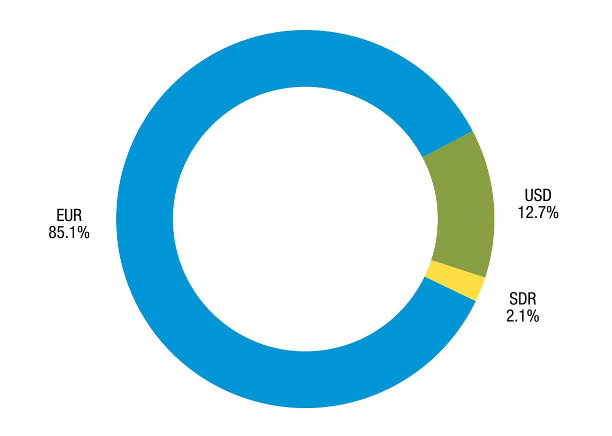
Note: Positive values refer to the purchase and negative to the sale of foreign exchange by the CNB.
Source: CNB.

Figure 11.3 Structure of international reserves investment
as at 31 December 2018



Source: CNB.

Figure 11.4 Currency structure of total international reserves
as at 31 December 2018



Source: CNB.

vault.

In 2018, the currency structure of international reserves changed slightly in favour of the euro. The share of the euro, 83.2% at the end of 2017, stood at 85.1% at the end of December 2018. Over the same period, the share of the US dollar decreased from 14.5% at the end of 2017 to 12.7%. The share of SDRs in the international reserves also dropped slightly, from 2.3% to 2.1%. The rise in the euro component of reserves in 2018 was due to the allocation of the entire amount of the growth in international reserves to the euro portfolio, as the amounts of dollar investments and SDRs were kept stable.

11.2 Financial markets and international reserves management results in 2018

Financial markets in 2018 were marked by increased volatility, further tightening of the US monetary policy and the ending of the ECB's securities purchase programme as well as by the first signs of the future rise in interest rates. The market volatility grew against the backdrop of frequent threats of trade war, political uncertainty in Europe and numerous geopolitical risks as well as the overall slowdown in global growth and the lack of pick-up in inflation.

During the year, the European Central Bank kept its interest rates unchanged and began curtailing the securities purchase programme, putting an end to it at the end of 2018. European yields remained low and mostly negative, while the yield curve for German bonds for all maturities up to seven years was in negative territory at the end of the year.

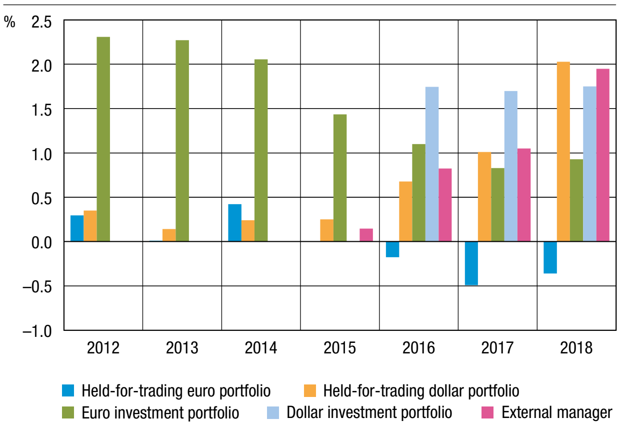
In 2018, the Fed raised its benchmark interest rate to a range between 2.25% and 2.50% on four occasions, and continued the process of reducing its balance sheet. US yields rose across the entire curve in 2018 which was markedly flattened. The divergent trends in the monetary policies of the Fed and the ECB, increased political uncertainty in Europe and expectations that European interest rates will remain stable over a longer period of time contributed to the weakening of the euro against the US dollar.

In these conditions and despite the fact that the unfavourable environment of a prolonged period of negative euro yields continued, the CNB ensured an adequate earnings from reserves management in 2018 as well. This was largely due to strategic and tactical decisions on international reserves management in the 2011 – 2018 period and ongoing adjustments of investment guidelines. Investments of net international reserves generated a total income of EUR 62.1m or HRK 460.9m in 2018.

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

The entire euro portfolio of net reserves generated a rate of return of 0.18% in 2018, while the rate of return on the entire dollar portfolio stood at 1.88%. If held-for-trading and investment portfolios are observed separately, the euro held-for-trading portfolio generated a rate of return of –0.36%, while the dollar held-for-trading portfolio generated a rate of return of 2.03% in 2018. In 2018, the euro-denominated investment portfolio yielded a return of 0.93%, while the dollar-denominated investment portfolio yielded 1.75%.

Figure 11.5 Annual rates of return on the CNB foreign currency portfolios from 2012 to 2018



Source: CNB.

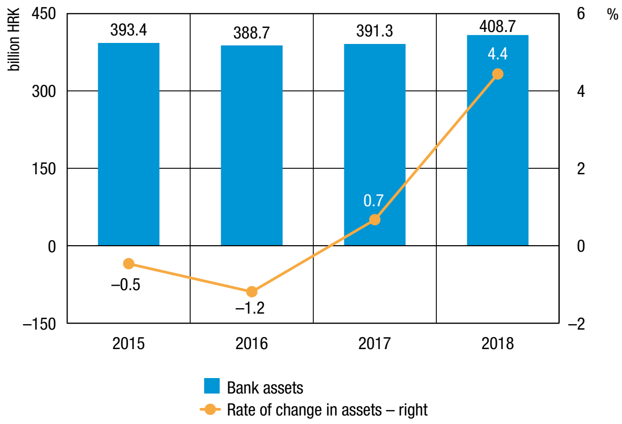
The held-for-trading portfolios, which account for approximately 58% of net reserves, have short average maturities and are used as a source of liquidity. Investment portfolios, which account for approximately 38% of net reserves, have a longer average maturity and serve as a source of more stable long-term income.

In 2018, the rate of return on the US dollar funds entrusted for management to an international financial institution was 1.95%. The entrusting of funds to an international financial institution enabled additional diversification and knowledge-exchange in the field of investment management.

12 Business operations of credit institutions

The downward trend in the number of credit institutions present since 2010 accelerated in 2018. The number of credit institutions was reduced by five, and at the end of the year, 21 banks and four housing savings banks were operating in the Republic of Croatia. The most significant factor was the merger of Splitska banka and OTP banka, making Splitska banka the fourth largest bank in the system in terms of assets. In addition, there was one branch of an EU credit institution operating in the country, while almost 160 institutions from the EU (and the EEA) notified the CNB of the direct provision of mutually recognised services in the territory of the Republic of Croatia.[14] Credit institutions in foreign ownership continued to dominate the banking system, accounting for 90.2% of total assets of credit institutions.

Figure 12.1 Bank assets

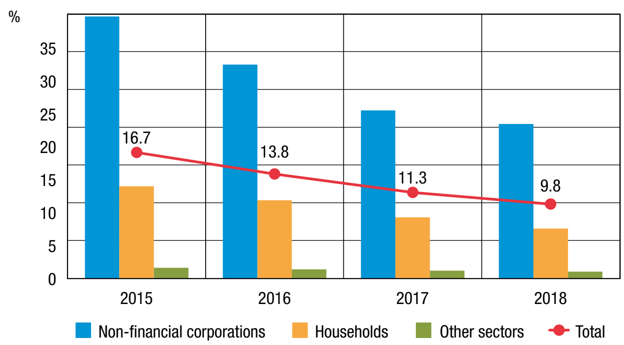


Source: CNB.

12.1 Banks

Having decreased or been stagnant for six years, bank assets increased noticeably in 2018 (4.4%, Figure 12.1). The structure of assets saw an increase in importance of highly liquid items, reflecting high LCRs[15] (161.0% at the end of 2018, Figure 12.4), and loans granted. The four-year decline in loans granted came to a halt, mainly as the outcome of stronger lending to households, in particular in the form of general-purpose cash loans. In order to cover potentially higher risk, the CNB issued recommendations on actions in granting non-housing consumer loans[16], and credit institutions were instructed to pay particular attention to these loans in the course of their internal risk assessments. Loans to non-financial corporations edged down on account of the sale of claims and the enforcement of government guarantees issued to corporations in the shipbuilding activity at the end of 2018. Increased lending at fixed interested rates continued, as did lending in kuna, strengthening the demand for this type of source of funds, as reflected in the greater attractiveness of the CNB structural operation[17] and the issuance of kuna bonds by one bank. The structural liquidity ratio, NSFR[18], stood at 147.8%, indicating a stable structure of sources, which relies heavily on domestic household deposits.

Figure 12.2 Share of risk category B and C loans in total loans of banks



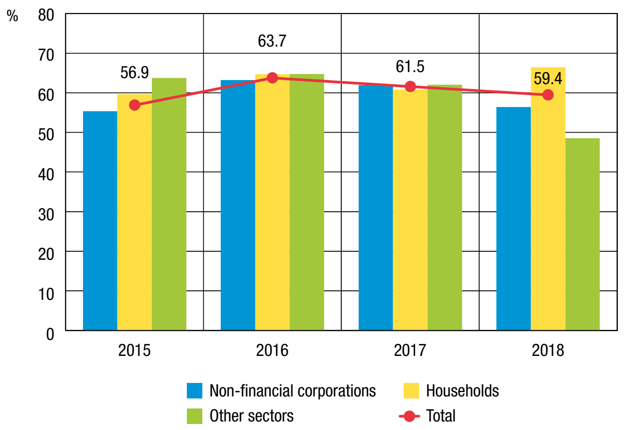
Note: In the period up to (including) 2017, distribution of loans into risk categories and impairment were governed by the Decision on the classification of placements and off-balance sheet liabilities of credit institutions (OG 41A/2014 and 28/2017, IAS 39), while since 2018 they have been regulated by the Decision on the classification of exposures into risk categories and the method of determining credit losses (OG 114/2017, IFRS 9).
Source: CNB.

Deposits of domestic sectors increased markedly in 2018, especially household deposits. They grew at accelerated rates, especially in the middle part of the year on account of the seasonal impact of the tourist season. Against this background, the share of sources from majority foreign owners remained relatively low (2.9% of assets). The strengthening of kuna deposits and transaction account deposits continued, with the latter exceeding almost a half of total bank deposits (at the end of 2015, they accounted for slightly more than a fourth). This is the result of low interest rates and a further fall in interest rates on time deposits, with a certain effect being undoubtedly exerted by the introduction of taxation of interest payments on savings in 2015.[19]

The quality of loans improved, mainly influenced by the sale

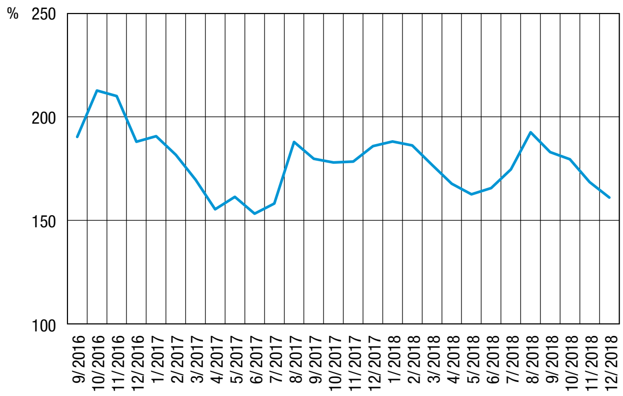
14 Updated information on credit institutions operating in the territory of the Republic of Croatia may be found here.
15 LCR (liquidity coverage ratio) measures the ability of a bank to overcome a 30-day stress period from the aspect of liquidity and is to amount to at least 100%.
16 Recommendation on actions in granting non-housing consumer loans.
17 The CNB held a structural operation in December, placing a total of HRK 1.4bn to banks for a five-year term at a fixed interest rate of 1.2%.
18 NSFR (net stable funding ratio) requires banks to maintain stable sources of funding in relation to their structure of assets and off-balance sheet items. The final calibration of the indicator (the numerator and the denominator) is yet to be determined and banks are currently not required to comply with its minimum value of 100%.
19 The Act on Amendments to the Income Tax Act (OG 143/2014) introduced a tax on interest on kuna and foreign currency savings deposits (sight and time savings deposits and annuity savings) at a rate of 12% in 2015. Interest on the positive balance in giro accounts, current

Figure 12.3 Coverage of B and C risk category loans by impairment



Note: See note in Figure 12.2.
Source: CNB.

Figure 12.4 Liquidity coverage ratio (LCR)



Source: CNB.

of claims. The share of non-performing loans (B and C risk category loans) fell below 10%, from 11.3% to 9.8% (Figure 12.2). Non-performing loans increased early in the year due to the implementation of the new accounting standard for financial instruments and the application of the new subordinate legislation on the classification of exposures from the beginning of 2018.[20] As regards non-financial corporations particularly important was the obligation to classify loans to clients in default into the category of non-performing loans, while households were marked by the effect of provisions related to the pulling effect[21] and the three-month probation period necessary to re-classify a loan from the category of non-performing loans[22]. However, these trends changed by the end of the year and non-performing loans fell to 6.6% in the household sector and to 20.4% in the sector of non-financial corporations. In the sector of non-financial corporations, non-performing loans to manufacturing accounted for the largest share, with the second largest share being accounted for by construction due to large amount of claims sold. Over the past few years, the bulk of credit growth in this sector was accounted for by tourism, i.e. by accommodation and food service activities.

The downward trend in the level of loan losses (i.e. the coverage ratio between non-performing loans and impairment), which had started in 2017, continued in 2018. The coverage ratio fell to 59.4% (Figure 12.3) under the influence of the sale of claims with above-average coverage and the inflow of new loans with collection difficulties (including the reclassification due to the described changes in regulatory treatment), where the level of losses is still low. These developments outweighed the effects of the rules on the gradual increase in impairment, depending on the time elapsed since the debtor's delinquency in meeting obligations. Since its introduction in late 2013, the coverage of non-performing loans trended up, and the rise in related costs motivated banks to pursue a more active approach in resolving non-performing loans, especially through the sale of claims. The total amount of the claims sold fell substantially from 2017, which was marked by record high sales, with claims on non-financial corporations and professional buyers accounting for the major shares[23].

In 2018, bank profits[24] grew by 44.4% on account of smaller credit risk expenses, with lower expenses related to the Agrokor Group having a key impact. In 2017, bank earnings were heavily burdened by expenses related to credit risk, arising from operating difficulties in the Agrokor Group. With these expenses trending downward in 2018, ROAA and ROAE indicators recovered, increasing to 1.4% and 8.6% respectively (Figure 12.5). However, operating profitability, i.e. profitability before impairment and provisions, weakened markedly, decreasing from 2.2% to 1.9%. Net operating income edged down, due to a decline in all components, most notably net interest income as the main source of bank income. The influence of significant savings on interest expenses weakened, due

accounts and foreign currency accounts is not subject to tax provided that the interest rate does not exceed 0.5% a year.

20 The implementation of International Financial Reporting Standard 9, which replaced International Accounting Standard 39, started on 1 January 2018, making it mandatory for the CNB to adjust the national regulation on the classification of exposures and the method of determining losses (Decision on the classification of exposures into risk categories and the method of determining credit losses). The retrospective implementation of IFRS 9 caused banks to increase impairments and provisions for credit exposures and to report related costs (losses) within capital (mainly in retained earnings). Under the old standard, IAS 39, loss recognition was based on the fact that impairment is recognised at the moment when the loss is incurred (the so-called incurred loss model). The new standard changed the way in which loss is recognised in such a way that losses are recognised in the amount in which they can be expected, i.e. before they are actually incurred (the so-called expected loss model). For more information on the initial application of IFRS 9 in Croatian credit institutions, see Banks Bulletin No. 31.

21 Instead of assessing the occurrence of default at debtor level, credit institutions may opt for performing such an assessment based on an individual product for retail exposures. In that case, if balance sheet exposures in default account for over 20% of all balance sheet exposures to that debtor, all exposures to that debtor are considered to be in default and have to be classified into risk category B or C.

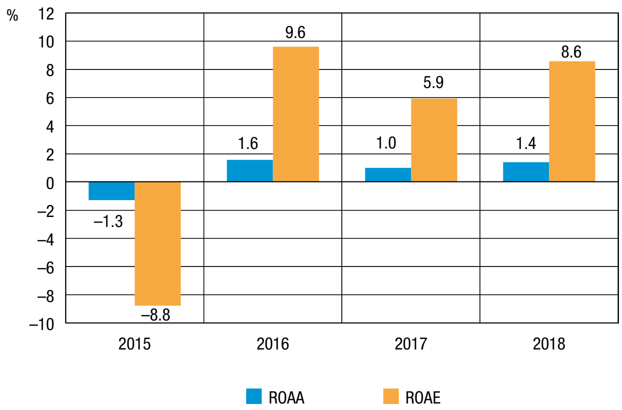
22 Exceptionally, in the case of restructured exposures, the probation period amounts to at least 12 months.

23 Sale of placements is regulated by the Decision on the sale of placements by credit institutions.

24 From continuing operations, before tax.

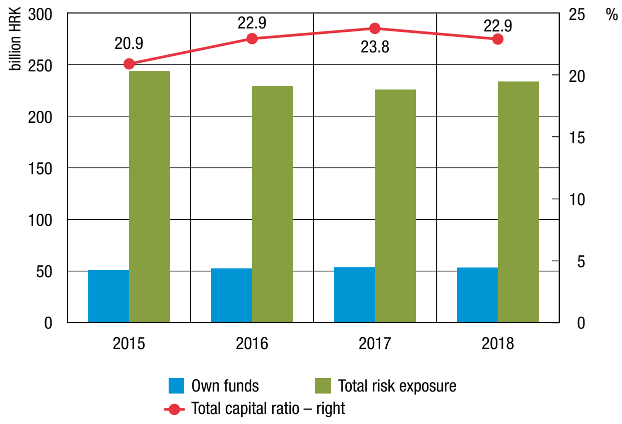
25 Croatian Motorways, Croatian Roads and Rijeka – Zagreb Motorway.

Figure 12.5 Bank return on average assets (ROAA) and return on average equity (ROAE)



Source: CNB.

Figure 12.6 Bank total capital ratio



Source: CNB.

to the low level already reached, and the impact of interest income prevailed due to declining interest rates. Interest income from domestic government fell at an especially sharp rate, a significant part of which can be attributed to early repayment of loans at the end of 2017 and to favourable refinancing of the road sector[25] in April 2018. New lending activity of banks resulted in the moderate increase of interest income from general-purpose cash loans to households, while non-interest income decreased, mostly on account of the smaller income from dividends. The profitability of O-SII banks[26] was markedly higher than the profitability of other banks, most notably in three leading banks that were the only ones to report above-average ROAA. Three banks, all from the group of small banks, reported a current year loss.

Total capital ratio decreased on account of the heightened business activities of banks and the rise in credit risk exposure. At the end of 2018, it stood at 22.9%, down by 0.9 percentage points from the end of 2017 (Figure 12.6). The average credit risk weight decreased slightly, to 49.4%, primarily under the influence of the sale of claims and despite the changes in the weighting of exposures to the domestic central government and the central bank denominated in a currency other than the kuna. In 2018, those exposures were no longer assigned a preferential risk weight of 0% but a risk weight of 20%. Own funds held steady, notwithstanding losses of HRK 1.4bn arising from the introduction of IFRS 9. This was largely the result of the inclusion of unrealised gains on assets measured at fair value, which in line with regulations were excluded from own funds until the end of 2017. Although lower, total capital ratio remained high, and even if all exposures became fully irrecoverable, it would still amount to a high 19.9%.

12.2 Housing savings banks

Due to a merger of one housing savings bank with its parent bank[27], the assets of housing savings banks decreased by one third, to only 1.3% of total assets of credit institutions. If the effect of merger is excluded, the assets of housing savings banks increased by 3.4%, the highest growth being observed in deposits and loans granted. The quality of loans improved as a result of the decrease in the share of non-performing loans to 1.4%. The exit of one housing savings bank from the system weakened the profit. However, even if that effect is excluded it would decrease, to be more accurate it would halve, due mostly to the base period effect, i.e. the income from the sale of domestic government bonds in 2017 in one housing savings bank. ROAA and ROAE went down to 0.2% and 1.5% respectively, with one housing savings bank operating at a loss. Notwithstanding a considerable decrease, total capital ratio remained high (24.2%).

26 Other systemically important (O-SII) credit institutions are credit institution the failure or malfunction of which could lead to systemic risk in the Republic of Croatia. The last review of other systemically important credit institutions, carried out in January 2019, identified a total of seven O-SII credit institutions. More information may be found here.

27 Prva stambena štedionica d.d. merged with Zagrebačka banka d.d. on 1 June 2018.

Table 12.1 Ownership structure of banks and their share in total bank assets
end of period

	Dec. 2016		Dec. 2017		Dec. 2018	
	Number of banks	Share	Number of banks	Share	Number of banks	Share
Domestic ownership	11	10.3	10	9.9	10	9.8
Domestic private ownership	8	4.0	7	3.7	7	3.6
Domestic state ownership	3	6.3	3	6.1	3	6.2
Foreign ownership	15	89.7	15	90.1	11	90.2
Total	**26**	**100.0**	**25**	**100.0**	**21**	**100.0**

Source: CNB.

Table 12.2 Structure of bank assets
end of period, in million HRK and %

	Dec. 2016		Dec. 2017			Dec. 2018		
	Amount	Share	Amount	Share	Change	Amount	Share	Change
Cash, cash balances at central banks and other demand deposits	56,355.2	14.5	70,735.5	18.1	25.5	63,342.1	15.5	–10.5
Cash on hand	7,706.9	2.0	8,440.2	2.2	9.5	9,274.3	2.3	9.9
Cash balances at central banks	48,648.2	12.5	62,295.3	15.9	28.1	45,182.7	11.1	–27.5
Other demand deposits	....	....	....	....	....	8,885.0	2.2	–
Financial assets held for trading	6,153.1	1.6	3,297.5	0.8	–46.4	4,152.8	1.0	25.9
Derivatives	2,648.2	0.7	1,071.4	0.3	–59.5	1,233.5	0.3	15.1
Equity instruments	82.5	0.0	74.4	0.0	–9.8	165.9	0.0	123.0
Debt securities	3,422.3	0.9	2,151.7	0.5	–37.1	2,753.4	0.7	28.0
Loans and advances	0.0	0.0	0.0	0.0	–	0.0	0.0	–
Non-trading financial assets mandatorily at fair value through profit or loss	6,062.9	1.6	2,121.0	0.5	–65.0	724.9	0.2	–65.8
Equity instruments	6.4	0.0	1.8	0.0	–72.0	628.4	0.2	35,024.0
Debt securities	6,056.6	1.6	2,119.2	0.5	–65.0	0.0	0.0	–100.0
Loans and advances	0.0	0.0	0.0	0.0	–	96.6	0.0	–
Financial assets at fair value through profit or loss	....	....	....	....	....	402.1	0.1	–
Debt securities	....	....	....	....	....	402.1	0.1	–
Loans and advances	....	....	....	....	....	0.0	0.0	–
Financial assets at fair value through other comprehensive income	39,753.3	10.2	45,591.8	11.7	14.7	49,130.5	12.0	7.8
Equity instruments	544.9	0.1	608.3	0.2	11.6	649.1	0.2	6.7
Debt securities	39,208.3	10.1	44,983.5	11.5	14.7	48,481.4	11.9	7.8
Loans and advances	0.0	0.0	0.0	0.0	–	0.0	0.0	–
Financial assets at amortised cost	267,423.0	68.8	252,017.8	64.4	–5.8	277,394.5	67.9	10.1
Debt securities	8,671.0	2.2	4,823.6	1.2	–44.4	3,401.1	0.8	–29.5
Loans and advances	258,751.9	66.6	247,194.2	63.2	–4.5	273,993.4	67.0	10.8
Derivatives – hedge accounting	10.8	0.0	0.0	0.0	–100.0	0.4	0.0	–
Fair value changes of the hedged items in portfolio hedge of interest rate risk	0.0	0.0	0.0	0.0	–	5.3	0.0	–
Investments in subsidiaries, joint ventures and associates	4,365.7	1.1	8,794.7	2.2	101.4	5,447.6	1.3	–38.1
Tangible assets	5,230.8	1.3	4,923.0	1.3	–5.9	4,327.8	1.1	–12.1
Property, plant and equipment	4,964.2	1.3	4,633.3	1.2	–6.7	4,087.9	1.0	–11.8
Investment property	266.6	0.1	289.7	0.1	8.7	240.0	0.1	–17.2
Intangible assets	1,211.4	0.3	1,186.6	0.3	–2.0	1,397.8	0.3	17.8
Goodwill	74.1	0.0	74.1	0.0	0.0	74.1	0.0	0.0
Other intangible assets	1,137.4	0.3	1,112.6	0.3	–2.2	1,323.7	0.3	19.0

	Dec. 2016		Dec. 2017			Dec. 2018		
	Amount	Share	Amount	Share	Change	Amount	Share	Change
Tax assets	1,166.9	0.3	1,396.0	0.4	19.6	1,009.2	0.2	–27.7
Current tax assets	229.9	0.1	525.0	0.1	128.3	243.3	0.1	–53.7
Deferred tax assets	936.9	0.2	871.0	0.2	–7.0	765.9	0.2	–12.1
Other assets	575.2	0.1	491.6	0.1	–14.5	976.6	0.2	98.7
Non-current assets and disposal groups classified as held for sale	413.5	0.1	780.8	0.2	88.8	392.8	0.1	–49.7
Total assets	**388,721.9**	**100.0**	**391,336.4**	**100.0**	**0.7**	**408,704.4**	**100.0**	**4.4**

Notes: As of 2018, the source of data on bank assets have been the data obtained within the statistical and prudential reporting system, compiled according to the F 01.01 form of the Commission Implementing Regulation (EU) No 680/2014. Based on the economic and accounting essence of each item, the data for previous periods have been adjusted to the asset structure envisaged in the mentioned form. It should be noted that the comparison of data is limited, to an extent, due to methodological differences.
Source: CNB.

Table 12.3 Structure of bank liabilities and equity

end of period, in million HRK and %

	Dec. 2016		Dec. 2017			Dec. 2018		
	Amount	Share	Amount	Share	Change	Amount	Share	Change
Financial liabilities held for trading	2,261.2	0.6	932.3	0.2	–58.8	1,036.5	0.3	11.2
Derivatives	2,261.2	0.6	932.3	0.2	–58.8	1,036.5	0.3	11.2
Short positions	0.0	0.0	0.0	0.0	–	0.0	0.0	–
Deposits	....	....	....	....	....	0.0	0.0	–
Issued debt securities	....	....	....	....	....	0.0	0.0	–
Other financial liabilities	0.0	0.0	0.0	0.0	–	0.0	0.0	–
Financial liabilities at fair value through profit or loss	0.0	0.0	0.0	0.0	–	0.0	0.0	–
Financial liabilities measured at amortised cost	324,827.5	83.6	323,870.5	82.8	–0.3	344,245.8	84.2	6.3
Deposits	324,347.7	83.4	323,316.4	82.6	–0.3	342,734.3	83.9	6.0
Issued debt securities	355.5	0.1	430.4	0.1	21.1	905.8	0.2	110.4
Other financial liabilities	124.3	0.0	123.7	0.0	–0.5	605.7	0.1	389.6
Derivatives – hedge accounting	9.9	0.0	4.3	0.0	–57.0	13.1	0.0	207.8
Fair value changes of the hedged items in portfolio hedge of interest rate risk	0.0	0.0	0.0	0.0	–	0.0	0.0	–
Provisions	2,243.1	0.6	2,469.6	0.6	10.1	2,470.8	0.6	0.1
Pensions and other post employment defined benefit obligations	10.9	0.0	13.9	0.0	27.5	10.8	0.0	–22.3
Other long-term employee benefits	349.2	0.1	272.9	0.1	–21.9	347.3	0.1	27.3
Restructuring	15.8	0.0	166.7	0.0	957.3	113.8	0.0	–31.7
Pending legal issues and tax litigation	482.8	0.1	594.6	0.2	23.2	591.3	0.1	–0.6
Commitments and guarantees given	1,147.4	0.3	1,258.2	0.3	9.7	1,201.7	0.3	–4.5
Other provisions	237.0	0.1	163.3	0.0	–31.1	205.9	0.1	26.1
Tax liabilities	726.8	0.2	581.7	0.1	–20.0	226.1	0.1	–61.1
Current tax liabilities	669.3	0.2	488.4	0.1	–27.0	132.2	0.0	–72.9
Deferred tax liabilities	57.6	0.0	93.3	0.0	62.1	93.9	0.0	0.7
Other liabilities	3,801.6	1.0	5,295.5	1.4	39.3	3,554.4	0.9	–32.9
Liabilities included in disposal groups classified as held for sale	0.0	0.0	0.0	0.0	–	0.0	0.0	–
Total liabilities	**333,870.1**	**85.9**	**333,153.9**	**85.1**	**–0.2**	**351,546.7**	**86.0**	**5.5**
Capital	25,584.9	6.6	26,064.7	6.7	1.9	24,516.2	6.0	–5.9
Paid up capital	25,584.9	6.6	26,064.7	6.7	1.9	24,516.2	6.0	–5.9
Unpaid capital which has been called up	....	....	....	....	....	0.0	0.0	–
Share premium	8,592.5	2.2	8,531.1	2.2	–0.7	8,093.5	2.0	–5.1
Equity instruments issued other than capital	0.0	0.0	0.0	0.0	–	0.0	0.0	–

	Dec. 2016		Dec. 2017			Dec. 2018		
	Amount	Share	Amount	Share	Change	Amount	Share	Change
Other equity	....	....	....	....	....	13.6	0.0	–
Accumulated other comprehensive income	863.8	0.2	1,175.6	0.3	36.1	1,000.6	0.2	–14.9
Retained earnings	11,222.1	2.9	15,473.6	4.0	37.9	16,680.3	4.1	7.8
Other reserves	3,653.0	0.9	3,685.6	0.9	0.9	2,033.7	0.5	–44.8
Reserves or accumulated losses of investments in subsidiaries, joint ventures and associates accounted for using the equity method	....	....	....	....	....	0.0	0.0	–
Other	3,653.0	0.9	3,685.6	0.9	0.9	2,033.7	0.5	–44.8
(–) Treasury shares	–95.8	0.0	–96.1	0.0	0.2	–124.1	0.0	29.2
Profit or loss attributable to owners of the parent	5,031.3	1.3	3,348.0	0.9	–33.5	4,943.8	1.2	47.7
(–) Interim dividends	....	....	....	....	....	0.0	0.0	–
Minority interests [Non-controlling interests]	0.0	0.0	0.0	0.0	–	0.0	0.0	–
Total equity	**54,851.8**	**14.1**	**58,182.5**	**14.9**	**6.1**	**57,157.7**	**14.0**	**–1.8**
Total liabilities and total equity	**388,721.9**	**100.0**	**391,336.4**	**100.0**	**0.7**	**408,704.4**	**100.0**	**4.4**

Notes: As of 2018, the source of data on bank liabilities and equity have been the data obtained within the statistical and prudential reporting system, compiled according to the F 01.02 and F 01.03 forms of the Commission Implementing Regulation (EU) No 680/2014. Based on the economic and accounting essence of each item, the data for previous periods have been adjusted to the structure of liabilities and equity envisaged in the mentioned forms. It should be noted that the comparison of data is limited, to an extent, due to methodological differences.
Source: CNB.

Table 12.4 Bank income statement

in reference periods, in million HRK and %

	Amount		Change
	Jan. – Dec. 2017	Jan. – Dec. 2018	
Interest income	14,744.8	11,632.4	–21.1
Financial assets held for trading	1,339.4	267.3	–80.0
Non-trading financial assets mandatorily at fair value through profit or loss	48.8	4.4	–90.9
Financial assets at fair value through profit or loss	0.0	14.3	–
Financial assets at fair value through other comprehensive income	692.6	624.2	–9.9
Financial assets at amortised cost	12,621.1	10,688.4	–15.3
Derivatives – hedge accounting, interest rate risk	0.1	0.1	–14.2
Other assets	42.7	20.9	–50.9
Interest income on liabilities	0.0	12.8	–
(Interest expenses)	3,809.4	1,786.8	–53.1
(Financial liabilities held for trading)	1,241.9	173.1	–86.1
(Financial liabilities designated at fair value through profit or loss)	0.0	0.0	–
(Financial liabilities measured at amortised cost)	2,512.8	1,510.3	–39.9
(Derivatives – hedge accounting, interest rate risk)	2.0	4.1	109.0
(Other liabilities)	52.7	21.9	–58.4
(Interest expense on assets)	0.0	77.3	–
Net interest income	**10,935.4**	**9,845.6**	**–10.0**
Dividend income	**826.3**	**468.4**	**–43.3**
Fee and commission income	4,848.7	4,813.4	–0.7
(Fee and commission expenses)	1,437.9	1,550.3	7.8
Net fee and commission income	**3,410.7**	**3,263.1**	**–4.3**
Gains (losses)	**1,392.1**	**1,539.3**	**10.6**
Other operating income	452.7	330.3	–27.0
(Other operating expenses)	934.9	881.3	–5.7
Total operating income, net	**16,082.3**	**14,565.5**	**–9.4**

	Amount		Change
	Jan. – Dec. 2017	Jan. – Dec. 2018	
(Administrative expenses)	6,646.9	6,287.4	–5.4
(Staff expenses)	3,799.5	3,668.1	–3.5
(Other administrative expenses)	2,847.3	2,619.4	–8.0
(Depreciation)	711.1	666.7	–6.2
Administrative expenses and depreciation	**7,358.0**	**6,954.1**	**–5.5**
Modification gains (–) losses, net	0.0	–38.9	–
Operating profit	**8,724.3**	**7,572.5**	**–13.2**
(Provisions or (–) reversal of provisions)	596.0	220.4	–63.0
(Commitments and guarantees given)	116.1	–1.1	–
(Other provisions)	480.0	221.5	–53.8
(Impairment or (–) reversal of impairment on financial assets not measured at fair value through profit or loss)	3,739.8	1,635.4	–56.3
(Financial assets at fair value through other comprehensive income)	40.4	–3.0	–
(Financial assets at amortised cost)	3,699.4	1,638.3	–55.7
(Impairment or (–) reversal of impairment of investments in subsidiaries, joint ventures and associates)	317.6	82.1	–74.1
(Impairment or (–) reversal of impairment on non–financial assets)	185.9	65.8	–64.6
Impairment and provisions	**4,839.4**	**2,003.7**	**–58.6**
Negative goodwill recognised in profit or loss	0.0	0.0	–
Share of the profit or (–) loss of investments in subsidiaries, joint ventures and associates accounted for using the equity method	0.0	40.4	–
Profit or (–) loss from non–current assets and disposal groups classified as held for sale not qualifying as discontinued operations	19.8	31.1	57.2
Profit or (–) loss before tax from continuing operations	**3,904.7**	**5,640.2**	**44.4**
(Tax expense or (–) income related to profit or loss from continuing operations)	560.9	696.2	24.1
Profit or (–) loss after tax from continuing operations	**3,343.8**	**4,944.0**	**47.9**
Profit or (–) loss after tax from discontinued operations	4.3	–0.2	–
Profit or (–) loss before tax from discontinued operations	...	–0.2	–
(Tax expense or (–) income related to discontinued operations)	...	0.0	–
Profit (loss) for the year	**3,348.0**	**4,943.8**	**47.7**

Notes: As of 2018, the source of data on the bank income statement have been the data obtained within the statistical and prudential reporting system, compiled according to the F 02.00 form of the Commission Implementing Regulation (EU) No 680/2014. Based on the economic and accounting essence of each item, the data for previous periods have been adjusted to the income statement structure envisaged in the mentioned form. It should be noted that the comparison of data is limited, to an extent, due to methodological differences.
Source: CNB.

Table 12.5 Distribution of total bank exposure by risk categories

end of period, in million HRK and %

Risk (sub) category	Dec. 2016			Dec. 2017			Dec. 2018		
	Total exposure	Impairment and provisions	Coverage (%)	Total exposure	Impairment and provisions	Coverage (%)	Total exposure	Impairment and provisions	Coverage (%)
A	365,032.2	3,344.5	0.9	363,088.8	3,148.2	0.9	431,573.6	3,847.4	0.9
A-1	....	....	....	....	....	....	402,981.7	2,404.0	0.6
A-2	....	....	....	....	....	....	28,591.9	1,443.3	5.0
B	28,608.9	14,274.1	49.9	26,151.7	13,254.0	50.7	23,426.7	10,909.5	46.6
B-1	8,411.0	1,185.9	14.1	7,751.3	963.9	12.4	8,418.4	801.5	9.5
B-2	12,168.7	6,488.8	53.3	9,908.0	5,322.0	53.7	7,962.5	4,131.0	51.9
B-3	8,029.2	6,599.4	82.2	8,492.3	6,968.1	82.1	7,045.9	5,976.9	84.8
C	10,691.5	10,693.2	100.0	7,685.9	7,686.2	100.0	7,577.0	7,580.2	100.0
Total	**404,332.6**	**28,311.7**	**7.0**	**396,926.3**	**24,088.4**	**6.1**	**462,577.3**	**22,337.0**	**4.8**

Note: For the period up to (including) 2017, impairment, provisions and distribution of exposure were governed by the Decision on the classification of placements and off-balance sheet liabilities of credit institutions (OG 41A/2014 and 28/2017, IAS 39), while as of 2018, they have been governed by the Decision on the classification of exposures into risk categories and the method of determining credit losses (OG 114/2017, IFRS 9).
Source: CNB.

Table 12.6 Bank loans

end of period, in million HRK and %

	Dec. 2016		Dec. 2017			Dec. 2018		
	Amount	Share	Amount	Share	Change	Amount	Share	Change
Loans								
General government	50,997.2	19.5	39,883.9	16.2	–21.8	40,675.2	16.0	2.0
Non-financial corporations	83,378.8	31.9	81,808.3	33.3	–1.9	81,090.9	31.9	–0.9
Construction	9,945.0	3.8	7,626.9	3.1	–23.3	6,596.6	2.6	–13.5
Information and communication	1,769.0	0.7	1,540.8	0.6	–12.9	1,497.1	0.6	–2.8
Agriculture	4,972.0	1.9	5,245.7	2.1	5.5	5,228.7	2.1	–0.3
Real estate activities	6,009.9	2.3	5,358.2	2.2	–10.8	5,712.8	2.2	6.6
Manufacturing	19,245.0	7.4	18,849.0	7.7	–2.1	18,700.8	7.3	–0.8
Transportation and storage	3,057.1	1.2	3,055.4	1.2	–0.1	3,189.6	1.3	4.4
Accommodation and food service activities	8,530.8	3.3	9,923.7	4.0	16.3	10,700.9	4.2	7.8
Professional, scientific and technical activities	4,865.8	1.9	5,059.6	2.1	4.0	4,522.7	1.8	–10.6
Trade	16,364.2	6.3	15,535.6	6.3	–5.1	15,337.9	6.0	–1.3
Other activities	8,619.9	3.3	9,613.5	3.9	11.5	9,603.7	3.8	–0.1
Households	113,246.0	43.4	114,531.7	46.6	1.1	121,019.3	47.5	5.7
General-purpose cash loans	40,734.7	15.6	42,940.9	17.5	5.4	47,698.2	18.7	11.1
Mortgage loans	2,207.0	0.8	1,940.5	0.8	–12.1	1,848.3	0.7	–4.8
Credit card loans	3,607.9	1.4	3,528.9	1.4	–2.2	3,643.8	1.4	3.3
Investment loans	2,326.3	0.9	2,314.2	0.9	–0.5	2,481.4	1.0	7.2
Overdrafts	7,422.1	2.8	6,993.3	2.8	–5.8	6,848.0	2.7	–2.1
Housing loans	48,236.0	18.5	48,439.3	19.7	0.4	50,712.9	19.9	4.7
Other household loans	8,712.0	3.3	8,374.6	3.4	–3.9	7,786.6	3.1	–7.0
Other sectors	13,577.6	5.2	9,641.3	3.9	–29.0	11,724.8	4.6	21.6
Total	**261,199.5**	**100.0**	**245,865.3**	**100.0**	**–5.9**	**254,510.1**	**100.0**	**3.5**
B and C risk category loans								
General government	8.6	0.0	7.9	0.0	–8.1	4.5	0.0	–43.6
Non-financial corporations	23,586.3	65.4	18,172.4	65.1	–23.0	16,563.2	6.5	–8.9

	Dec. 2016		Dec. 2017			Dec. 2018		
	Amount	Share	Amount	Share	Change	Amount	Share	Change
Construction	6,534.3	18.1	4,226.7	15.2	–35.3	2,939.1	1.2	–30.5
Information and communication	925.6	2.6	296.7	1.1	–67.9	247.6	0.1	–16.6
Agriculture	640.9	1.8	596.7	2.1	–6.9	803.5	0.3	34.7
Real estate activities	2,154.0	6.0	1,388.5	5.0	–35.5	1,151.6	0.5	–17.1
Manufacturing	4,814.3	13.4	3,582.9	12.8	–25.6	3,636.4	1.4	1.5
Transportation and storage	338.1	0.9	473.0	1.7	39.9	457.0	0.2	–3.4
Accommodation and food service activities	1,333.1	3.7	1,294.8	4.6	–2.9	948.7	0.4	–26.7
Professional, scientific and technical activities	1,318.7	3.7	988.2	3.5	–25.1	847.9	0.3	–14.2
Trade	4,646.5	12.9	3,435.9	12.3	–26.1	2,533.9	1.0	–26.3
Other activities	880.8	2.4	1,889.0	6.8	114.5	2,997.5	1.2	58.7
Households	11,699.9	32.5	9,230.1	33.1	–21.1	7,941.9	3.1	–14.0
General-purpose cash loans	3,062.8	8.5	2,560.1	9.2	–16.4	2,547.3	1.0	–0.5
Mortgage loans	664.4	1.8	520.1	1.9	–21.7	432.7	0.2	–16.8
Credit card loans	116.4	0.3	80.4	0.3	–30.9	76.9	0.0	–4.4
Investment loans	510.9	1.4	386.9	1.4	–24.3	276.9	0.1	–28.4
Overdrafts	741.5	2.1	416.5	1.5	–43.8	413.0	0.2	–0.8
Housing loans	3,941.7	10.9	2,990.4	10.7	–24.1	2,529.6	1.0	–15.4
Other household loans	2,662.3	7.4	2,275.8	8.2	–14.5	1,665.7	0.7	–26.8
Other sectors	750.7	2.1	484.1	1.7	–35.5	453.0	0.2	–6.4
Total	**36,045.4**	**100.0**	**27,894.5**	**100.0**	**–22.6**	**24,962.7**	**9.8**	**–10.5**
B and C risk category loans impairment								
General government	3.7	0.0	2.2	0.0	–40.1	2.4	0.0	8.7
Non-financial corporations	14,912.5	64.9	11,250.5	65.5	–24.6	9,339.8	3.7	–17.0
Construction	4,405.2	19.2	3,058.9	17.8	–30.6	2,150.0	0.8	–29.7
Information and communication	527.6	2.3	159.1	0.9	–69.8	123.2	0.0	–22.5
Agriculture	390.8	1.7	356.2	2.1	–8.8	420.8	0.2	18.1
Real estate activities	1,364.8	5.9	772.0	4.5	–43.4	722.6	0.3	–6.4
Manufacturing	2,903.7	12.6	2,186.0	12.7	–24.7	2,244.5	0.9	2.7
Transportation and storage	186.7	0.8	173.4	1.0	–7.1	178.8	0.1	3.1
Accommodation and food service activities	615.7	2.7	586.0	3.4	–4.8	388.5	0.2	–33.7
Professional, scientific and technical activities	813.6	3.5	615.7	3.6	–24.3	365.3	0.1	–40.7
Trade	3,152.4	13.7	2,252.0	13.1	–28.6	1,845.1	0.7	–18.1
Other activities	551.9	2.4	1,091.3	6.4	97.7	900.9	0.4	–17.4
Households	7,566.7	32.9	5,611.1	32.7	–25.8	5,275.3	2.1	–6.0
General-purpose cash loans	2,138.3	9.3	1,736.1	10.1	–18.8	1,666.6	0.7	–4.0
Mortgage loans	396.7	1.7	320.9	1.9	–19.1	294.7	0.1	–8.2
Credit card loans	107.9	0.5	65.4	0.4	–39.4	59.2	0.0	–9.4
Investment loans	346.5	1.5	275.1	1.6	–20.6	216.2	0.1	–21.4
Overdrafts	697.9	3.0	379.0	2.2	–45.7	332.2	0.1	–12.3
Housing loans	2,506.4	10.9	1,759.2	10.2	–29.8	1,700.5	0.7	–3.3
Other household loans	1,373.0	6.0	1,075.5	6.3	–21.7	1,005.8	0.4	–6.5
Other sectors	487.8	2.1	302.8	1.8	–37.9	219.6	0.1	–27.5
Total	**22,970.6**	**100.0**	**17,166.6**	**100.0**	**–25.3**	**14,837.1**	**5.8**	**–13.6**

Notes: Distribution by institutional sectors is performed in line with the European System of National and Regional Accounts 2010 (ESA 2010). The households sector comprises households and non-profit institutions serving households. Data for financial institutions and non-residents is included in the Other sectors item. In the period up to (including) 2017, distribution of loans into risk categories and impairment were governed by the Decision on the classification of placements and off-balance sheet liabilities of credit institutions (OG 41A/2014 and 28/2017, IAS 39), while since 2018 they have been regulated by the Decision on the classification of exposures into risk categories and the method of determining credit losses (OG 114/2017, IFRS 9).
Source: CNB.

Table 12.7 Own funds, risk exposure and capital ratios of banks

end of period, in million HRK and %

	Dec. 2016		Dec. 2017			Dec. 2018		
	Amount	Share	Amount	Share	Change	Amount	Share	Change
Own funds	**52,568.9**	**100.0**	**53,645.3**	**100.0**	**2.0**	**53,474.1**	**100.0**	**–0.3**
Tier 1 capital	48,859.2	92.9	50,447.8	94.0	3.3	51,004.3	95.4	1.1
Common equity tier 1 capital	48,859.2	92.9	50,447.8	94.0	3.3	51,004.3	95.4	1.1
Capital instruments eligible as common equity tier 1 capital	33,904.3	64.5	34,352.8	64.0	1.3	32,477.4	60.7	–5.5
Retained earnings	14,278.2	27.2	18,535.6	34.6	29.8	16,770.3	31.4	–9.5
Other items	676.6	1.3	–2,440.6	–4.5	–	1,756.6	3.3	–
Additional tier 1 capital	0.0	0.0	0.0	0.0	–	0.0	0.0	–
Tier 2 capital	3,709.7	7.1	3,197.5	6.0	–13.8	2,469.8	4.6	–22.8
Total risk exposure amount	**229,271.8**	**100.0**	**225,836.3**	**100.0**	**–1.5**	**233,613.1**	**100.0**	**3.4**
Risk weighted exposure amounts for credit, counterparty credit and dilution risks and free deliveries	202,283.2	88.2	199,205.8	88.2	–1.5	208,363.5	89.2	4.6
Standardised approach	174,732.6	76.2	170,866.5	75.7	–2.2	177,826.3	76.1	4.1
Internal ratings based approach (IRB)	27,550.6	12.0	28,339.2	12.5	2.9	30,537.2	13.1	7.8
Position, foreign exchange and commodities risks	4,569.6	2.0	5,148.3	2.3	12.7	4,734.1	2.0	–8.0
Operational risk	22,099.5	9.6	21,363.5	9.5	–3.3	20,347.5	8.7	–4.8
Credit valuation adjustment	319.5	0.1	118.8	0.1	–62.8	168.0	0.1	41.4
Common equity tier 1 capital ratio	**21.3**	**–**	**22.3**	**–**	**4.8**	**21.8**	**–**	**–2.3**
Tier 1 capital ratio	**21.3**	**–**	**22.3**	**–**	**4.8**	**21.8**	**–**	**–2.3**
Total capital ratio	**22.9**	**–**	**23.8**	**–**	**3.6**	**22.9**	**–**	**–3.6**

Source: CNB.

Table 12.8 Structure of housing savings bank assets

end of period, in million HRK and %

	Dec. 2016		Dec. 2017			Dec. 2018		
	Amount	Share	Amount	Share	Change	Amount	Share	Change
Cash, cash balances at central banks and other demand deposits	0.0	0.0	0.0	0.0	–75.0	201.2	3.7	3353062.6
Cash on hand	0.0	0.0	0.0	0.0	–75.0	0.0	0.0	51.8
Cash balances at central banks	0.0	0.0	0.0	0.0	–	0.0	0.0	–
Other demand deposits	....	....	....	....	....	201.2	3.7	–
Financial assets held for trading	270.9	3.5	221.3	2.8	–18.3	265.3	4.9	19.9
Derivatives	0.0	0.0	0.0	0.0	–	0.0	0.0	–
Equity instruments	0.0	0.0	0.0	0.0	–	0.0	0.0	–
Debt securities	270.9	3.5	221.3	2.8	–18.3	265.3	4.9	19.9
Loans and advances	0.0	0.0	0.0	0.0	–	0.0	0.0	–
Non-trading financial assets mandatorily at fair value through profit or loss	34.9	0.4	0.0	0.0	–100.0	0.0	0.0	–
Equity instruments	0.0	0.0	0.0	0.0	–	0.0	0.0	–
Debt securities	34.9	0.4	0.0	0.0	–100.0	0.0	0.0	–
Loans and advances	0.0	0.0	0.0	0.0	–	0.0	0.0	–
Financial assets at fair value through profit or loss	....	....	....	....	....	0.0	0.0	–
Debt securities	....	....	....	....	....	0.0	0.0	–
Loans and advances	....	....	....	....	....	0.0	0.0	–
Financial assets at fair value through other comprehensive income	1,965.7	25.2	2,052.8	25.9	4.4	1,026.1	18.8	–50.0
Equity instruments	0.0	0.0	0.0	0.0	–	0.0	0.0	–
Debt securities	1,965.7	25.2	2,052.8	25.9	4.4	1,026.1	18.8	–50.0
Loans and advances	0.0	0.0	0.0	0.0	–	0.0	0.0	–
Financial assets at amortised cost	5,482.7	70.2	5,600.4	70.8	2.1	3,934.3	72.2	–29.8

Debt securities	725.9	9.3	672.7	8.5	–7.3	505.8	9.3	–24.8
Loans and advances	4,756.8	60.9	4,927.7	62.3	3.6	3,428.5	62.9	–30.4
Derivatives – hedge accounting	0.0	0.0	0.0	0.0	–	0.0	0.0	–
Fair value changes of the hedged items in portfolio hedge of interest rate risk	0.0	0.0	0.0	0.0	–	0.0	0.0	–
Investments in subsidiaries, joint ventures and associates	0.0	0.0	0.0	0.0	–	0.0	0.0	–
Tangible assets	1.9	0.0	2.9	0.0	49.0	3.4	0.1	17.8
Property, plant and equipment	1.9	0.0	2.9	0.0	49.0	2.5	0.0	–11.9
Investment property	0.0	0.0	0.0	0.0	–	0.9	0.0	–
Intangible assets	8.0	0.1	9.4	0.1	16.4	9.6	0.2	2.6
Goodwill	0.0	0.0	0.0	0.0	–	0.0	0.0	–
Other intangible assets	8.0	0.1	9.4	0.1	16.4	9.6	0.2	2.6
Tax assets	13.8	0.2	11.0	0.1	–20.0	8.8	0.2	–20.3
Current tax assets	5.7	0.1	3.8	0.0	–34.3	1.7	0.0	–54.9
Deferred tax assets	8.0	0.1	7.3	0.1	–9.8	7.1	0.1	–2.4
Other assets	31.2	0.4	15.8	0.2	–49.2	3.4	0.1	–78.8
Non-current assets and disposal groups classified as held for sale	1.9	0.0	1.1	0.0	–40.2	0.5	0.0	–56.3
Total assets	**7,811.1**	**100.0**	**7,914.7**	**100.0**	**1.3**	**5,452.5**	**100.0**	**–31.1**

Note: See note in Table 12.2.
Source: CNB.

Table 12.9 Structure of housing savings bank liabilities and equity

end of period, in million HRK and %

	Dec. 2016		Dec. 2017			Dec. 2018		
	Amount	Share	Amount	Share	Change	Amount	Share	Change
Financial liabilities held for trading	0.0	0.0	0.1	0.0	–	2.8	0.1	4456.7
Derivatives	0.0	0.0	0.1	0.0	–	2.8	0.1	4456.7
Short positions	0.0	0.0	0.0	0.0	–	0.0	0.0	–
Deposits	....	....	....	....	....	0.0	0.0	–
Issued debt securities	....	....	....	....	....	0.0	0.0	–
Other financial liabilities	0.0	0.0	0.0	0.0	–	0.0	0.0	–
Financial liabilities at fair value through profit or loss	0.0	0.0	0.0	0.0	–	0.0	0.0	–
Financial liabilities measured at amortised cost	6,843.1	87.6	6,950.9	87.8	1.6	4,881.4	89.5	–29.8
Deposits	6,842.1	87.6	6,949.6	87.8	1.6	4,880.4	89.5	–29.8
Issued debt securities	0.0	0.0	0.0	0.0	–	0.0	0.0	–
Other financial liabilities	1.0	0.0	1.3	0.0	23.5	1.1	0.0	–17.6
Derivatives – hedge accounting	0.0	0.0	0.0	0.0	–	0.0	0.0	–
Fair value changes of the hedged items in portfolio hedge of interest rate risk	0.0	0.0	0.0	0.0	–	0.0	0.0	–
Provisions	5.4	0.1	11.3	0.1	108.5	5.0	0.1	–55.2
Pensions and other post employment defined benefit obligations	0.0	0.0	0.0	0.0	–	0.0	0.0	–
Other long-term employee benefits	1.7	0.0	2.9	0.0	70.7	2.8	0.1	–3.4
Restructuring	0.0	0.0	4.5	0.1	–	0.0	0.0	–100.0
Pending legal issues and tax litigation	1.2	0.0	1.7	0.0	43.0	0.9	0.0	–47.0
Commitments and guarantees given	0.5	0.0	0.5	0.0	6.6	0.4	0.0	–30.3
Other provisions	2.1	0.0	1.7	0.0	–15.5	1.0	0.0	–41.2
Tax liabilities	29.9	0.4	25.6	0.3	–14.4	13.4	0.2	–47.8
Current tax liabilities	11.6	0.1	9.2	0.1	–20.4	8.7	0.2	–5.6
Deferred tax liabilities	18.3	0.2	16.4	0.2	–10.6	4.7	0.1	–71.5
Other liabilities	95.2	1.2	76.1	1.0	–20.1	36.7	0.7	–51.7
Liabilities included in disposal groups classified as held for sale	0.0	0.0	0.0	0.0	–	0.0	0.0	–

Total liabilities	**6,973.7**	**89.3**	**7,063.9**	**89.3**	**1.3**	**4,939.3**	**90.6**	**–30.1**
Capital	487.9	6.2	487.9	6.2	0.0	407.9	7.5	–16.4
Paid up capital	487.9	6.2	487.9	6.2	0.0	407.9	7.5	–16.4
Unpaid capital which has been called up	0.0	0.0	0.0	0.0	–	0.0	0.0	–
Share premium	0.0	0.0	0.0	0.0	–	0.0	0.0	–
Equity instruments issued other than capital	0.0	0.0	0.0	0.0	–	0.0	0.0	–
Other equity	....	....	....	....	....	0.0	0.0	–
Accumulated other comprehensive income	108.9	1.4	97.5	1.2	–10.4	22.6	0.4	–76.8
Retained earnings	200.5	2.6	221.5	2.8	10.4	64.9	1.2	–70.7
Other reserves	–6.3	–0.1	–5.4	–0.1	–14.0	7.7	0.1	–
Reserves or accumulated losses of investments in subsidiaries, joint ventures and associates accounted for using the equity method	....	....	....	....	....	0.0	0.0	–
Other	–6.3	–0.1	–5.4	–0.1	–14.0	7.7	0.1	–
(–) Treasury shares	0.0	0.0	0.0	0.0	–	0.0	0.0	–
Profit or loss attributable to owners of the parent	46.4	0.6	49.3	0.6	6.3	10.0	0.2	–79.8
(–) Interim dividends	....	....	....	....	....	0.0	0.0	–
Minority interests [Non–controlling interests]	0.0	0.0	0.0	0.0	–	0.0	0.0	–
Total equity	**837.4**	**10.7**	**850.8**	**10.7**	**1.6**	**513.2**	**9.4**	**–39.7**
Total liabilities and total equity	**7,811.1**	**100.0**	**7,914.7**	**100.0**	**1.3**	**5,452.5**	**100.0**	**–31.1**

Note: See note in Table 12.3.
Source: CNB.

Table 12.10 Housing savings bank income statement

in reference periods, in million HRK and %

	Amount		Change
	Jan. – Dec. 2017	Jan. – Dec. 2018	
Interest income	317.6	206.0	–35.1
Financial assets held for trading	12.2	11.6	–4.7
Non-trading financial assets mandatorily at fair value through profit or loss	0.2	0.0	–100.0
Financial assets at fair value through profit or loss	0.0	0.0	–
Financial assets at fair value through other comprehensive income	63.6	29.2	–54.1
Financial assets at amortised cost	241.0	164.2	–31.9
Derivatives – hedge accounting, interest rate risk	0.0	0.0	–
Other assets	0.7	1.0	45.7
Interest income on liabilities	0.0	0.0	–
(Interest expenses)	180.6	113.0	–37.4
(Financial liabilities held for trading)	0.0	1.1	7,346.7
(Financial liabilities designated at fair value through profit or loss)	0.0	0.0	–
(Financial liabilities measured at amortised cost)	180.5	111.7	–38.1
(Derivatives – hedge accounting, interest rate risk)	0.0	0.0	–
(Other liabilities)	0.1	0.1	104.8
(Interest expense on assets)	0.0	0.0	–
Net interest income	**137.0**	**93.0**	**–32.1**
Dividend income	**0.0**	**0.0**	**–**
Fee and commission income	45.8	34.7	–24.2
(Fee and commission expenses)	4.9	5.1	4.1
Net fee and commission income	**40.8**	**29.5**	**–27.6**
Gains (losses)	**6.6**	**–8.8**	**–**
Other operating income	4.0	3.4	–13.9
(Other operating expenses)	22.4	18.8	–15.8

	Amount		Change
	Jan. – Dec. 2017	Jan. – Dec. 2018	
Total operating income, net	**166.1**	**98.3**	**–40.8**
(Administrative expenses)	96.7	84.2	–13.0
(Staff expenses)	53.4	47.0	–12.0
(Other administrative expenses)	43.3	37.2	–14.2
(Depreciation)	2.5	2.7	8.2
Administrative expenses and depreciation	**99.2**	**86.8**	**–12.5**
Modification gains (–) losses, net	0.0	0.0	–
Operating profit	**66.8**	**11.5**	**–82.8**
(Provisions or (–) reversal of provisions)	6.3	0.3	–95.9
(Commitments and guarantees given)	0.0	–0.1	–
(Other provisions)	6.3	0.4	–94.3
(Impairment or (–) reversal of impairment on financial assets not measured at fair value through profit or loss)	1.9	–2.5	–
(Financial assets at fair value through other comprehensive income)	0.0	–2.1	–
(Financial assets at amortised cost)	1.9	–0.4	–
(Impairment or (–) reversal of impairment of investments in subsidiaries, joint ventures and associates)	0.0	0.0	–
(Impairment or (–) reversal of impairment on non–financial assets)	0.4	0.0	–100.0
Impairment and provisions	**8.6**	**–2.2**	**–**
Negative goodwill recognised in profit or loss	0.0	0.0	–
Share of the profit or (–) loss of investments in subsidiaries, joint ventures and associates accounted for using the equity method	0.0	0.0	–
Profit or (–) loss from non-current assets and disposal groups classified as held for sale not qualifying as discontinued operations	0.0	0.0	–
Profit or (–) loss before tax from continuing operations	**58.3**	**13.7**	**–76.4**
(Tax expense or (–) income related to profit or loss from continuing operations)	8.9	3.8	–57.7
Profit or (–) loss after tax from continuing operations	**49.3**	**10.0**	**–79.8**
Profit or (–) loss after tax from discontinued operations	0.0	0.0	–100.0
Profit or (–) loss before tax from discontinued operations	...	0.0	–
(Tax expense or (–) income related to discontinued operations)	...	0.0	–
Profit (loss) for the year	**49.3**	**10.0**	**–79.8**

Note: See note in Table 12.4.
Source: CNB.

Table 12.11 Distribution of housing savings banks total exposure by risk categories

end of period, in million HRK and %

Risk category	Dec. 2016		Dec. 2017			Dec. 2018		
	Amount	Share	Amount	Share	Change	Amount	Share	Change
A	5,544.2	98.7	5,663.5	98.6	2.2	5,225.7	99.2	–7.7
B	65.1	1.2	68.3	1.2	5.0	34.8	0.7	–49.1
C	10.7	0.2	9.6	0.2	–10.3	9.7	0.2	1.1
Total	**5,619.9**	**100.0**	**5,741.4**	**100.0**	**2.2**	**5,270.2**	**100.0**	**–8.2**

Note: See note in Table 12.5.
Source: CNB.

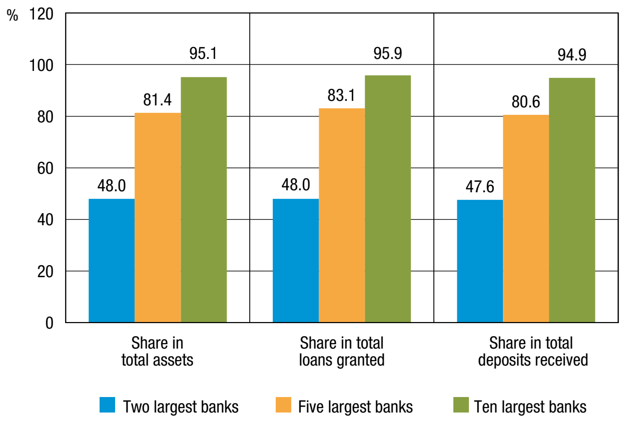
Table 12.12 Coverage of housing savings bank total exposure by impairment and provisions

end of period, in million HRK and %

	Dec. 2016	Dec. 2017	Dec. 2018
Total impairment and provisions	**76.0**	**77.8**	**60.3**
Impairment and provisions for risk categories B and C	27.9	28.8	23.3
Impairment and provisions for risk category A	48.1	49.0	37.0
Total exposure	**5,619.9**	**5,741.4**	**5,270.2**
Coverage (%)	**1.4**	**1.4**	**1.1**

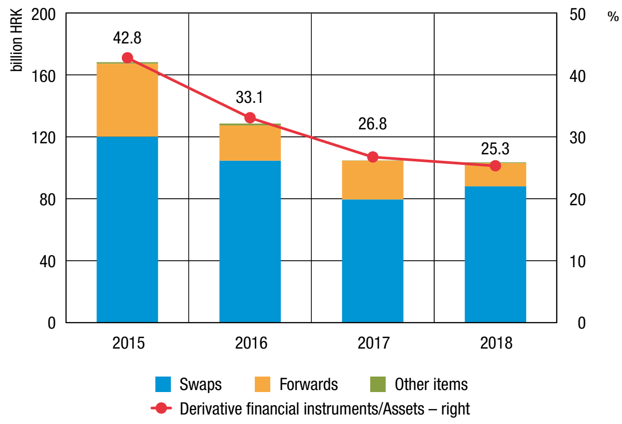
Note: See note in Table 12.5.
Source: CNB.

Figure 12.7 Shares of assets, loans and deposits of the largest banks in total assets, loans and deposits
as at 31 December 2018



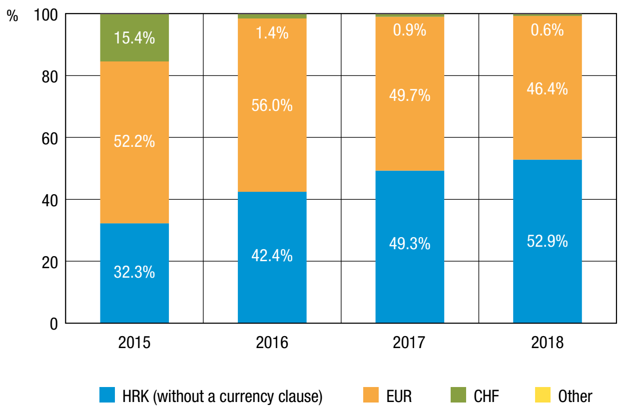
Source: CNB.

Figure 12.11 Bank derivative financial instruments
notional amount



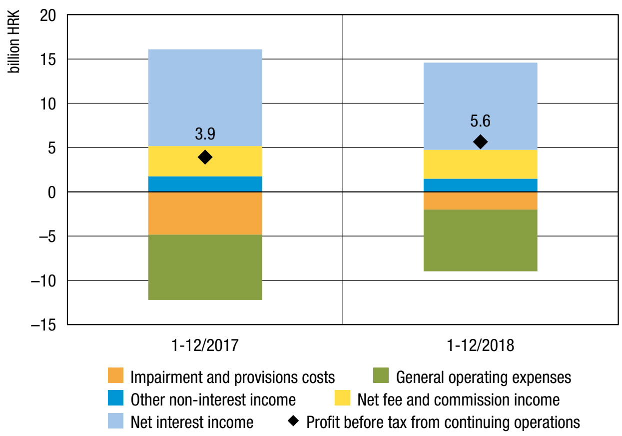
Source: CNB.

Figure 12.8 Currency structure of loans to households



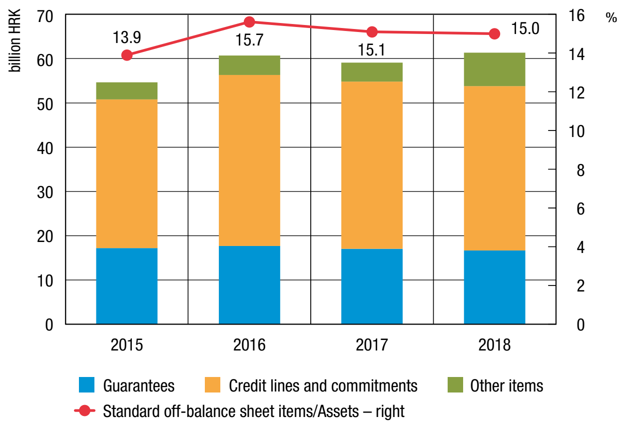
Source: CNB.

Figure 12.11 Bank profit (loss) from continuing operations
before taxes



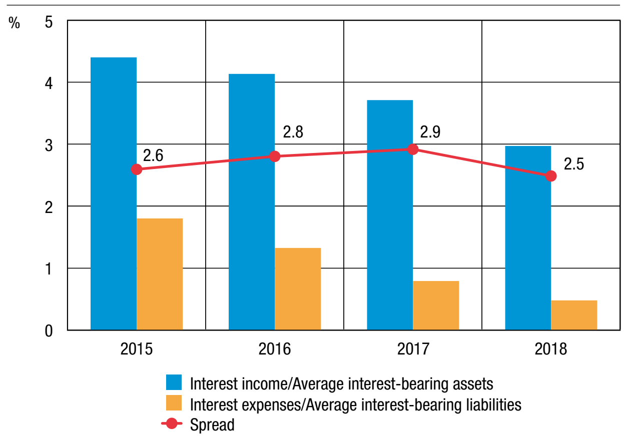
Note: See note in Table 12.4.
Source: CNB.

Figure 12.9 Bank standard off-balance sheet items



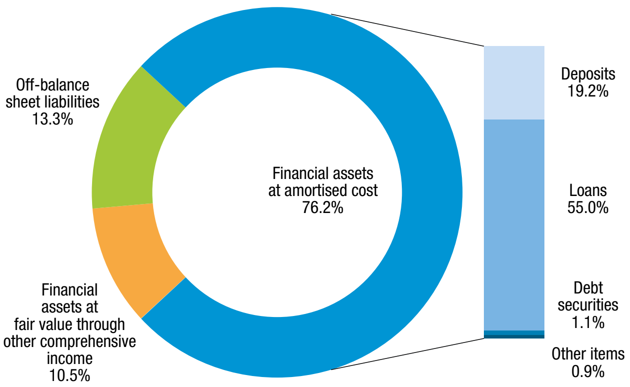
Source: CNB.

Figure 12.12 Spread



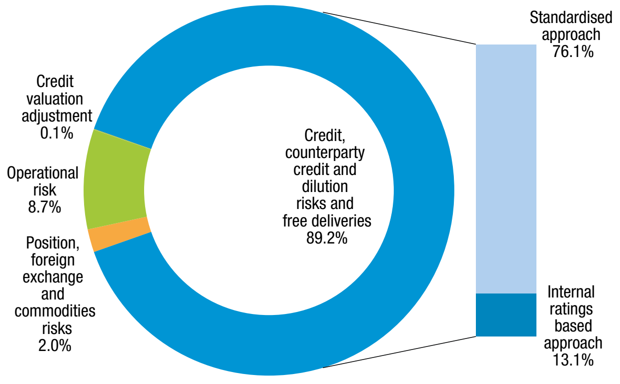
Note: See note in Table 12.4.
Source: CNB.

Figure 12.13 Structure of total bank exposure distributed into risk categories, by portfolio and instruments
as at 31 December 2018



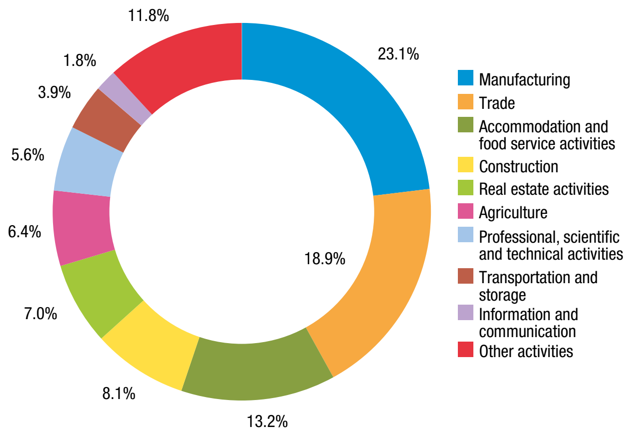
Source: CNB.

Figure 12.16 Structure of bank total risk exposure
as at 31 December 2018



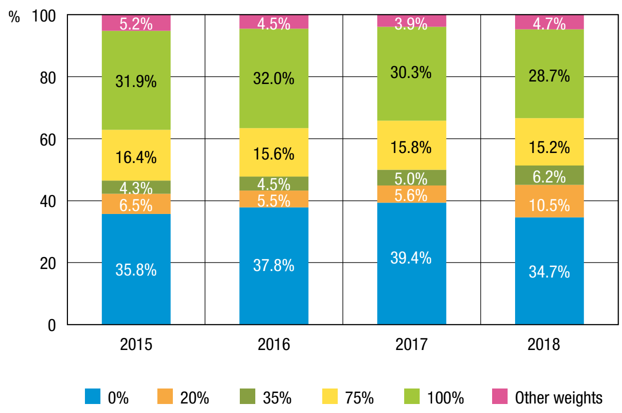
Source: CNB.

Figure 12.14 Structure of bank loans to non-financial corporations by activities
as at 31 December 2018



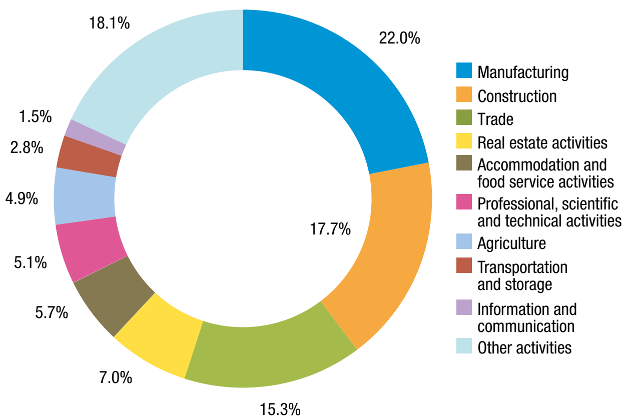
Source: CNB.

Figure 12.17 Structure of bank exposure weighted by credit risk weights according to the standardised approach



Source: CNB.

Figure 12.15 Structure of bank B and C risk category loans to non-financial corporations by activities
as at 31 December 2018



Source: CNB.

Abbreviations and symbols

Abbreviations

bn – billion
b.p. – basis points
BEA – U. S. Bureau of Economic Analysis
BOP – balance of payments
c.i.f. – cost, insurance and freight
CBRD – Croatian Bank for Reconstruction and Development
CBS – Central Bureau of Statistics
CDS – credit default swaps
CEE – Central and Eastern European
CEFTA – Central European Free Trade Agreement
CES – Croatian Employment Service
CHF – Swiss franc
CHIF – Croatian Health Insurance Fund
CHY – Yuan Renminbi
CICR – currency-induced credit risk
CPF – Croatian Privatisation Fund
CPI – consumer price index
CPII – Croatian Pension Insurance Institute
CM – Croatian Motorways
CNB – Croatian National Bank
CR – Croatian Roads
EBA – European Banking Authority
ECB – European Central Bank
EEA – European Economic Area
EFTA – European Free Trade Association
EMU – Economic and Monetary Union
EU – European Union
EUR – euro
excl. – excluding
f/c – foreign currency
FDI – foreign direct investment
Fed – Federal Reserve System
FINA – Financial Agency
f.o.b. – free on board
GDP – gross domestic product
GVA – gross value added
HANFA – Croatian Financial Services Supervisory Agency
HICP – harmonised index of consumer prices
HRK – kuna
HUB – Croatian Banking Association
incl. – including
IMF – International Monetary Fund
JPY – Japanese yen
m – million
MIGs – main industrial groupings
MM – monthly maturity
MoF – Ministry of Finance
NBS – National Bureau of Statistics of China
NCA – National Classification of Activities
n.e.c. – not elsewhere classified
NUIR – net usable international reserves
OECD – Organisation for Economic Co-Operation and Development
OG – Official Gazette
R – Republic
RAMP – Reserves and Advisory Management Program
ROAA – return on average assets
ROAE – return on average equity
o/w – of which
PPI – producer price index
Q – quarter
RR – reserve requirement
SDR – special drawing rights
SE – South-East
SGP – Stability and Growth Pact
SITC – Standard International Trade Classification
USD – US dollar
VAT – value added tax
ZSE – Zagreb Stock Exchange
ZMM – Zagreb Money Market

Symbols

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

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