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 2021

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HNB

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

in the Second Half of 2021

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1 Summary

Real GDP continued to grow in the second half of 2021, rising by 12.5% in the July to December period from the same period in the previous year. All domestic demand components, with the exception of the change in inventories, and net foreign demand made positive contributions to the growth. Quarterly data point to a slowdown in the dynamics of economic growth towards the end of the year, which can be attributed to GDP achieving the pre-pandemic level in mid-2021. The growth rate was 1.4% in the third quarter of 2021, while economic activity stagnated in the last three months of the year. Real GDP was 1.8% higher in the July to December period than in the first half of the year, when it grew at a high rate of 10.2%.

The period from July to December 2021 was marked by employment growth, which stemmed from the acceleration of economic activity and a later than usual beginning of seasonal employment. The continued implementation of job preservation measures additionally supported favourable labour market developments. Total employment grew by 2.3% at the end of December 2021 from December 2020 and by 1.7% from December 2019. However, the recovery was uneven, so that the highest increase in the number of employed persons was recorded in information and communication activities as well as in construction, while accommodation and food service activities continued to have a lower number of employed persons. The employment growth led to a decrease in the number of unemployed persons in the second half of the year, which in November 2021 for the first time fell below the pre-crisis levels, holding steady in December. Total employment was 21.4% lower than in December 2020. The stronger growth of wages in the rest of the economy led to the acceleration of wage growth in the third quarter, which intensified in the fourth quarter. The average nominal gross wage was 5.6% higher in December 2021 than in December 2020, while the nominal net wage rose by 6.8% due to the reduction of the tax burden. However, despite such a strong nominal growth, purchasing power increased by a mere 1.3% because of the growth in consumer prices.

Having accelerated to 2.0% in the first half of 2021 due to energy price growth, consumer price inflation continued to accelerate in the remaining part of the year, reaching 5.5% in December. Inflation growth in the June to December period was also due to an increase in energy prices and even more so to an increase in the prices of processed and unprocessed food products, caused by the spillover of high global prices of food raw materials and energy products onto consumer prices and yields of some field crops having been reduced due to inclement weather a in Croatia. To a smaller degree and mainly at the end of the year, inflation acceleration was also driven by an increase in the annual growth of industrial product prices, deriving from increases in the prices of refined petroleum products and other commodities in the world market as well as from global supply chain disturbances, which caused shortages of some semi-finished and finished goods. Against such a backdrop, core inflation also gained pace rapidly, increasing from 0.8% in June to 4.6% in December.

The current and capital account surplus widened sharply in the second half of 2021 from the same period in the previous year, mostly driven by the strong recovery of net exports of services, primarily tourism revenues, which in 2021 accounted for 87% of revenues from the record year 2019. The recovery of tourism revenues was primarily caused by improved pandemic trends and to some extent also by the structural characteristics of the Croatian tourism, such as the geographical vicinity of the main outbound markets (from which the largest number of tourists arrive by road transport) and the large share of private accommodation. The growth of net income from personal transfers and transactions with the EU budget also made a positive contribution to the current and capital account, albeit a considerably smaller one. Favourable developments were offset by the widening of the trade in goods deficit and an increase in the profit of foreign-owned banks and enterprises. At the same time, the net capital outflow in the financial account of the balance of payments reflects a further decrease in net debt liabilities of domestic sectors. Accordingly, the relative indicators of external debt and the net international investment position improved considerably, due also to the significant growth of nominal GDP.

The CNB continued to pursue an expansionary monetary policy in the second half of 2021, mainly purchasing foreign exchange inflows from the Ministry of Finance, mostly related to EU funds. Just as in the first half of the year, amid stable financing conditions on the domestic financial markets the central bank did not need to reach for additional monetary policy measures. Large purchases of foreign exchange from the government in 2021 contributed the most to a considerable increase in free reserves of banks, which led to a fall in the costs of financing, with some interest rates hitting record lows. Credit institutions’ corporate placements rose in 2021, with the demand for investment loans continuing to determine corporate lending, although to a much lesser extent than in the previous year, while loans for working capital and other loans shrank. Household lending grew steadily, fuelled mainly by further acceleration in the housing lending present for some years, and to a lesser extent by a small recovery in the growth of general-purpose cash loans.

According to the internationally comparable methodology of the European System of National and Regional Accounts (ESA 2010), the consolidated general government budget ran a deficit of HRK 3.5bn, which shows further improvement in public finances, reflecting the favourable impact of economic activity on tax revenues and a reduction in fiscal support to mitigate the negative effects of the crisis caused by the COVID-19 pandemic. As a result, the budget deficit in 2021 stood at HRK 12.4bn or 2.9% of GDP, which is a considerable improvement from the deficit of HRK 27.7bn or 7.3% of GDP in 2020. The consolidated general government debt at the end of 2021 stood at HRK 343.6bn, up HRK 2.3bn from the end of June of 2021. The public debt to GDP ratio fell considerably in 2021, from 87.3% at the end of 2020 to 79.8%, mirroring the favourable impact of economic activity recovery.

International reserves rose steeply in 2021, reaching record high. CNB’s international reserves rose by 32.1% while net reserves rose by 18.2% from the end of 2020. Although around 53% of government securities of euro area member states persistently carried negative yields, the rate of return on the entire euro portfolio in 2021 was 0.24%, while the rate of return on the entire US dollar portfolio totalled 1.20%. In the observed period, international reserves investments generated a total income of EUR 70.8m. Liquidity and safety of investment, the main objectives of international reserves management, were successfully completed despite an unfavourable environment of a prolonged period of low and negative yields on financial markets.

Strong capitalisation and high liquidity of the banking system facilitated stable and smooth operations in the second year of the COVID-19 pandemic, and business performance recovered in 2021 from the pressure of the costs of increased credit risk related to the pandemic.

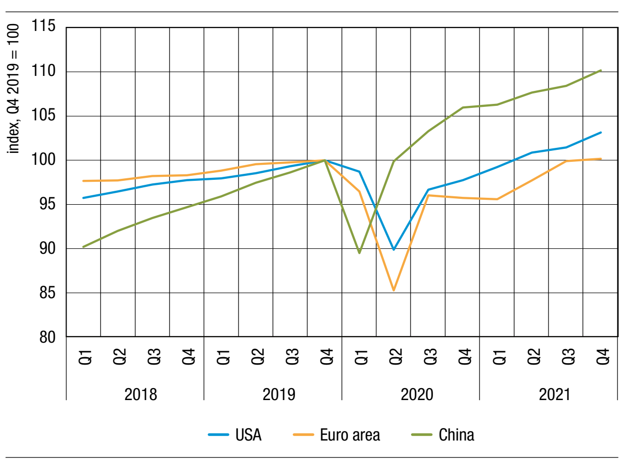
2 Global developments

In the second half of 2021, the global economy continued to recover from the crisis caused by the coronavirus pandemic and some countries once again tightened containment measures. With rising costs connected with supply chain disturbances and high energy and commodity prices, inflationary pressures increased further towards the end of the year. The monetary policies of central banks of the world's largest economies remained accommodative in the second half of 2021, although the intensification of monetary policy normalisation was already being announced in that period on account of rising inflation.

In the second half of 2021, the global economy continued to recover from the crisis caused by the coronavirus pandemic (Figure 2.1), with disruptions in global supply chains and increased uncertainty still present. Disruptions in global supply chains, partly mitigated during the summer, and the reduced availability of some important commodities and goods, continued to weigh on the global production sector's recovery. In contrast, the relatively mild pandemic containment measures imposed in most countries during the observed period contributed to the recovery of the service sector. However, due to the fast spread of the new coronavirus Omicron variant late in the year, some countries, those in Europe in particular, once again tightened containment measures. With rising costs connected with supply chain disturbances and high energy and commodity prices, inflationary pressures increased further towards the end of the year. Under such conditions, following a long period of very low interest rates, a large number of central banks started or accelerated monetary policy normalisation processes.

The US economy slowed down considerably after the summer of 2021, when problems in global supply chains intensified, the economic activity regained momentum as early as near the end of the year. The US GDP increased by a total of 2.3% in the second half of 2021, growing at a slightly slower rate than in the first half of the year. The main contribution to economic growth came from the strong recovery of investment activity in the production sector and the growth of goods exports, whereas the contribution of personal consumption was slightly lower, despite fiscal support. Labour market conditions continued to improve, so that the unemployment rate declined below 4% by the end of 2021. The relatively strong economic activity was accompanied by mounting inflationary pressures, with the result that the annual growth rate of consumer prices in the US reached 7.0% at

Figure 2.1 Economic growth in selected markets



Sources: Eurostat, BEA and NBS.

the end of the year, the fastest acceleration of inflation among large developed countries.

In contrast with the US recovery, the eurozone recovery accelerated in the third quarter of 2021, before slowing down significantly again in the last quarter, when the shortage of some intermediate goods started to affect the manufacturing sector more noticeably. In addition, personal consumption was partly weakened when Omicron appeared late in the year. Nevertheless, economic activity increased by a total of 3.5% in the second half of the year from the first half, returning to the pre-pandemic level. As regards individual member states, the largest contribution to the acceleration of economic growth in the second half of 2021 came from France, Italy and Spain, to some extent because they did not tighten containment measures, while Germany's contribution decreased markedly due to the country's greater participation in global supply chains. Inflation in the eurozone started growing rapidly later than inflation in the US, reaching a long-time high of 5% in December 2021.

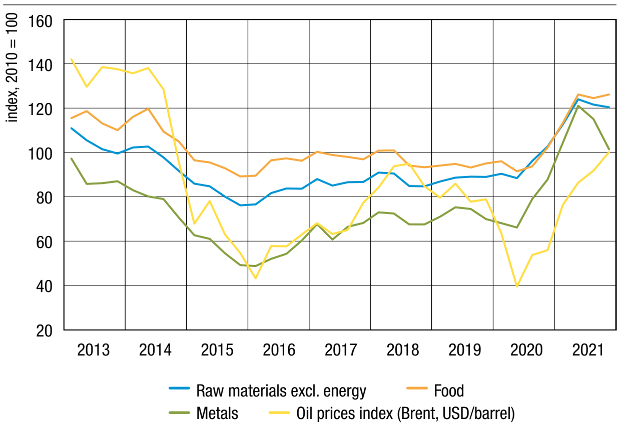
2.1 Croatia's main trading partners

Economic recovery continued in all Croatia's major trading partners in the second half of 2021. However, economic recovery decelerated in most partners from the eurozone towards the end of the year, when problems in the manufacturing sector grew worse and when some countries, such as Germany and Austria, tightened containment measures. Economic developments were somewhat more favourable in trading partners from Southeastern Europe, since these countries are less integrated and less sensitive to global supply chain disturbances.

2.2 Prices, exchange rates and financing conditions

The growth of energy product prices slowed down markedly in the second half of 2021, while the prices of most other commodities dropped (Figure 2.2). The price of a barrel of Brent crude oil grew by 15.9% to USD 100, having risen more than 50% in the previous part of the year. The slowdown was especially pronounced late in the year, when the Omicron coronavirus variant created considerable uncertainty regarding global economic recovery.

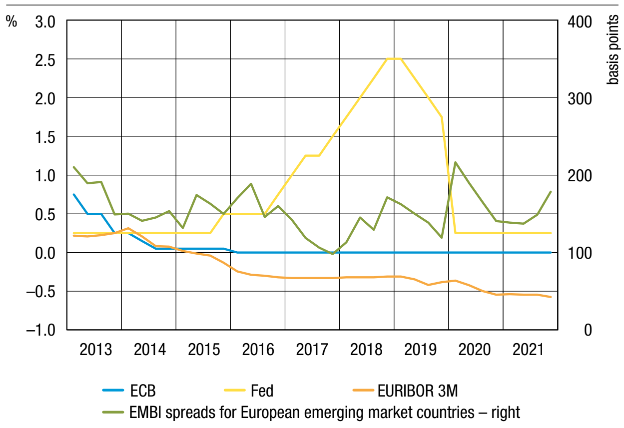
Figure 2.2 Raw material prices in the world market in US dollars



Sources: IMF and Bloomberg.

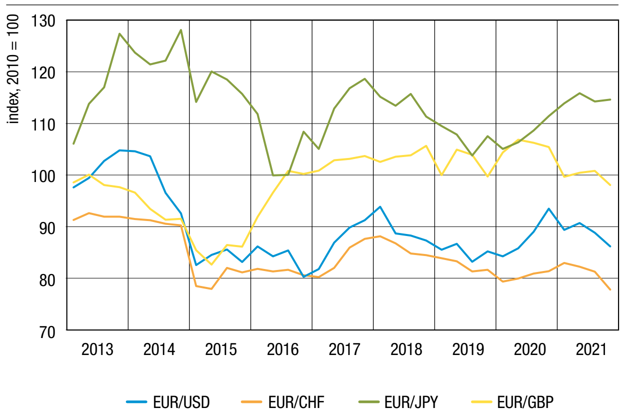
The prices of commodities excluding energy edged down by 2.3% from the end of the first half of 2021 in the second half of the year. Prices of metals recorded sharper decreases than those of other categories (16.2%), remaining, however, about one third higher than in the pre-pandemic period. Like oil prices, metal prices decreased as a result of a deterioration of the global recovery outlook and increased uncertainty surrounding the decarbonisation of developed economies. Food raw materials' prices held steady, but

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



Source: Blomberg.

Figure 2.4 Exchange rate movements of individual currencies against the euro



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

their relatively high level continued to be boosted by strong demand, coupled with supply-side shocks (occasional disruptions in supply) and high energy products' prices.

The monetary policies of central banks in the world's largest economies remained accommodative in the second half of 2021, although the intensification of the monetary policy normalisation process was announced on account of rising inflation. In December 2021, Fed decided to double the tapering of its asset purchase programme from USD 15bn to USD 30bn per month. The ECB decided to end the pandemic emergency purchase programme until March 2022, strengthening standard support measures in the transition period in order to alleviate the uncertainties caused by the appearance of Omicron. Both of the central banks kept their key interest rates at record low levels during the observed period.

Financing conditions for European emerging market countries, including Croatia, worsened in the second half of 2021 (Figure 2.3). This is a result of inflation growth and the expected accelerated normalisation of large central banks' monetary policies as well as of an increase in risk aversion as regards investments in this group of countries.

Developments in the global foreign exchange market in the second half of 2021 mostly reflected the expectations regarding a faster normalisation of the Fed's monetary policy, but also the fact that the outlook for economic recovery in the eurozone was weaker than the outlook for recovery in the US. The US dollar strengthened by 5% versus the euro in the observed period, with the EUR/USD exchange rate standing at 1.13 at the end of the year (Figure 2.4). The dollar appreciated against the euro at an especially high rate in the last quarter of the year, when the Fed ratcheted up its rhetoric about the pace of monetary policy normalisation and when the uncertainty surrounding the appearance of Omicron increased. The exchange rate of the Swiss franc also strengthened against the euro in the second half of the year, rising by 5.4% and ending December at EUR/CHF 1.04. Like the US dollar, the Swiss franc strengthened on the back of increased uncertainty and risk aversion, which in general stimulated investors to invest in safer currencies.

3 Aggregate supply and demand

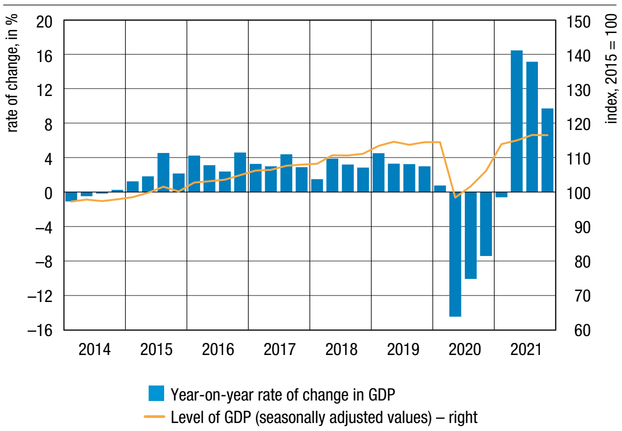
The economic activity growth continued in the second half of 2021 at a rate of 12.5%, driven primarily by the growth of exports, especially exports of services connected with the recovery of tourism.

Personal consumption continued to grow, rising at an annual rate of 11.6% due to an increase in employment and a decrease in unemployment as well as to a rise in household borrowing. Wages increased in nominal terms, but stagnated in real terms because of price growth.

Growth in economic activity, which started early in 2021 after a sharp contraction in 2020, continued in the second half of the year. Real GDP increased at an annual rate of 12.5% in the last six months of 2021, up on the 7.7% of the first part of the year. The highest individual contribution to total growth came from the growth of total exports, especially of services exports, resulting mainly from the recovery of tourist activity. Domestic demand components, with the exception of the change in inventories, also made a positive contribution to the growth. Goods and services imports grew, but less than total exports, with the result that net foreign demand made a significant contribution to total economic growth. Real GDP rose by 10.2% at the 2021 level, having decreased by 8.1% in the previous year.

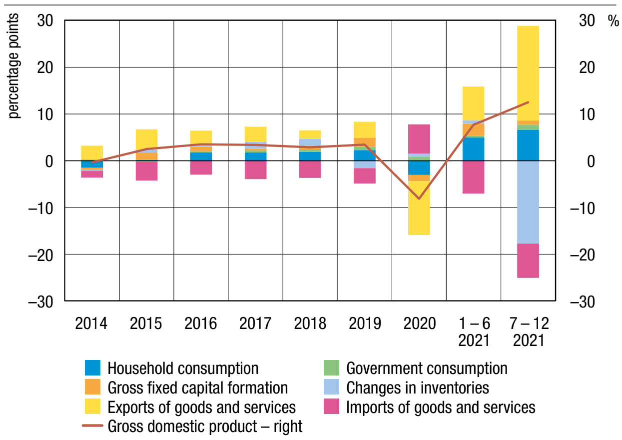
Seasonally adjusted data point to a slowdown in growth towards the end of the year, because the pre-pandemic level of real GDP was achieved as early as at mid-2021. In the first half of the year, real GDP increased by 10.2% relative to the previous six months, recording a markedly lower growth rate of 1.8% in the second half of the year. This deceleration reflects the difference in quarterly dynamics: the growth of 1.4% in the July

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.

to September period being in contrast with the economic stagnation at the end of the year.

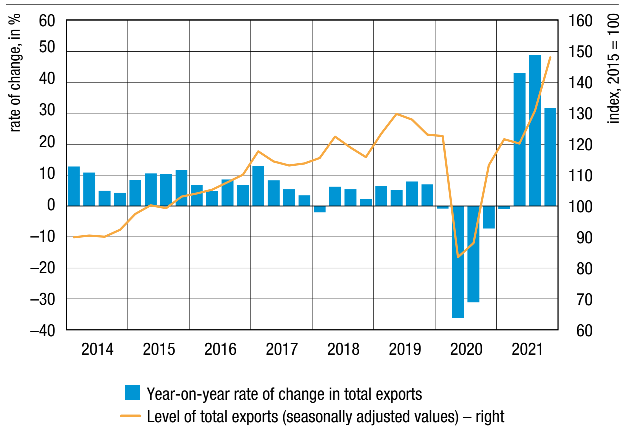
GDP by the production approach shows that gross value added was 11.5% higher in the second half of the year than in the same period in 2021 (annual growth was 6.2% in the first half of the year). The highest increases were recorded in wholesale and retail trade, transportation and storage as well as in accommodation and food service activities, i.e., in activities involving a close physical contact, which saw the sharpest decrease in 2020.

3.1 Aggregate demand

In the second half of 2021, real goods and services exports continued to grow at a high rate, up by 41.9% from the same period in the previous year (20.5% annually in the first six months). The high growth rate of total exports resulted mainly from the strong recovery of exports of services, supported by good results in tourism in the third quarter. Real services exports grew by 65.7% from the same period in the previous year, which recorded a decrease of 41.1%. Services exports increased at a rate of 51.5% at the 2021 level, which was, however, insufficient to offset the sharp fall in 2020 (42.0%) and reach the pre-pandemic level. Goods exports also increased sharply in the second half of 2021, up by 19.1% from the same period in the previous year (21.1% in the first six months). Observed on a quarterly basis, goods exports grew at an annual rate of 13.1% in the July to September period, accelerating to 24.7% in the last three months of the year. Nominal data on trade in goods broken down by main industrial groupings show that exports, especially of energy, increased annually in all main industrial groupings (MIG) in the second half of 2021. Goods exports rose by a total of 20.0% in 2021, following a stagnation in 2020, while total real exports went up by 33.3% (–22.7% in 2020).

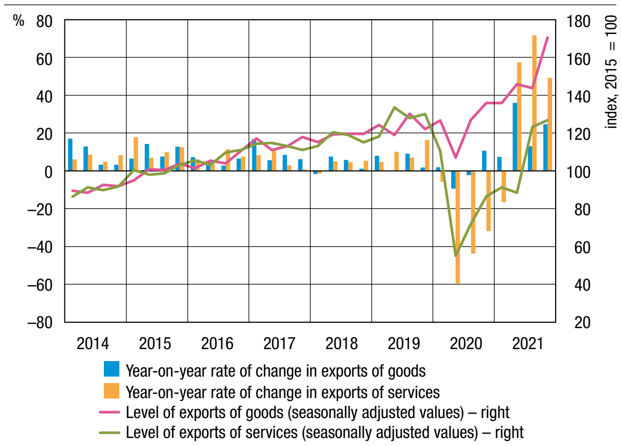
Personal consumption continued to grow in the second half of 2021, up at an annual rate of 11.6%, having grown by 8.5% in the first half of the year. Personal consumption growth was spurred by a continued increase in employment and decrease in unemployment as well as by household borrowing growth, whereas real wages

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

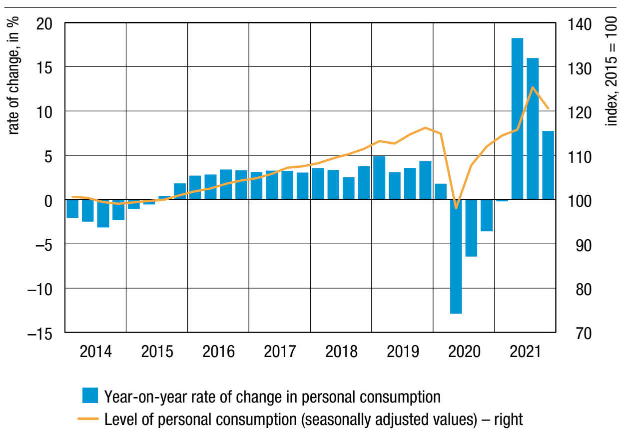


Source: CBS (seasonally adjusted by the CNB).

stagnated due to price growth, despite their nominal increase. Quarterly seasonally adjusted data show that personal consumption growth accelerated from 1.1% to 8.2% in the July to September period. However, the growth decreased at the end of the year from the previous three months (3.8%), which can be attributed to price increases as well as to the deterioration of consumer optimism and inflationary expectations in that period. Personal consumption grew by 10.1% in 2021 as a whole from 2020, when it fell by 5.3%.

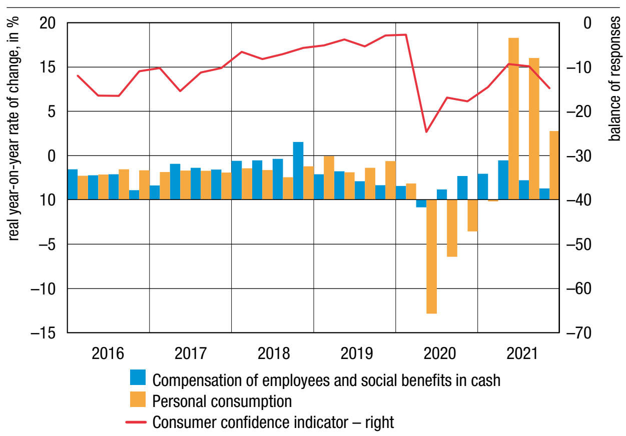
Gross fixed capital formation dropped by 0.7% in the second half of 2021 from the first half of the year, halting investment activity growth started in the second half of 2020. The capital investment downturn resulted from adverse developments in the last three months of 2021, that is, a quarterly decrease of 1.9%, which followed after a small increase of 0.4% in the third quarter. Nevertheless, capital investments were 4.1% higher annually in the second half of 2021 than in the same period in 2020 (annual growth in the first six months was 11.3%). Available fiscal data suggest that

Figure 3.5 Personal consumption
real values



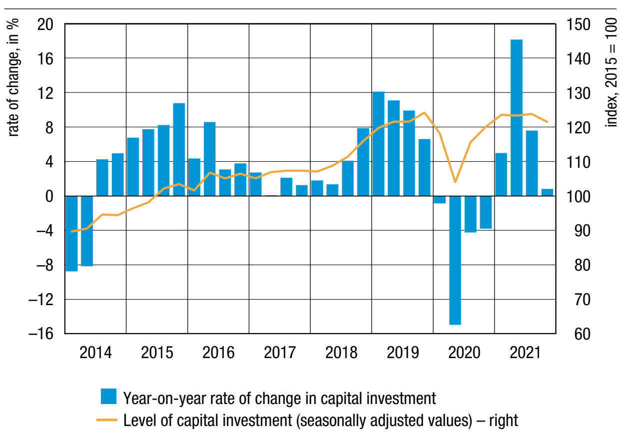
Source: CBS (seasonally adjusted by the CNB).

Figure 3.6 Determinants of personal consumption
real values and index



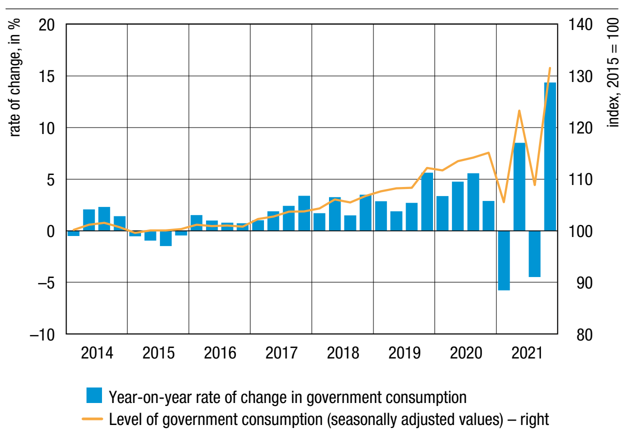
Note: Real values of compensation of employees and social benefits in cash were calculated by deflating nominal values using the personal consumption deflator.
Sources: CBS, Ipsos and CNB.

Figure 3.7 Gross fixed capital formation
real values



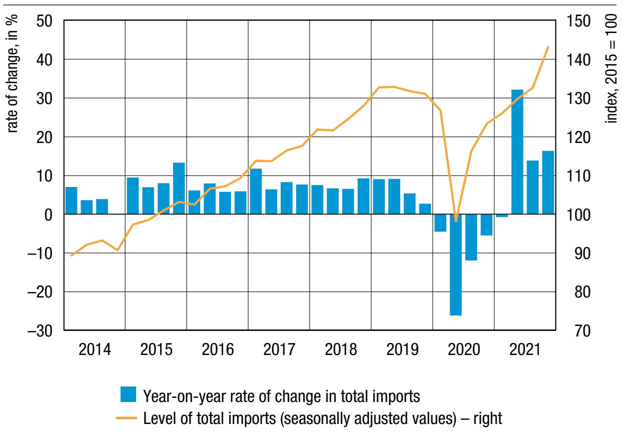
Source: CBS (seasonally adjusted by the CNB).

Figure 3.8 Government consumption
real values



Source: CBS (seasonally adjusted by the CNB).

Figure 3.9 Imports of goods and services
real values



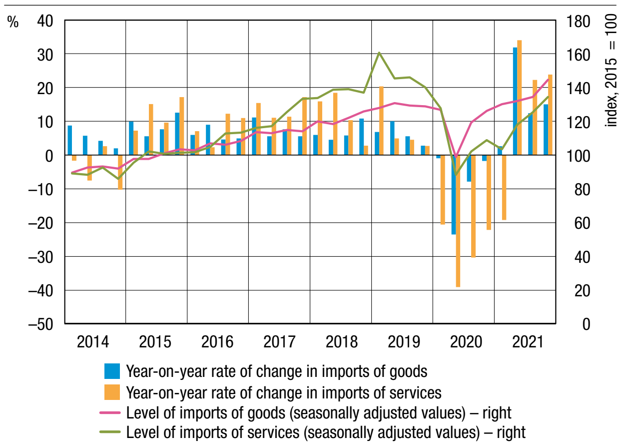
Source: CBS (seasonally adjusted by the CNB).

the decrease in investment activity is a consequence of a decline in general government investments, whereas private sector investments grew at a similar pace as in the first part of the year. Gross fixed capital formation expanded by a total of 7.6% in 2021, having fallen by 6.1% in 2020, and made a positive contribution to overall economic growth.

General government consumption was up by 4.8% in the second half of 2021 from the same period in 2020, rising at a faster pace than in the first half of the year, when it grew at an annual rate of 1.3%. Specifically, a nominal increase was seen in expenditures on goods and services, employee compensations and social transfers in kind. The annual government consumption growth rate totalled 3.1% in 2021.

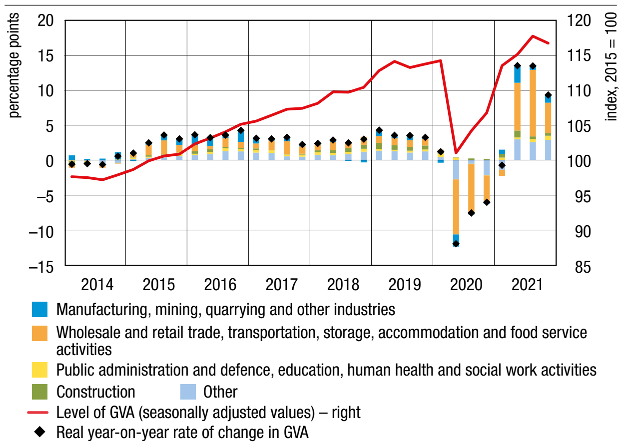
Total imports continued to grow strongly in the second half of 2021, rising 15.1% from the same period in 2020 (annual growth in the first six months was 14.2%). Broken down by quarters, total imports rose at an annual rate of 13.9% in the July to September period, 2.2% more than in the previous three months. Goods and services imports picked up towards the end of the year on the back of rising goods exports: total imports grew by 16.4% in the period from October to December from the same period in the previous year and by 8.0% from the previous three months. As shown by nominal data on goods imports, energy imports increased sharply on an annual level in the second half of the year. Total imports increased by 14.7% in the whole of 2021 following a drop of 12.3% in 2020. The growth of imports was lower than the growth of exports, so that the contribution of net exports to real GDP growth was extremely positive in 2021 (6.8 percentage points).

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).

3.2 Aggregate supply

The growth of real gross value added decelerated to 2.5% in the second half of 2021 from 8.4% in the previous six months. Observed on an annual level, the growth rate amounted to a high of 11.5% in the second half of 2021 as against the same period in the previous year, when it was 6.2%. Real GVA grew on an annual level in all activities, recording the highest growth rates in wholesale and retail trade, transportation and storage and in accommodation and food service activities, i.e. in activities related to tourism, which had been particularly affected by the negative effects of the pandemic in 2020. GVA increased annually by 8.9% in 2021, having fallen by 6.3% in 2020.

4 Labour market

Employment growth marked the second half of 2021. In addition to the revival of economic activity, the continued implementation of job preservation measures, although taking in a smaller number of workers, also accounted for the favourable trends. The number of unemployed persons for the first time fell below the pre-crisis levels in November 2021, with the registered unemployment rate standing at 6.9% and the ILO unemployment rate at 5.9% late in the previous year. Wages increased sharply in nominal terms, but purchasing power went up only by 1.3% due to consumer price growth.

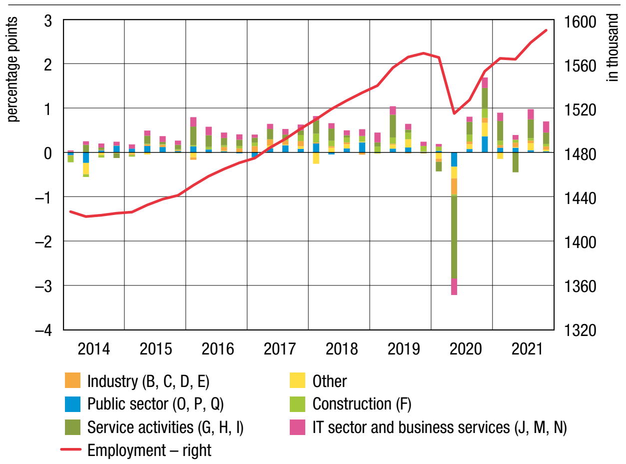
4.1 Employment and unemployment

The second half of 2021 was marked by employment growth, which stemmed from an uptick in economic activity and a later than usual start to seasonal employment. The number of employed persons, having risen markedly in June 2021, continued to grow in the following months, up by 1% on a quarterly level in the third quarter. The growth dynamics was somewhat slower late in the year (Figure 4.1). The continuation of job preservation measures contributed to favourable developments in the second half of the year, although there were considerably fewer workers covered by the measures than in the same period in 2020 (1.4% of total employment relative to 6.6%).

Total employment was 2.3% higher in December 2021 than in the same month in the previous year and 1.7% higher than in December 2019. The highest increases in the number of employed persons were recorded in information and communication activities as well as in construction, while accommodation and food service activities continued to have fewer employed persons.

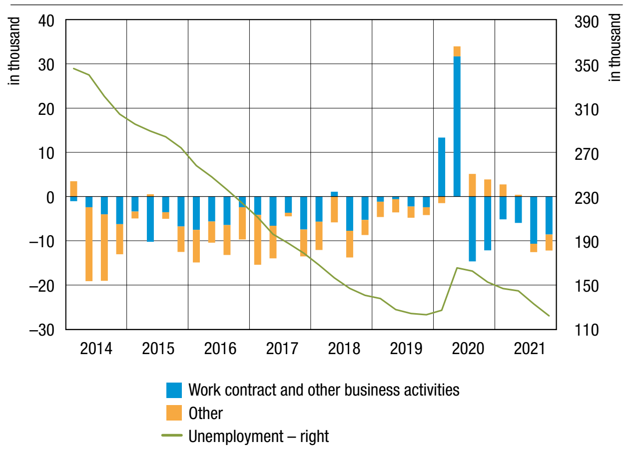
The movement in the number of unemployed persons in the second half of 2021 was influenced by employment growth and a later than usual start to the tourist season.

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



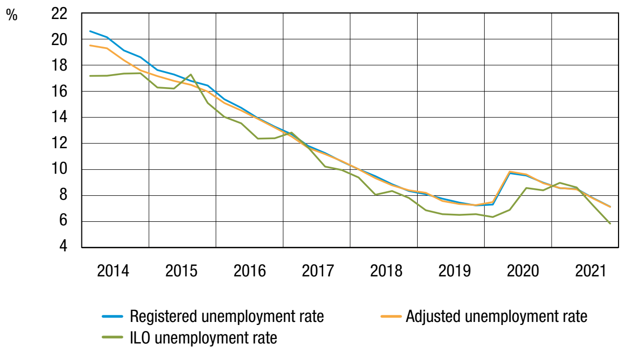
Source: CPII (seasonally adjusted by the CNB).

Figure 4.2 Total unemployment and net unemployment inflows
seasonally adjusted data



Source: CES (seasonally adjusted by the CNB).

Figure 4.3 Unemployment rates
seasonally adjusted data



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

Having decreased sharply in June 2021, unemployment continued to drop in the remainder of the year, albeit at lower rates, with the result that the number of unemployed persons dropped by an average of approximately 8% on the level of both quarters. With the decrease in unemployment continuing over several months, the number of unemployed persons fell below the pre-crisis levels for the first time, holding steady in December at its historical lows. In comparison with December 2020, total unemployment dropped by 21.4% or by 34 000.

The registered unemployment rate fell in the second half of 2021, down to 6.9% December from 8.3% in June and by 1.4 percentage points from December 2020. Labour Force Survey data also show that the unemployment rate decreased in the second part of the year, down to 7.2% in the third quarter from 8.6% in the second quarter and further to 5.9% in the fourth quarter.

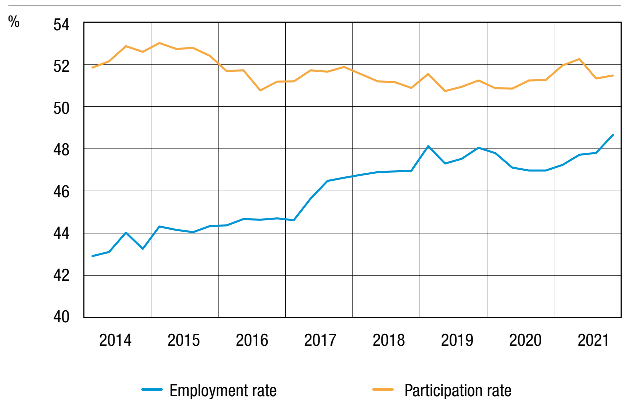
The ILO unemployment rate remained almost unchanged in the third quarter of 2021 (47.8% relative to 47.7%), increasing to 48.7% at the end of the year. In contrast, the participation rate went down from 52.3% to 51.3% in the third quarter due to a sharp decrease in the number of unemployed persons and the almost unchanged number of employed persons shown by the Labour Force Survey, edging up to 51.5% in the fourth quarter (Figure 4.4) on the back of a continuing decrease in unemployment and employment growth.

4.2 Wages and unit labour costs

The increase in the average nominal gross wage intensified in the third quarter of 2021 due to strong wage growth in the rest of the economy, while public sector wages remained almost unchanged from the previous quarter. As a result of the further acceleration of wage growth in the rest of the economy and the growth of wages in the public sector, wages grew at an even stronger pace in the fourth quarter (Figure 4.5).

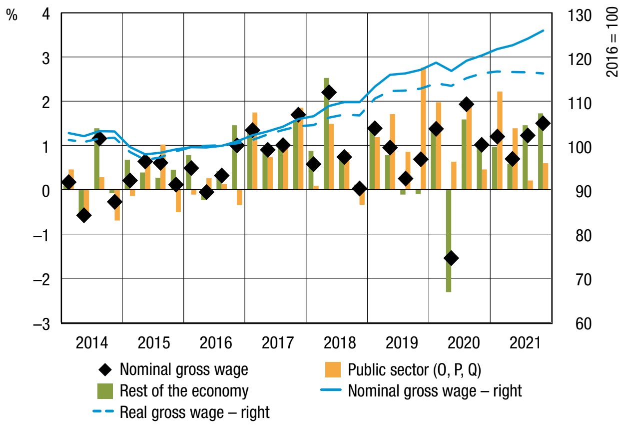
The average nominal gross wage was 5.6% higher in December 2021 than in December 2020, while the nominal

Figure 4.4 Labour Force Survey
seasonally adjusted series



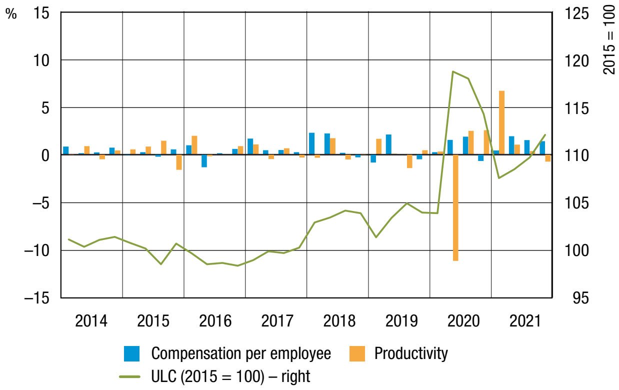
Source: CBS (seasonally adjusted by the CNB).

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



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

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



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

net wage rose by 6.8% due to the reduction of the tax burden. Nevertheless, despite the strong growth of the nominal value, the purchasing power increased only by 1.3% because of consumer price growth. The gap between the nominal and real value of wages widened towards the end of the year.

The unit labour cost continued to grow in the third quarter of 2021 as a consequence of compensation per employee growing more than labour productivity. Due to the continued growth of compensation per employee in the fourth quarter, coupled with a decrease in productivity, the growth of unit labour cost accelerated.

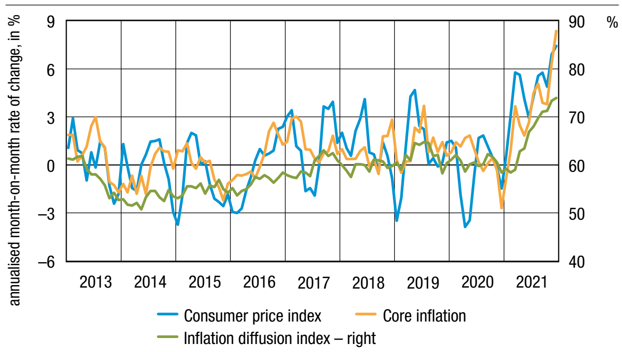
5 Inflation

The average annual consumer price inflation (CPI) accelerated sharply in 2021, due primarily to the growth of energy and food product prices. The prices of a large number of industrial products also grew, driven up by the spillovers of rising refined petroleum product prices, the global growth of commodity prices and shipping freights as well as because of difficulties in global supply chains.

The annual inflation rate measured by the harmonised index of consumer prices (HICP) in the euro area accelerated from 1.9% in June to 5.0% in December, while Croatia's rate was, at 5.2% in December, only 0.2 percentage points higher than the euro area rate.

The average annual consumer price inflation (CPI) accelerated sharply in 2021, due to a large extent to increases in the prices of energy, the highest being that in the prices of refined petroleum products, which reflects the global increase in crude oil prices. The acceleration of inflation in the second half of the year also resulted from the growth of food product prices, caused by the spillover of high global prices of food raw materials and energy products on consumer prices and yields of some field crops having been reduced due to weather adversities. The prices of a large number of industrial products also grew at the end of the year, driven up by increases in the prices of refined petroleum products and other commodities in the world market as well as in shipping freights, and by disturbances in global supply chains, which caused shortages of some semi-finished and finished goods. Under such conditions, the inflation diffusion index increased, that is, the shares of products whose prices rose in a certain month in the total number of products grew (Figure 5.1).

Figure 5.1 Indicators of current inflation trends

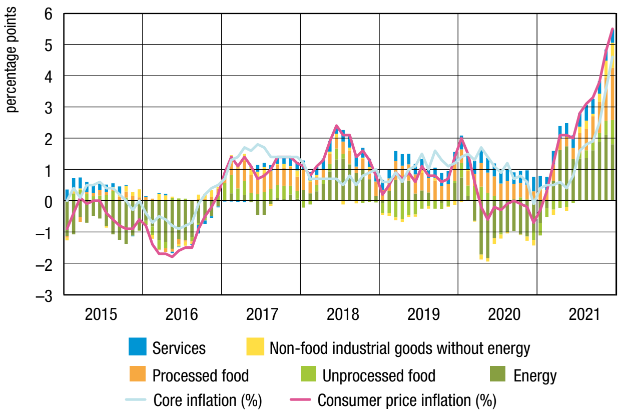


Notes: The month-on-month rate of change is calculated from the quarterly moving average of seasonally adjusted consumer price indices. The inflation diffusion index shows the share of the number of products whose prices increased in a given month in the total number of products, measured by a 6-month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

Having accelerated to 2.0% in June 2021 from –0.7% in December 2020, inflation continued to accelerate in the remaining six months of 2021, reaching 5.5% in December. The contributions of all major CPI components increased, but food products made the largest contribution to inflation in December, totalling 2.1 percentage points (Figure 5.2).

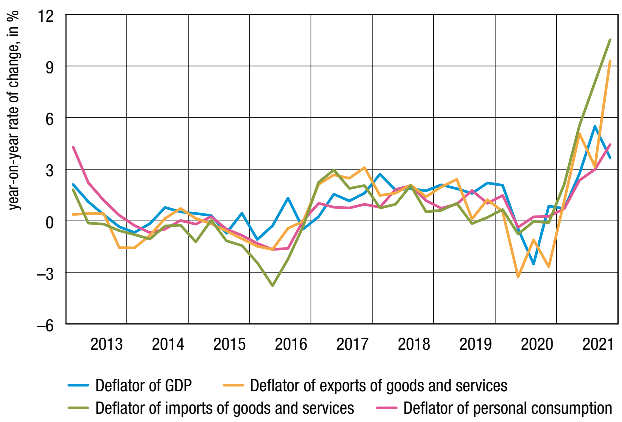
Broken down by components, the annual growth rate of energy prices went up from 8.1% in June to 11.0% in December. The annual growth rate of processed food products also increased, from 1.5% in June to 7.0% in December, mostly as a result of

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



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

Figure 5.3 Deflator of GDP and its individual components



Source: CBS.

the spillover of imported cost pressures, that is, increases in the global prices of food raw materials and energy products, onto the consumer prices of bread, milk, cheese and eggs, and oils and fats. The annual rate of change in the prices of unprocessed food products grew from –0.9% to 9.0% because of reduced yields of some crops (fruit and vegetables) caused by adverse weather conditions and the rise of meat prices in the global market.

In addition to energy and food prices, the annual growth rate of industrial products' prices also accelerated, increasing from 0.0% in June to 3.1% in December. The bulk of the acceleration was in December, which points to the gradual spillover of global price increases in industrial commodities and some intermediate goods (e.g. semiconductors) onto these prices. This is confirmed by the indicators of price trends in early production

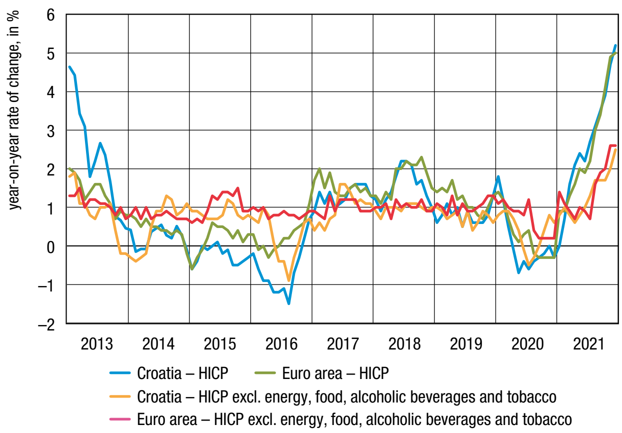
Table 5.1 Price indicators

year-on-year rate of change

	12/20	3/21	6/21	9/21	12/21
Consumer price index and its components					
Total index	–0.7	1.2	2.0	3.3	5.5
Energy	–5.7	3.9	8.1	9.8	11.0
Unprocessed food	–3.5	–3.3	–0.9	3.0	9.0
Processed food	1.3	2.2	1.5	3.5	7.0
Non-food industrial goods without energy	–0.7	–0.7	0.0	0.3	3.1
Services	1.8	1.7	1.6	1.9	1.7
Other price indicators					
Core inflation	–0.1	0.5	0.8	1.9	4.6
Index of industrial producer prices on the domestic market	–1.2	3.2	7.8	13.7	19.6
Index of industrial producer prices on the domestic market (excl. energy)	0.1	0.7	1.4	3.0	4.3
Harmonised index of consumer prices	–0.3	1.6	2.2	3.5	5.2
Harmonised index of consumer prices at constant tax rates	–0.1	1.1	2.0	3.3	5.0

Sources: CBS and Eurostat.

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



Source: Eurostat.

and distribution phases: the annual growth rate of domestic producer prices of intermediate goods grew from 3.4% in June to 7.7% in December, while the annual growth of producer prices of durable consumer goods accelerated slightly less, from 2.0% in June to 2.7% in December.

Services were the only component whose annual growth rate of prices rose only incrementally in December (1.6%) from June (1.7%).

Core inflation, which excludes the prices of agricultural products, energy prices and administered prices and is monitored because it shows an inflation component that is influenced by domestic developments and economic policies, accelerated from 0.8% in June to 4.6% in December (Table 1). The acceleration mainly happened in the last two months of 2021, when core inflation accelerated by 2.1 percentage points, due primarily to the increased contributions of food products (excluding agricultural products), clothing and footwear, used motor vehicles1, non-durable household goods, personal hygiene products and furniture.

The implicit deflator of GDP increased from 2.7% in the second quarter of 2021 to 3.7% in the fourth quarter. The deflators of exports and imports of goods and services increased in the second half of the year, with the deflator of imports of goods and services increasing more than the deflator of exports of goods and services, which is a sign of deterioration of trade conditions (Figure 5.3).

The annual inflation rate measured by the harmonised index of consumer prices (HICP) in the euro area accelerated from 1.9% in June to 5.0% in December (Figure 5.4), mostly as a result of the growth of energy prices. As well as by refined petroleum products, whose contribution continued to grow because of the growth of crude oil prices in the world market, the acceleration of inflation was driven by other energy components, especially natural gas and electricity, whose prices increased due to the considerable growth of prices of natural gas in the world market in the second half of 2021. The growth of prices of energy products and other commodities in the world market gradually spilled over to consumer prices of food and industrial products in the euro area. As a result of this and the gradual recovery of demand related to the reopening of European economies, the annual growth rate of the prices of these inflation components rose gradually towards the end of the year, spurred additionally by the positive impact of the base period (VAT cuts in Germany at mid-2020). The annual

1 The use of public transport decreased and the use of individual transport increased during the pandemic, with the result that the prices of motor vehicles, motor bicycles and bicycles grew.

growth rate of services prices also increased, driven by the recovery of demand, with the result that core inflation (which excludes the prices of energy, food, beverages and tobacco) in the euro area accelerated in the second part of the year (from 0.9% in June to 2.6% in December) before reaching the highest level since it started to be measured in 2002 in December.

The annual rate of inflation in Croatia measured by the harmonised index of consumer prices (HICP) stood at 5.2% in June 2021, exceeding the annual HICP inflation rate in the euro area by 0.2%. Croatia's core inflation (measured by the HICP excluding energy, food, beverages and tobacco) stood at 2.5% in December, slightly below euro area inflation (2.6%).

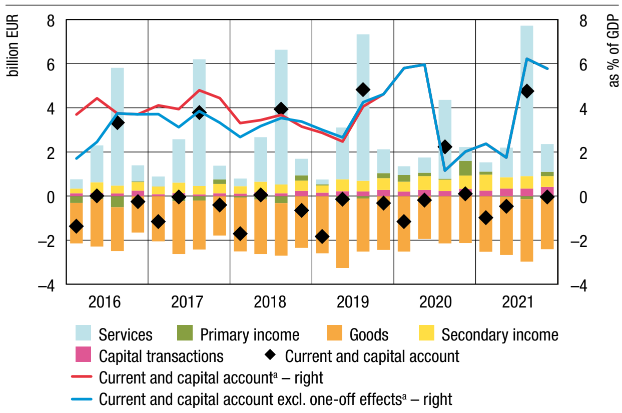
6 Current and capital account

The current and capital account surplus widened sharply in the second half of 2021 from the same period in the previous year, mostly driven by the strong recovery of net exports of services, primarily relating to tourism revenues. The surplus increased to 5.8% of GDP at the end of 2021, up 3.8 percentage points from 2020.

The growth of foreign trade in goods reflects the strong recovery of foreign and domestic demand as well as the growth of prices of energy products and other commodities in the world market. The balance of foreign trade in goods narrowed by 0.8 percentage points from 2002 and the deficit amounted to 18.1% of GDP at the end of 2021.

The current and capital account surplus widened sharply in the second half of 2021 from the same period in the previous year, mostly driven by the recovery of net exports of services, primarily tourism revenues. The growth of net income from personal transfers and transactions with the EU budget also positively contributed to the current and capital account, albeit more modestly. In contrast, the goods trade deficit increased and so did the negative investment income balance, the latter due to a marked increase in the profits of foreign-owned banks and enterprises. On the 2021 level, the current and capital account surplus was at 5.8% of GDP 3.8 percentage points higher than in the whole of 2020 (Figure 6.1).

Figure 6.1 Current and capital account balance and its structure



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

6.1 Foreign trade and competitiveness

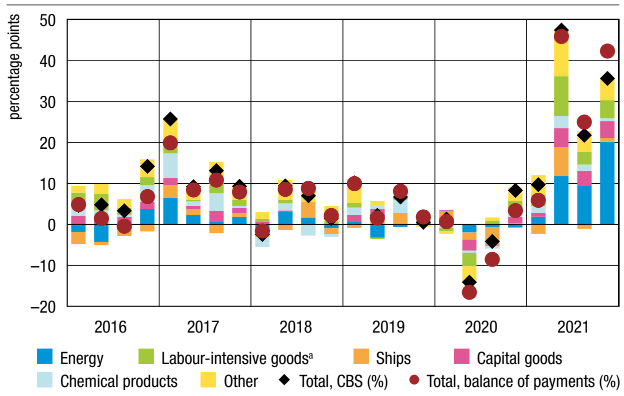
Following a strong jump in the first half of 2021, foreign trade in goods further stepped up its pace in the last six months of the year. According to the balance of payments data[2], goods exports grew by 34.0% and goods imports by 29.6% in the second half of 2021, while the deficit increased by 22.8% in that period (due to a much larger import base) from the same period in the previous year. This increased pace of foreign trade reflects a continued strong recovery of foreign and domestic demand as

2 According to CBS data, goods exports rose by 29.0%, goods imports by 28.0% and the deficit by 25.7% in the second half of 2021. For more information on the differences in the scope of foreign trade in goods according to the balance of payments and CBS data, see Box 3 Foreign trade developments according to the balance of payments data, Macroeconomic Developments and Outlook No. 2, July 2017.

well as the growth of prices of energy products and other commodities in the world market. On the 2021 level, the goods trade deficit stood at 18.1% of GDP, which is a decrease of 0.8 percentage points on 2020.

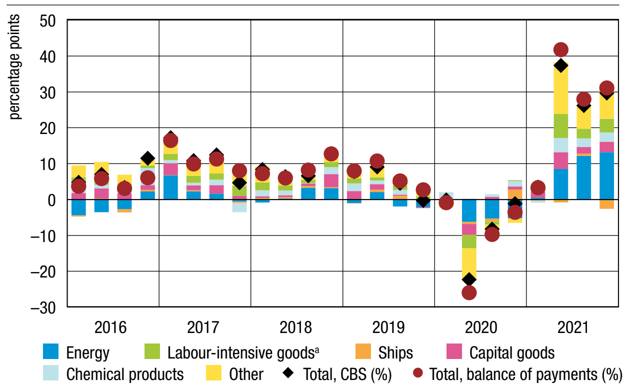
Detailed CBS data show that the growth of total goods exports was primarily due to growth of exports of energy products (Figure 6.2), especially the growth of electricity exports to Slovenia. In addition to energy product exports, exports of capital goods, most notably electrical machinery, apparatus and appliances to Germany and metal industry products to Italy, Germany and Slovenia, also increased. Export performance was also favourably influenced by an increase in exports of other chemical products (excluding medical and pharmaceutical products) to Hungary, Italy and Germany and of food products (in particular cereals and cereal products to Italy): However, exports of medical and pharmaceutical products to the US and Belgium dropped noticeably.

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



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

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

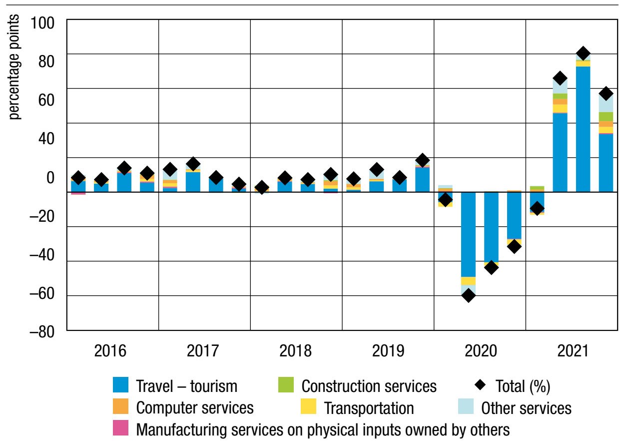


[a] Labour-intensive goods (according to the SITC) include: textile, wearing apparel, footwear, leather, paper, cork and wood, furniture, manufactures of metals and non-metallic mineral manufactures, prefabricated buildings and manufactured articles n.e.c.
Sources: CBS and CNB.

The increase in total goods imports was, like exports, mainly driven by energy products (Figure 6.3), most of all by natural and industrial gas imports from the US and oil and refined petroleum products imports from Italy. In addition to energy product imports, imports of metal industry products from Italy and of other chemical products (excluding medical and pharmaceutical products) from Italy and Germany also grew. Imports of food products rose too (especially of vegetables and food from Italy and the Netherlands) as well as imports of specific capital goods (electrical machinery, apparatus and appliances from China).

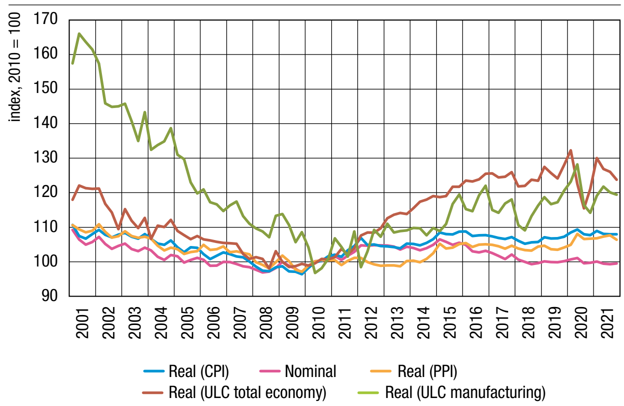
The surplus in the international trade in services expanded strongly in the second half of 2021 because tourism revenues were twice as high as in the same period in the previous year, when they plummeted due to the coronavirus pandemic (Figure 6.4). The recovery of tourism revenues was primarily caused by improved pandemic trends and to some extent also by the structural characteristics of Croatian tourism, such as the geographical vicinity of the main outbound markets (from which the largest number of tourists arrive by road transport) and the large share of private accommodation.

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



Source: CNB.

Figure 6.5 Nominal and real effective exchange rates of the kuna



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

Tourism revenues in 2021 amounted to 87% of the revenues from the record year 2019. Net exports of other services also increased, although much less. The surplus in the international trade in services thus rose from 10.5% of GDP in 2020 to 17.2% in 2021.

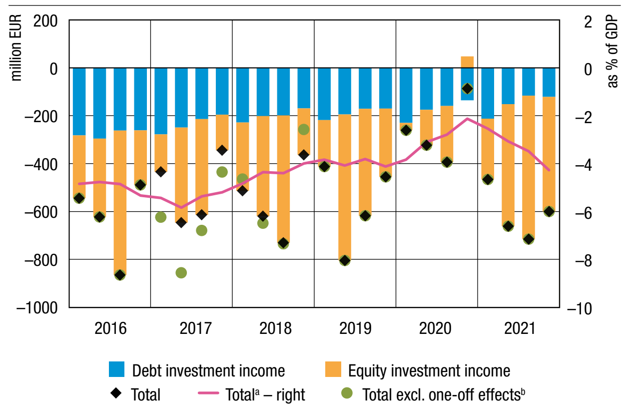
The price and cost competitiveness of Croatian exports improved in the second half of 2021 as against the same period in the previous year. Depreciation was recorded in the real effective kuna exchange rates deflated by consumer and producer prices and in the real effective kuna exchange rates deflated by unit labour costs in the overall economy. Such developments stemmed from more favourable price and cost developments in Croatia than those seen in major trading partners. At the same time, the nominal effective exchange rate of the kuna appreciated slightly, mainly as a result of the appreciation of the kuna against the euro.

6.2 Income and transactions with the EU

The negative investment income balance increased sharply by EUR 0.8bn in the second half of 2021 from the same period in the previous year (Figure 6.6), which was due to a rise in expenditures on direct equity investments resulting from considerably improved business results of domestic banks and non-financial corporations (particularly those in real estate and accommodation activities) in foreign ownership. Unfavourable developments were offset slightly by a drop in interest expenditures on debt investments.

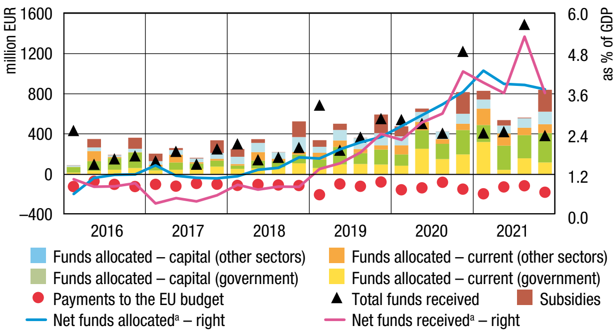
Net income from transactions with the EU budget edged up by EUR 0.1bn in

Figure 6.6 Investment income



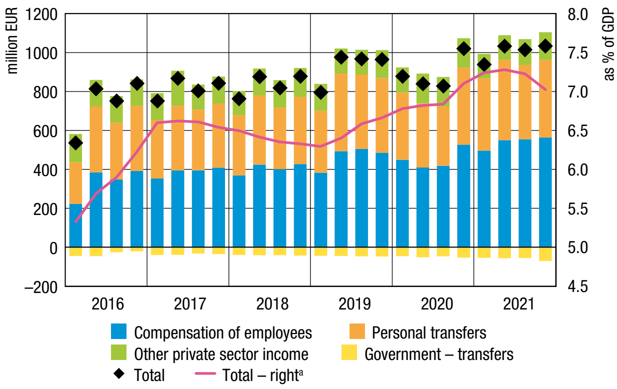
[a] Sum of the last four quarters, excluding one-off effects. [b] One-off effects include bank provisions for loans to the Agrokor Group in 2017 and 2018.
Source: CNB.

Figure 6.7 Transactions with the EU budget



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

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



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

the second half of 2021 as against the same period in the previous year due to the use of capital revenues rising at a higher rate than payments to the EU budget. Although the surplus of allocated funds over the payments to the EU budget was in the whole of 2021 higher than in the previous year, the relative indicator remained unchanged as a result of strong GDP growth, amounting to 3.7% of GDP as in 2020.

The net inflow from other income, excluding investment income and transactions with the EU budget, grew by EUR 0.2bn from the same period in the previous year on the back of an increase in net revenues from compensation of persons temporarily employed abroad and, to a lesser degree, revenues from personal transfers from abroad (Figure 6.8).

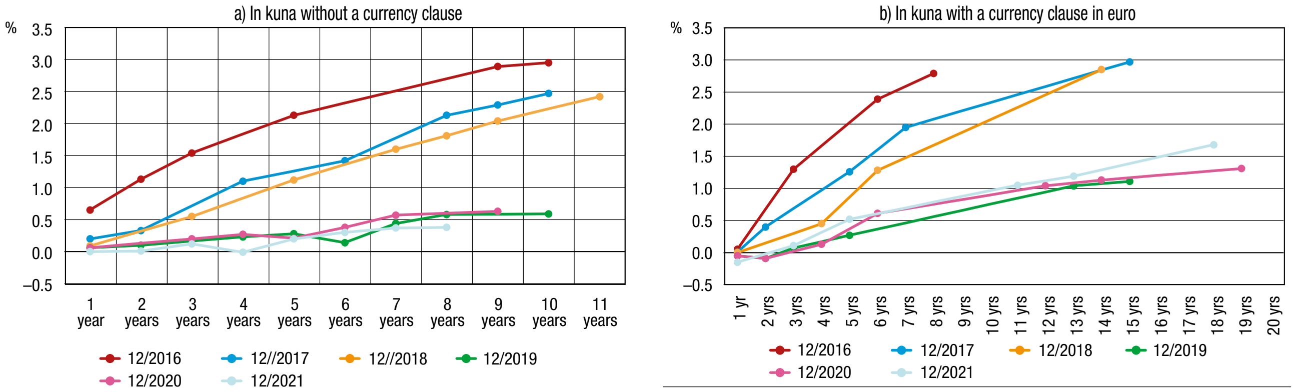
7 Private sector financing

The costs of domestic sectors financing trended downwards in the second half of 2021, with some interest rates hitting record lows. The banks also continued to ease the standards of lending to corporates and households. The costs of government borrowing, one of the determinants of the costs of private sector borrowing, mainly decreased from the end of 2020 and the country's credit ratings remained at the levels seen in the years before. The interest rates on corporate and household loans were low and stable, and the costs of housing financing stood at an average 2.56%.

The costs of government borrowing, one of the determinants of the costs of borrowing of other domestic sectors, mainly fell from the end of the previous year. The already very low interest rates on short-term borrowing thus dropped further. The interest rate on one-year kuna T-bills on the domestic market fell slightly from 0.06% at the end of the previous year to 0.00% in October 2021, and continued to hold steady at that level in November (Figure 7.1a), thus ensuring for the first time interest-free kuna debt financing. The interest rate on one year euro T-bills in October also fell to the lowest level ever of –0.15% (Figure 7.1b), and in May 2021 and October 2020 it stood at –0.05%. Long-term yields on government bonds at the end of 2021 were close to pre-pandemic levels, whereas the costs of long-term financing in kuna without a currency clause were generally more favourable. Although there was an issue of domestic bonds in early July, in the second half of 2021, the government did not issue new bonds on the domestic and international markets.

As regards credit rating, the credit rating agency Fitch upgraded Croatia's rating from BBB – to BBB with positive outlook, two levels above speculative rating. The country's rating by Standard & Poor's has remained unchanged at BBB – with stable outlook since March 2019, while Moody's is the only credit rating agency to have kept

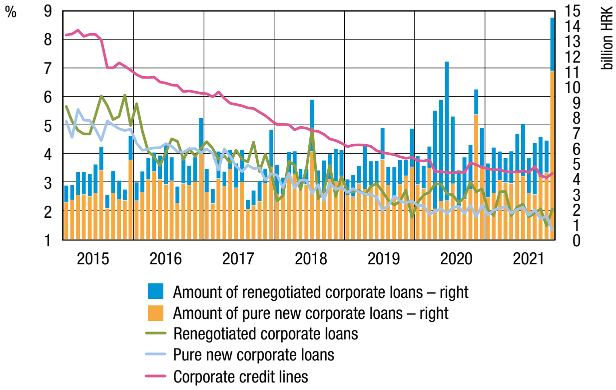
Figure 7.1 Yield-to-maturity on RC bonds



Notes: The dots show the achieved yields, while other values have been interpolated. Data for a one-year yield refer to the achieved interest rate on one-year kuna T-bills without a currency clause. Data for the end of 2021 refers to November.
Source: CNB.

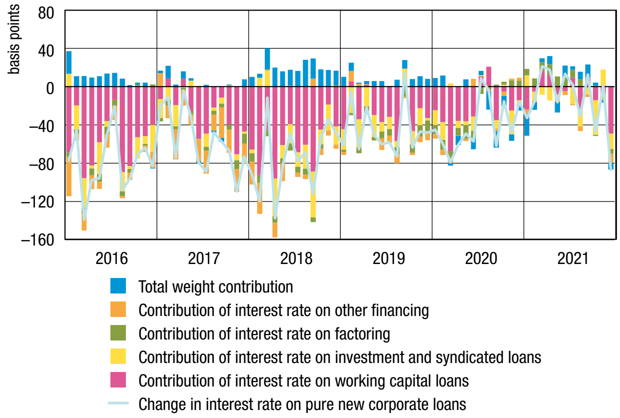
Notes: The dots show the achieved yields, while other values have been interpolated. Data for a one-year yield refer to the achieved interest rate on one-year T-bills with a currency clause in euro. Data for the end of 2016 refer to November and for the end of 2017, 2019, 2020 and 2021 refer to October.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

Figure 7.2 Interest rates and amounts of corporate loans



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

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



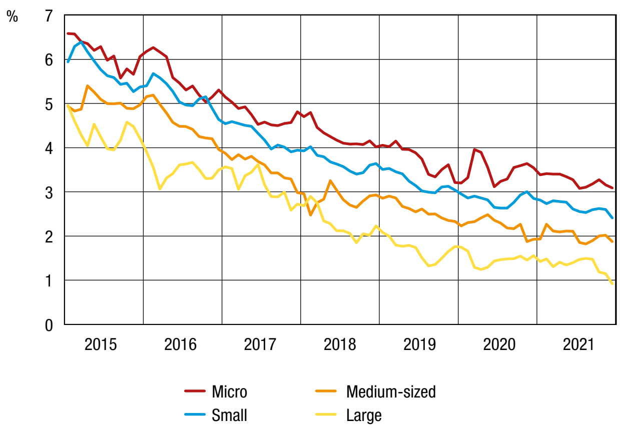
Note: Calculated by applying the Bennet index, according to which total contribution is divided into interest rate effect and weight effect.
Source: CNB.

Croatia's rating one level below investment grade, at Ba1, with stable outlook.

After being cut for the first time below 2% in March 2020, the interest rate on pure new loans to corporates was relatively stable and ranged between 1.7% and 2.2% until November 2021 (Figure 7.2). In December 2021, it fell to the lowest level ever, of 1.30%, mostly driven by the monthly fall in the interest rates on loans to large enterprises. Compared with the end of the year before, the interest rate on pure new loans to corporates was down by 87 basis points (Figure 7.3) in December 2021, mostly driven by a fall in the interest rates on loans for working capital (53 basis points) and investment and syndicated loans (19 basis points). In terms of corporate size, the annual fall was mostly fuelled by a fall in the interest rates on loans to large enterprises (60 basis points).

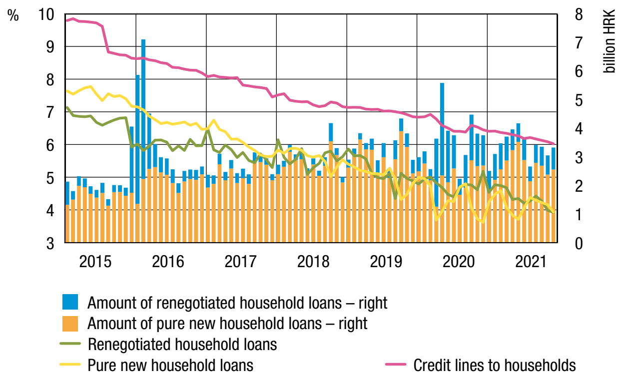
The quarterly average of financing costs at the end of 2021 for all categories of enterprises by size was below that at the end of the previous year (Figure 7.4). The fall in interest rates is greater with rising size of enterprises as large enterprises generally

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



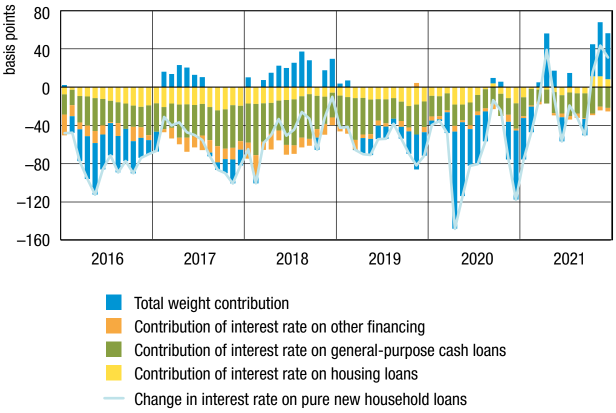
Note: Quarterly weighted moving averages.
Source: CNB.

Figure 7.5 Interest rates and amounts of household loans



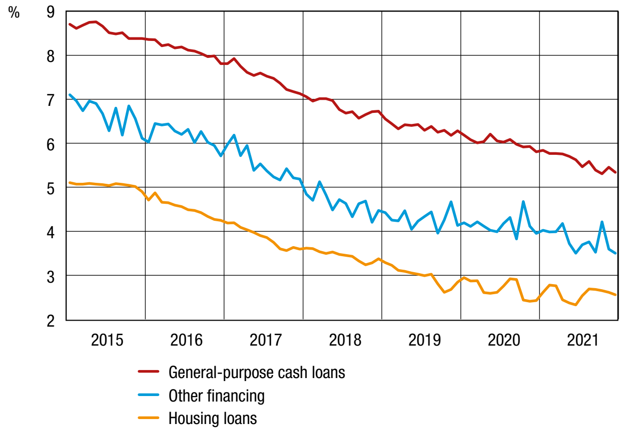
Note: Data on pure new loans are not available for credit card loans, overdrafts, revolving loans and receivables on charge cards since their new business volume (for other instruments, this includes both pure new loans and renegotiated loans) is equal to balances and thus included in the credit line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

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



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

Figure 7.7 Interest rates on pure new household loans by purpose

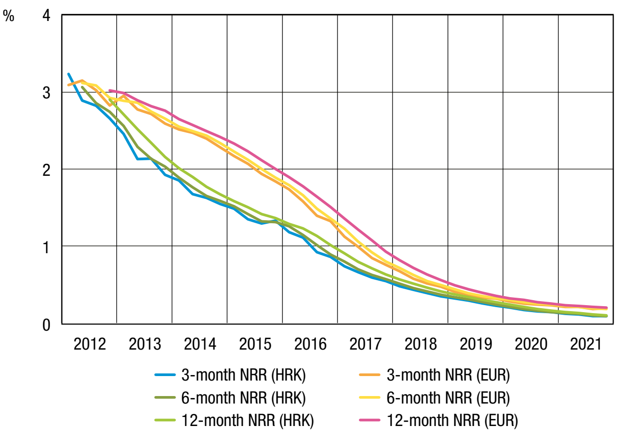


Source: CNB.

pose lesser risk. Thus the average weighted interest rate on pure new loans to micro enterprises in December 2021 was some 2 percentage points higher than that on pure new loans to large enterprises, which is similar to the average difference seen over the past year.

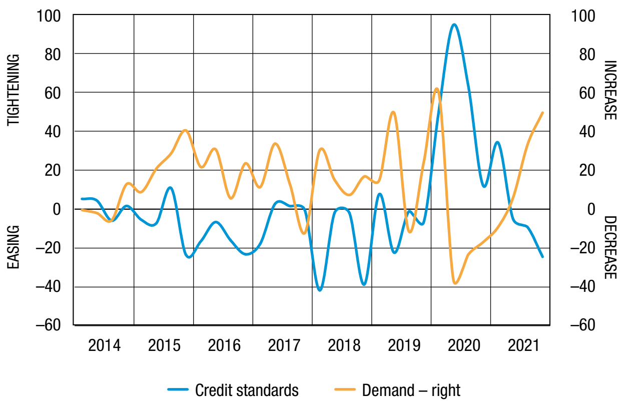
The interest rate on pure new household loans stood at 3.94% at the end of 2021 (Figure 7.5). The volatility of this interest rate seen in the past few years is, on the one hand, the result of large amounts of housing loans granted in the framework of the housing loan subsidy programme that led to a further fall in interest rates on housing loans, and on the other, the result of a considerably higher level of interest rates on general-purpose cash loans that account for a large share of newly granted household loans. On an annual level, the interest rate on pure new household loans rose by 31 basis points in December 2021 from the same month of the year before (Figure (7.6) as a result of the government housing loan subsidy programme that is mirrored mostly in the contribution of the change in the weight to interest rate increase (48 basis points).

Figure 7.8 National reference rate (NRR)



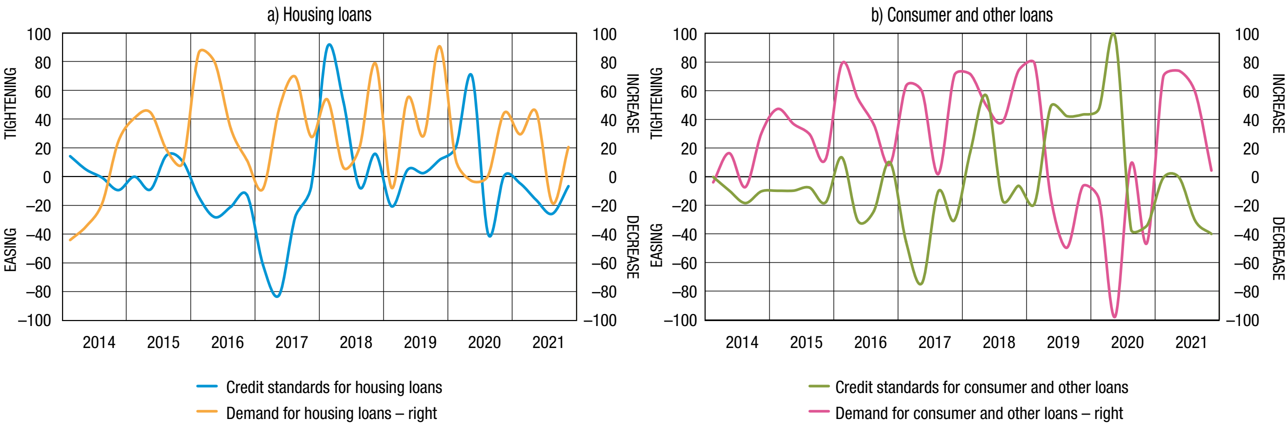
Note: The rates shown are the rates for all natural and legal persons.
Sources: CNB and HUB.

Figure 7.9 Credit standards and corporate demand for loans



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

Figure 7.10 Credit standards and household demand for loans



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

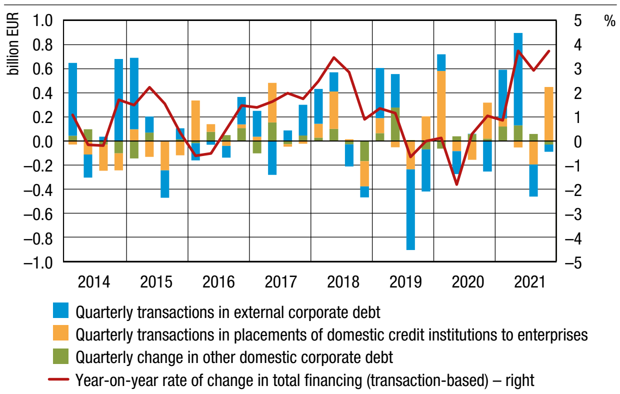
In contrast with the positive contribution of the weight to the change in the interest rate on total household loans, the contribution of interest rates to this change was negative, primarily because of a reduction in the interest rate on general-purpose cash loans (22 basis points), while the costs of housing financing rose on an annual level, reflecting the absence of the subsidy programme in October 2021.

The interest rate on general-purpose cash loans approached the lowest recorded levels and stood at 5.34% in December (Figure 7.7), while the costs of housing financing were half that, i.e. 2.56%. The bulk of household credit activity was accounted for by these two instruments with general-purpose cash loans accounting for 45% and housing loans for 42% of total pure new household loans in 2021.

Further decrease in the costs of financing of the Croatian banking system in conditions of the exceptionally expansionary monetary policy and historically high surplus liquidity helped maintain the favourable financing conditions of the private sector. The national reference rate[3] thus continued to fall in the second half of 2021 (Figure 7.8) but so did the EURIBOR (Figure 2.3).

According to the bank lending survey, the recovery in the standards of corporate lending and demand that started in the second quarter of 2021 accelerated in the remainder of the year (Figure 7.9), particularly in the segment of small and

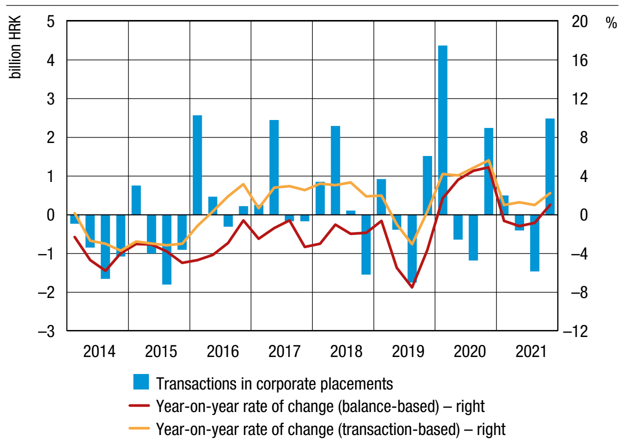
Figure 7.11 Corporate financing



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

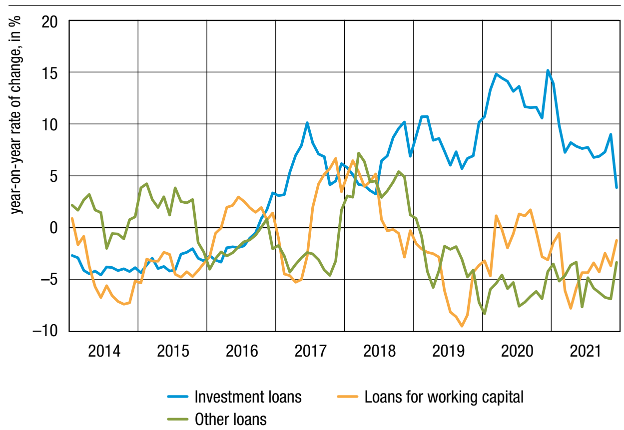
3 The national reference rate (NRR) is the average interest rate paid on deposits by the banking sector. It is used as one of the benchmark interest rates for determining the level of the variable component of variable interest rate on loans, in accordance with Article 11a of the Consumer Credit Act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

Figure 7.12 Corporate domestic placements of credit institutions



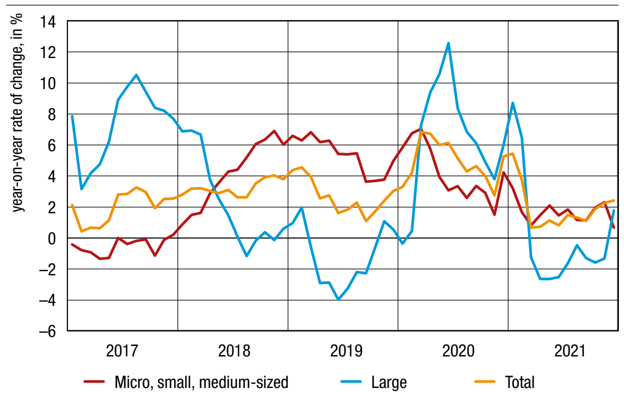
Source: CNB.

Figure 7.13 Growth in corporate loans by purpose
transaction-based



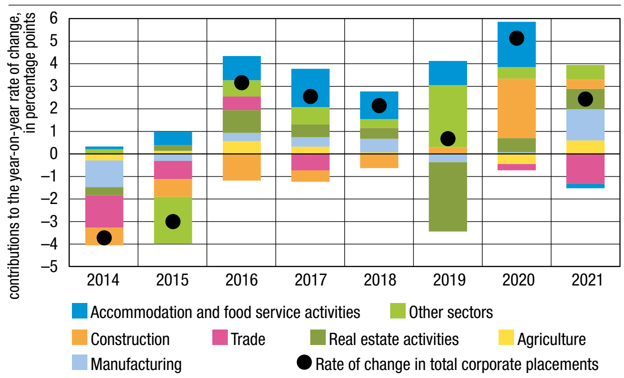
Source: CNB.

Figure 7.14 Growth in corporate placements by size
transaction-based



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

Figure 7.15 Growth in corporate placements by activity
transaction-based

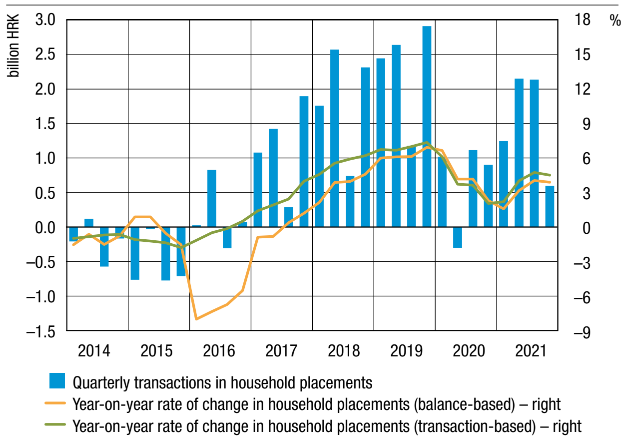


Note: In October 2019, a large corporation switched from Section L (Real estate activities) to Section E (Water supply, sewerage, waste management and remediation activities). This is why in 2019 a sharp decrease in placements was recorded in Real estate activities, and a substantial rise was seen in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

medium-sized enterprises and long-term loans. The easing of standards in the second half of the year was mostly driven by competition among banks and bank liquidity. At the same time, total demand for corporate loans rose considerably and the recovery was particularly strong in large enterprises and long-term loans, which were still seeing a fall in demand in the second quarter. According to bank responses, the increase in total demand in the second part of the year was mostly fuelled by corporate demand for financing inventories and working capital, debt restructuring and mergers, acquisitions and corporate restructuring, and for the first time since the outbreak of the pandemic, the fourth quarter of 2021 also witnessed an increased corporate demand for investment financing.

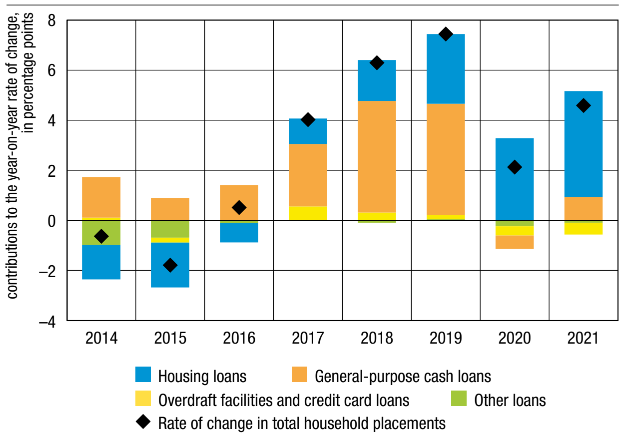
In the household sector, credit lending standards continued to ease (Figure 7.10), particularly those for consumer and other loans. The easing of standards for consumer and other loans was mostly driven by competitive pressure among banks and for

Figure 7.16 Household placements



Source: CNB.

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



Source: CNB.

housing loans also by expectations regarding general economic developments. The demand for housing and consumer and other loans continued to rise throughout the second half of the year, although at a slower pace than in the first half of the year. The growing demand for housing loans was spurred by growing consumer confidence while consumer and other loans were driven by the demand for durable consumer goods.

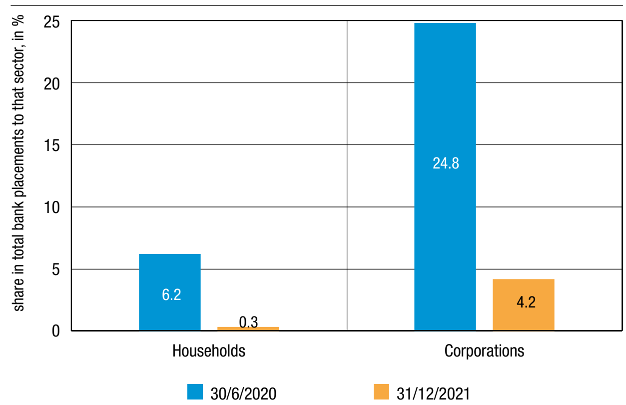
Following a sharp growth in total corporate debt in the first half of 2021, mainly due to foreign borrowing, the second half of the year witnessed a small deleveraging (Figure 7.11), mostly as a result of a reduction in corporate foreign debt. Total corporate debt in 2021 rose by 3.7% (transaction-based), primarily because of growth in foreign debt and placements of domestic credit institutions and to a lesser extent because of growth in other domestic financing.

Corporate borrowing was subdued until December 2021 when it was followed by a sharp rise in borrowing triggered by greater individual transactions. Thus corporate placements of credit institutions fell by HRK 0.5bn or 0.5% in the first eleven months of 2021 but rose by HRK 2.5bn in December, with the resulting annual growth standing at 2.3% at the end of the year (transaction-based, Figure 7.12). The demand for investment loans continued to determine the growth in corporate loans, with investment loans rising 3.9% at the end of the year (Figure 7.13), which comes to only one fourth of the growth from the year before. Loans for working capital fell by 1.2% on an annual level followed by other loans that fell by 3.3%, a smaller fall than that at the end of 2020. Lending to micro, small and medium-sized enterprises slowed down, growing by 0.7% in 2021, while loans to large enterprises rose by 1.18%, after nine consecutive months of deleveraging (Figure 7.14).

In terms of activities, the growth in placements in 2021 was recorded in manufacturing, real estate activities, other activities, agriculture and construction. In contrast, placements fell in trade and accommodation and food service activities (Figure 7.15).

Following a considerable slowdown in the previous year, mostly driven by smaller

Figure 7.18 Placements under payment deferral or restructuring measures



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

demand for general-purpose cash loans, the growth in household placements started to accelerate in 2021, with the annual growth rate rising from 2.1% at the end of 2020 to 4.5% in December 2021 (transaction-based, Figure 7.16). The several-year upward trend in housing loans growth continued to gain momentum (Figure 7.17), spurred also by the implementation of the government subsidy programme. Housing loans grew 9.2%, up from 7.5% in the year before. At the same time, after falling persistently for several months, general-purpose cash loans had grown 2.4% by the end of 2021.

The total amount of bank placements associated with payment deferral or restructuring measures fell towards the end of 2021 to its lowest level ever, mostly as a result of expiry of the granted moratoria. Thus, towards the end of October, 4.2% of bank placements to corporates and 0.3% of household placements were covered by the measures, a considerable decrease from mid-2020.

8 Foreign capital flows

The financial account of the balance of payments recorded a large net capital outflow in the second half of 2021, which was the result of a fall in net debt liabilities of domestic sectors, while net equity liabilities rose noticeably.

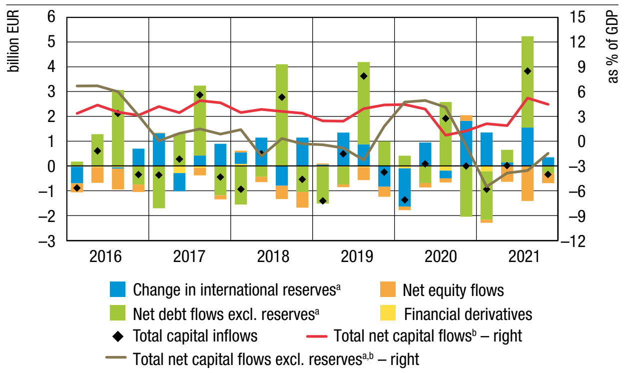
The increased inflows from EU funds and the European Commission's pre-financing payment under the National Recovery and Resilience Plan prompted the government to sell a large share of the foreign exchange to the CNB and to deposit another share in the account with the CNB, which led to a sharp rise in international reserves. Relative external debt indicators improved, with gross external debt standing at 77.9% of GDP, a decrease of 6.4 percentage points from the end of June. Net external debt stood at EUR 2.3bn or only 4.0% of GDP, having fallen by 10.5 percentage points from end-June.

The financial account of the balance of payments, changes in gross international reserves and liabilities of the CNB excluded, recorded a large net capital outflow of EUR 1.6bn in the second half of 2021, up from EUR 1.2bn in the same period of the year before. The net capital outflow was the result of a sharp fall in net debt liabilities of domestic sectors, while net equity liabilities rose considerably. Since the international reserves of the central bank were much bigger, the total net capital outflow was even more prominent, standing at EUR 3.5bn (Figure 8.1).

The net inflow from equity investments in the second half of 2021 stood at EUR 1.8bn, and resulted from a large increase in liabilities. This was largely driven by reinvested earnings of domestic business entities in non-resident ownership, which, due to rising profitability in a large number of activities, particularly in the financial sector, outperformed those in the same period of the year before. Although there was also a significant increase in inflows from direct equity investments in Croatia from the previous period (Figure 8.2), mostly to be credited are a further increase in investments in real estate and a major takeover transaction in the domestic food industry, completed in the second half of last year.

A large net outflow of debt capital of EUR 3.4bn (changes in gross international reserves and liabilities of the CNB excluded) in the second half of 2021 mostly mirrors the fall in net debt liabilities of other domestic sectors (including their net liabilities to affiliated

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



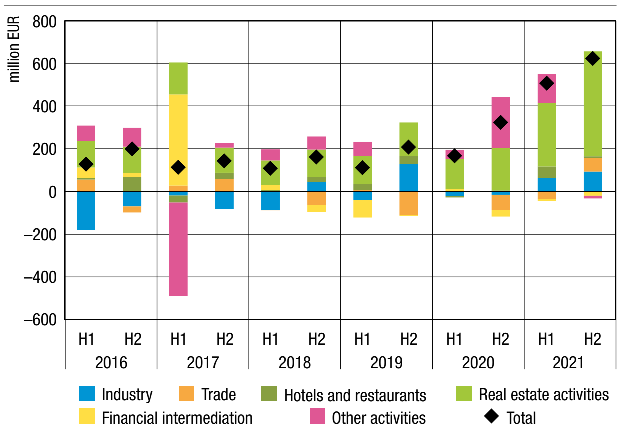
[a] Changes in gross international reserves net of CNB foreign liabilities.
[b] Sum of the previous four quarters.
Notes: Net flows are the difference between changes in assets and liabilities. Equity flows comprise changes in foreign direct equity investments, reinvested earnings and portfolio equity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

creditors). In addition, the net debt position of banks improved considerably and also worth noting is the pronounced rise in bank assets in the TARGET2 system administered by the central bank. The net foreign position of the government did not improve so much, mainly due to the bond repayment issued on the domestic market in July, which was partly owned by non-residents.

A considerable fall in net external debt, coupled with a simultaneous robust growth of nominal GDP, resulted in an improvement in the international investment position (Figure 8.5), which stood at –34.0% of GDP at the end of 2021, down from –46.5% of GDP at the end of June 2021. Thus, after almost two full decades, the relative indicator of the international investment position stood within the threshold value of –35% of GDP defined under the Macroeconomic Imbalances Procedure. In addition to the reduction in net debt liabilities of the domestic sectors, the improvement in the relative indicator of international investment position was also supported by a favourable effect of price, exchange rate and other adjustments on the side of equity investments.

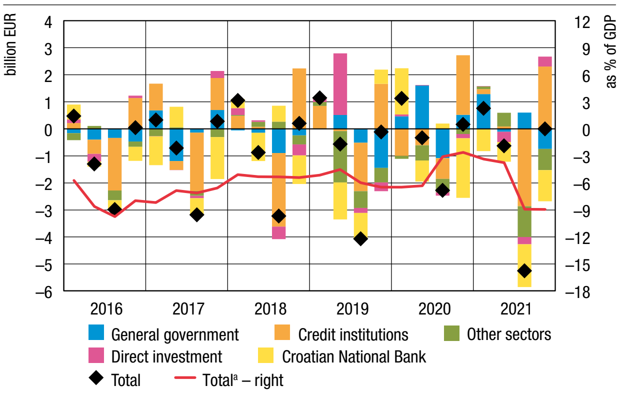
The Government sold a large share of the foreign exchange from increased inflows from EU funds and the European Commission's pre-financing payment under the National Recovery and Resilience Plan to the CNB and deposited another share in the account with the CNB, with the result that net transactions of the government and the central bank were the main determinants of a sharp rise in international reserves in the second half of 2021. Although to a lesser extent, the increased volume of repo transactions and growth of funds allocated under special drawing rights of

Figure 8.2 Foreign direct equity investment in Croatia by activities



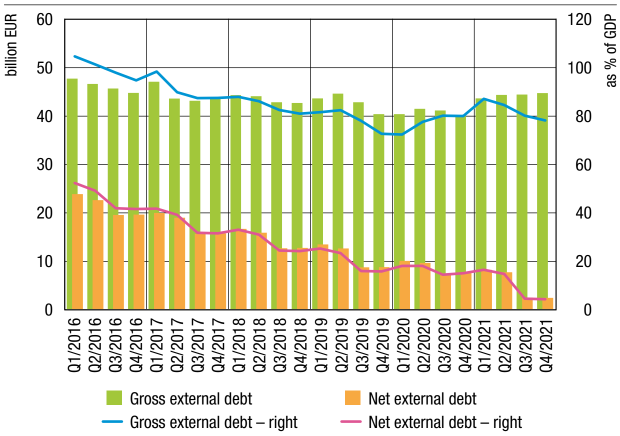
Note: Equity investment net of debt-to-equity transactions and round-tripping investments.
Source: CNB.

Figure 8.3 Net external debt transactions by sectors



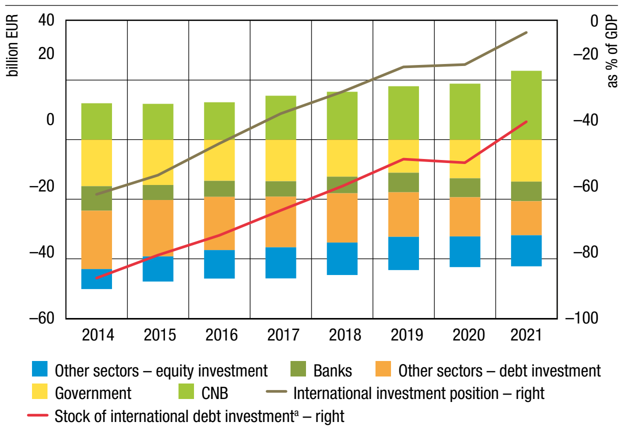
[a] Sum of the previous four quarters.
Notes: Transactions refer to the change in debt excluding cross-currency changes and other adjustments. Net external debt is calculated as the gross external debt stock net of foreign debt claims.
Source: CNB.

Figure 8.4 Stock of gross and net external debt



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

Figure 8.5 International investment position (net) by sectors



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

the International Monetary Fund (IMF) further contributed to the growth in gross international reserves, nevertheless, since foreign liabilities of the central bank rose by the same amount, they did not affect its net external position.

The relative indicators of external debt improved considerably in the second half of 2021 with the gross external debt standing at EUR 44.6bn or 77.9% of GDP at the end of 2021, down 6.4 percentage points from the end-June level, which can exclusively be attributed to the growth in nominal GDP, while debt stock in an absolute amount rose slightly. Since foreign assets of the domestic sectors, particularly the central bank, increased strongly at the same time, the improvement of the relative indicator of net external debt was even more pronounced. Thus, the net external debt stood at EUR 2.3bn at the end of 2021, or only 4.0% of GDP, down 10.5 percentage points from the end of June.

9 Monetary policy

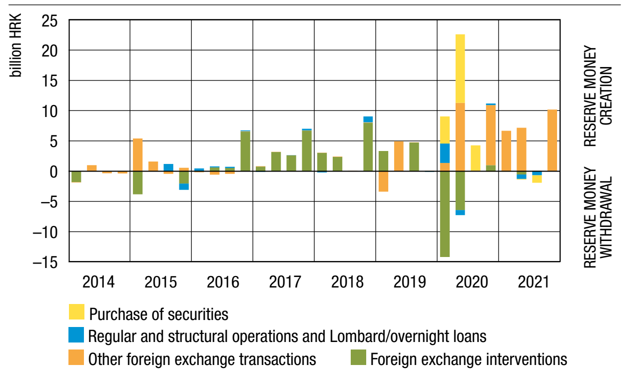
In the second half of 2021, the CNB continued to pursue an expansionary monetary policy while the exchange rate moved within a narrow range around the central parity of 7.5345. The CNB purchased net over EUR 3bn and created a total of HRK 23.5bn in reserve money. In contrast with 2020, when the CNB purchased government bonds to maintain the stability of the market in government securities, in 2021 the central bank did not need to resort to this monetary policy measure. As for other kuna operations, due to poor interest of banks amid a large surplus of kuna liquidity in the monetary system, in 2021 the CNB did not place funds through regular weekly operations nor did it use structural operations to create additional kuna liquidity.

In the second half of 2021, the CNB continued to an pursue expansionary monetary policy, mainly purchasing foreign exchange inflows from the Ministry of Finance (MoF). Just as in the first half of the year, the stable financing conditions on the domestic financial markets did not prompt the central bank to resort to additional monetary policy measures.

The exchange rate of the kuna against the euro was relatively stable throughout the second half of the year amid the absence of any significant pressures on the foreign exchange market. As a result, after selling to the banks at foreign exchange interventions in April and June a net total of EUR 70m, the CNB did not intervene in the market in the second half of the year. However, the central bank continued to purchase foreign exchange inflows from the MoF on several occasions, which were mostly related to inflows from EU funds. Thus, in addition to purchasing EUR 1.8bn in the first half of the year, the CNB purchased net EUR 1.4bn in the second half of the year. If total foreign exchange transactions in 2021 are observed, the CNB purchased net EUR 3.1bn, creating a total of HRK 23.5bn in reserve money (Figure 9.1).

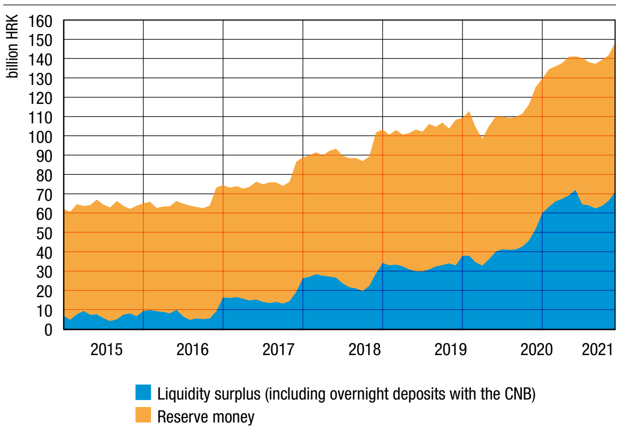
In contrast with 2020, when the CNB purchased government bonds to maintain stability of the market in government securities, in 2021 there was no need for the use of this monetary policy measure by the central bank. Some bonds fell due, which led to a HRK 1.5bn drop in the stock of total subscribed bonds of the Republic of Croatia from the end of the year before. As regards other kuna operations, the CNB continued to conduct regular weekly operations at a fixed repo rate of 0.05%. However, in the conditions of poor interest of banks and very large

Figure 9.1 Flows of reserve money (M0) creation



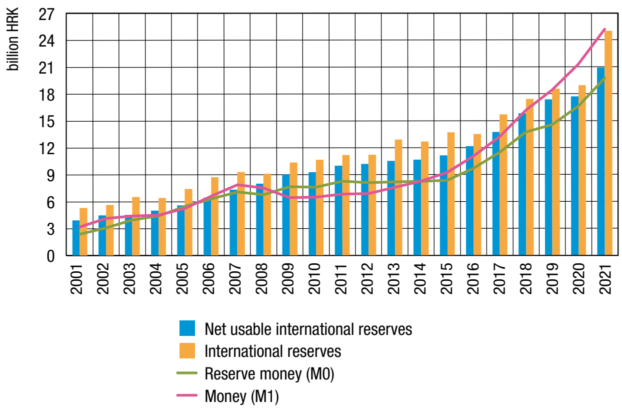
Notes: The Lombard facility cancelled on 28 September 2017 was replaced by the overnight facility. Other foreign exchange transactions include the purchase of foreign exchange from and the sale of foreign exchange to the MoF and the EC and foreign currency swaps with banks. The positive values refer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

Figure 9.2 Bank liquidity and reserve money



Source: CNB.

Figure 9.3 International reserves of the CNB and monetary aggregates



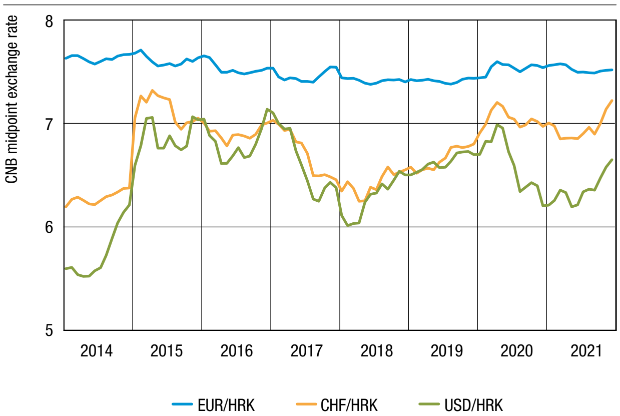
Note: Net usable international reserves are defined as international reserves net of CNB foreign liabilities, reserve requirements in f/c, government foreign currency deposits and off-balance sheet liabilities (swaps).
Source: CNB.

kuna liquidity surpluses in the monetary system, in 2021, the CNB did not use this monetary policy instrument to make placements. There were also no structural operations used to create additional kuna liquidity so their stock at the end of the year stood at HRK 3.1bn, down HRK 1.5bn from the end of 2020 due to early repayments.

After reaching a record high of HRK 72.0bn in June, banks' free reserves fell somewhat in the second half of the year, and stood at HRK 71.1bn in December 2021. However, surplus liquidity increased from December 2020 when it stood at HRK 51.7bn (Figure 9.2), which can almost entirely be attributed to the purchase of foreign exchange from the government.

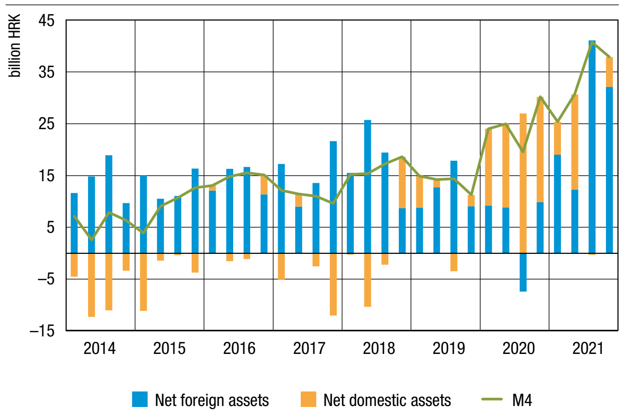
Gross international reserves of the Republic of Croatia amounted to EUR 25.0bn at the end of 2021 (Figure 9.3), having risen by EUR 6.1bn (32.1%) from the end of 2020. Net usable reserves rose by EUR 3.2bn (18.2%) in the same period and stood at EUR 20.9bn at the end of the year. The increase in gross reserves was mostly driven

Figure 9.4 Nominal exchange rates of the kuna against selected currencies



Source: CNB.

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



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

by purchases of foreign exchange from the government, a higher level of agreed repo transactions and Croatia's new allocation of special drawing rights in the International Monetary Fund. Both gross and net reserves are still higher than reserve money (M0). It should be noted that the CNB could still cover any need for additional foreign exchange liquidity with the funds available under a swap line agreed with the European Central Bank in April 2020, enabling the exchange of kuna for the euro up to EUR 2bn.

The exchange rate of the kuna against the euro was stable throughout 2021. Following a small depreciation in the first quarter, the appreciation of the nominal exchange rate of the kuna against the euro that started in May and June continued into mid-July when the exchange rate started to weaken amid rising epidemiological uncertainties and pronounced demand from the financial and corporate sectors for foreign exchange. The exchange rate appreciated slightly in August driven by increased inflows of foreign exchange at the peak of the tourist season. The exchange rate started depreciating slightly in September and this trend continued until the end of the year when the exchange rate of the kuna against the euro stood at 7.52 EUR/HRK, down 0.3% from the end of 2020. The average exchange rate in 2021 also stood at 7.52 EUR/HRK, down 0.1% from the average exchange rate in 2020 (Figure 9.4). Croatia entered the Exchange Rate Mechanism II (ERM II) with the central rate of the kuna being set at 1 euro = 7.5345 and the standard fluctuation band at ±15% around this rate. Compared to the central rate, the average exchange rate since joining the ERMII until end-2021 moved within a very narrow range of –1.0% do +0.7%. The exchange rate of the kuna against the US dollar and the Swiss franc was higher at the end of 2021 than at the end of 2020, reflecting the weakening of the euro against these two currencies on global financial markets.

The strong growth in monetary aggregates continued into the second half of 2021 at a faster pace than in the first six months of the year. The annual growth rate of total liquid assets (M4) stood at 10.4% at the end of 2021 (based on transactions), having accelerated from 8.7% in June last year and 9.1% at the end of last year (Figure 9.5). The growth in M4 in 2021 was primarily spurred by a large increase in net foreign assets (NFA), driven mostly by seasonal inflows of foreign exchange from tourism but also purchases of foreign exchange inflows from the MoF, mostly related to EU funds. The increase in net domestic assets (NDA) during that period was much smaller and mirrored the growth in placements to domestic sectors and to a lesser extent, the growth in net claims on the central government.

10 Public finance

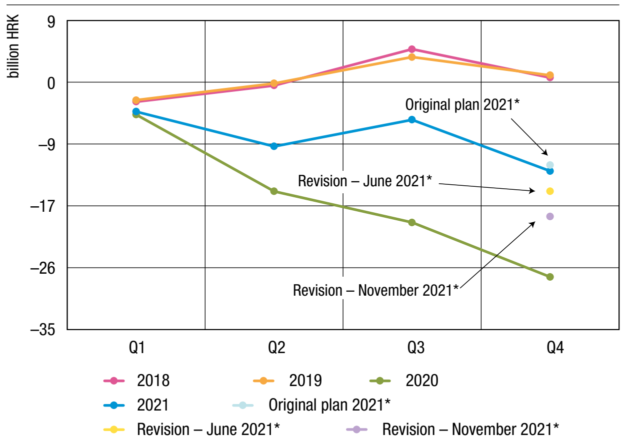
Government finances continued to improve in the second half of 2021 as a result of the recovery in economic activity and its effect on tax revenues and of a reduction in pandemic-related support and its effect on fiscal expenditures. The consolidated general government debt rose to HRK 343.6bn at the end of 2021, but the sharp growth in GDP reduced the public debt to GDP ratio in 2021 by 7.5 percentage points from the end of 2020, so that it stood at a little less than 80% at the end of 2021.

Government finances continued to improve in the second half of 2021, reflecting both the favourable impact of the recovery in economic activity on tax revenues and the reduction in fiscal support for mitigating the negative impacts of the COVID-19 pandemic. As a result, in the July to December 2021 period, according to the internationally comparable methodology of the European System of National and Regional Accounts (ESA 2010), the general government ran a deficit of HRK 3.5bn, which resulted in a total deficit of HRK 12.4bn or 2.9% of GDP in 2021. The budget performance in 2021 thus improved considerably from 2020, when the deficit stood at HRK 27.7bn, or 7.3% of GDP. The budget deficit was also visibly smaller than that planned under the November last year Amendments to the Government Budget for 2021 (HRK 6.5bn or 1.5% of GDP).

The decomposition of the change in the nominal general government balance into the structural and cyclical components shows that the fall in the nominal deficit last year is primarily the result of the favourable impact of the economic cycle, but also of the adjustment of the primary structural balance and a further fall in interest expenditures as a result of persistently favourable financing conditions in the capital markets.

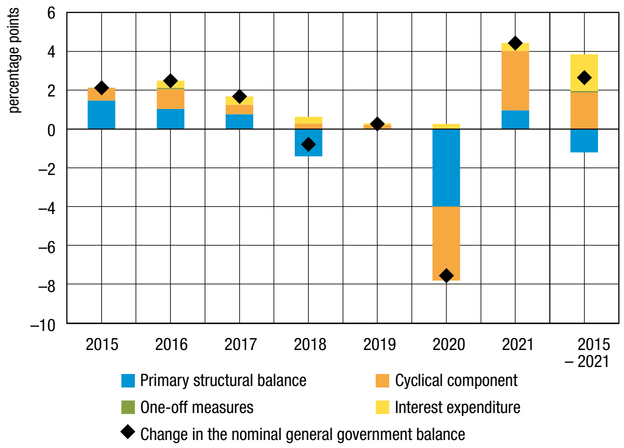
As for the revenue side of the budget, total revenues continued to rise considerably in the second half of 2021 (10.4%), albeit somewhat more slowly than in the first half of 2021 (13.4%). The increased growth in total revenues was mostly due to revenues from indirect taxes, which reflects in particular the recovery in personal consumption and increased tourist consumption. Social contributions also played a role in supporting this growth, owing to favourable developments in the labour market. The category of other revenues made a positive contribution to developments in total revenues, largely as a result of faster withdrawals of EU funds, in particular the funds under the multi-annual financial framework from

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



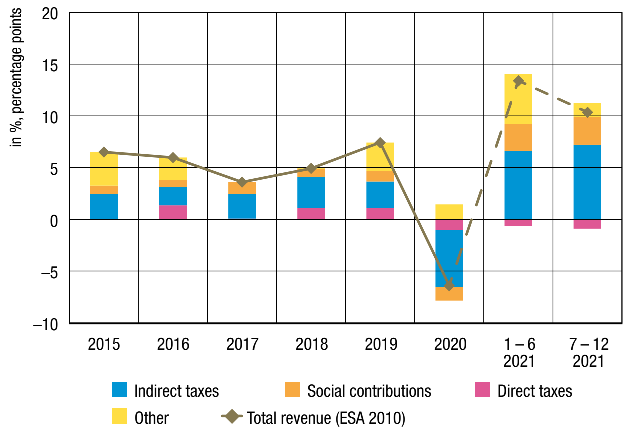
Sources: Eurostat and MoF (CNB calculations).

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



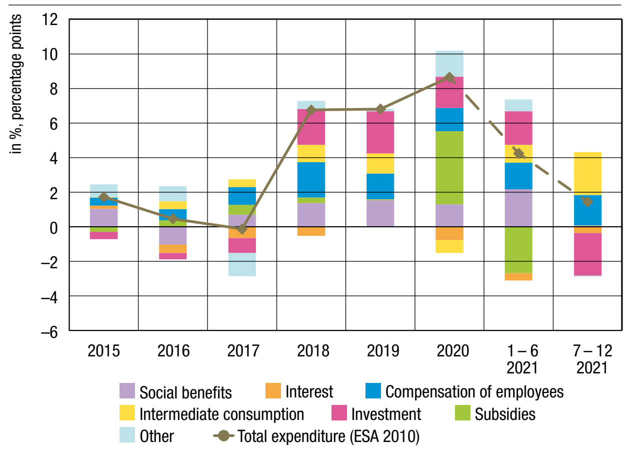
Source: CNB.

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



Source: Eurostat (CNB calculations).

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



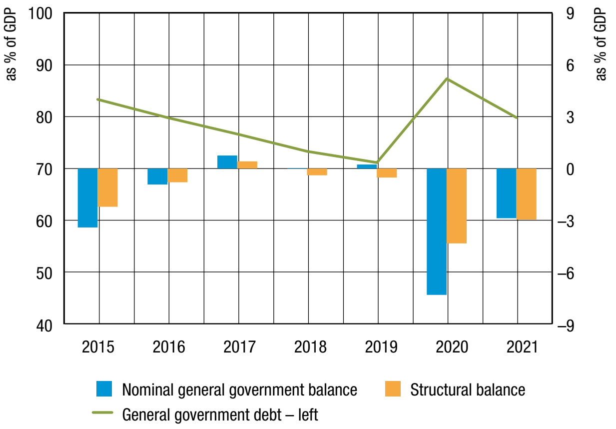
Source: Eurostat (CNB calculations).

2014 to 2020 (with the funds remaining available for withdrawal 3 years following the expiry of the programme). As regards other categories on the revenue side of the budget, revenues from direct taxes had a negative impact on developments in total revenues, largely reflecting the fall in revenues from profit tax under the annual calculation of profit for 2020 as a result of the crisis caused by the pandemic and the impact of changes in income and profit tax in force since 1 January 2021.

On the expenditure side of the consolidated general government budget, total expenditures in the second half of 2021 grew slower in the second half of the year (1.4%) than in the first half of the year (4.3%). A considerable growth in expenditures for intermediate consumption contributed the most to the increase in total expenditures on an annual level. Employee compensations continued to grow considerably, reflecting in part the increase in the base for the calculation of wages of civil servants and government employees. The growth in social security benefits, the most significant component on the expenditure side of the budget in terms of share, was very small. By contrast, expenditures for investments and other capital expenditures made a negative contribution to developments in total expenditures and so did interest expenditures, mirroring favourable financing conditions in the capital markets in 2021. Despite the reduction in pandemic-related support for job preservation, expenditures on subsidies held steady on an annual level.

The consolidated general government debt stood at HRK 343.6bn at the end of 2021, up HRK 2.3bn from the end of June of the same year. The strong recovery in

Figure 10.5 General government debt
end-period stock



Source: CNB.

economic activity resulted in a fall in the public debt to GDP ratio of 7.5 percentage points in 2021 from the end of 2020, with public debt standing at 79.8% of GDP at the end of 2021. As regards securities issues in the capital market in the second half of 2021, the Government of the Republic of Croatia issued a government bond maturing in 2028, nominally worth HRK 9bn, at 0.5% interest and yield to maturity of 0.533%.

11 International reserves management

Amid rising but still also predominantly negative yield rates on the European government securities market, international reserves management made satisfactory earnings. This continued the trend of positive results recorded in the previous years, with income from investment in 2021 standing at EUR 70.8m or HRK 532.0m.

The sharp growth in international reserves in 2021 was mostly fuelled by inflows of foreign exchange in the account of the Ministry of Finance, mostly purchased by the CNB while the increase in reserves was also fuelled by inflows associated with the IMF pandemic-related general allocation of SDRs. Liquidity and safety as the primary objective of international reserves management were successfully achieved.

International reserves rose steeply in 2021, reaching a record high. Liquidity and safety of investment, the main objectives of international reserves management, were successfully accomplished. Investment and tactical decisions have ensured satisfactory earnings despite the unfavourable environment of a prolonged period of low and negative yields on financial markets.

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

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

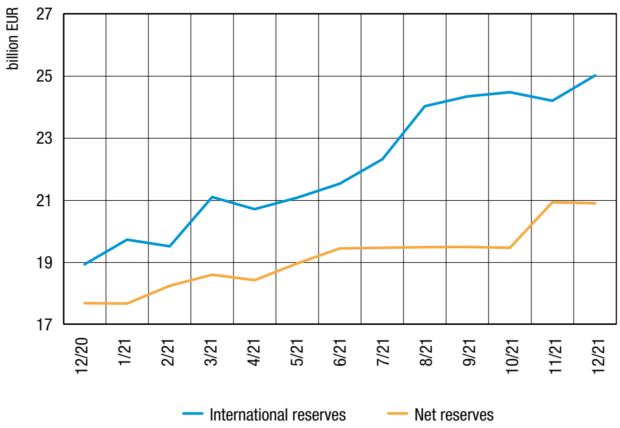
11.1 Structure of and developments in international reserves

On 31 December 2021, CNB’s international reserves amounted to EUR 25,021.2m, up by 32.1% from the end of 2020 when they stood at EUR 18,944.4m. Net reserves rose by 18.2% during that period, having risen from EUR 17,692.0m to EUR 20,910.3m at the end of the month.

The sharp growth in international reserves in 2021 was mostly fuelled by inflows of foreign exchange in the account of the Ministry of Finance, the bulk of which was purchased by the CNB while the increase in reserves was also fuelled by inflows from the IMF pandemic-related general allocation of SDRs.

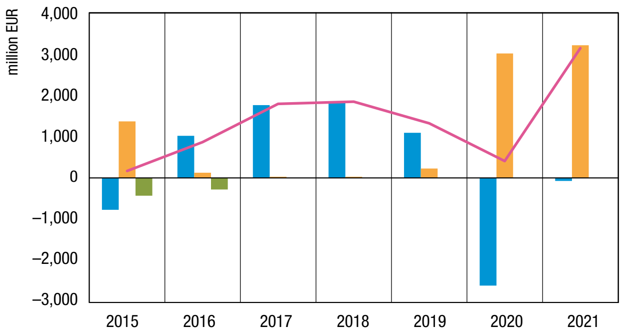
Securities of governments and government institutions, deposits with central

Figure 11.1 Monthly changes in total and net CNB international reserves
end of period



Source: CNB.

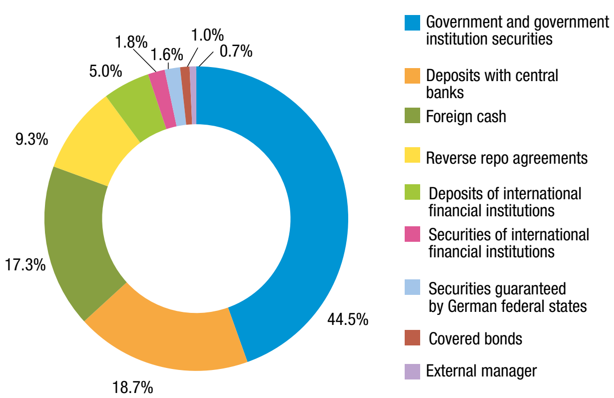
Figure 11.2 Foreign exchange interventions of the CNB with the banks, the MoF and the EC
in net amounts



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

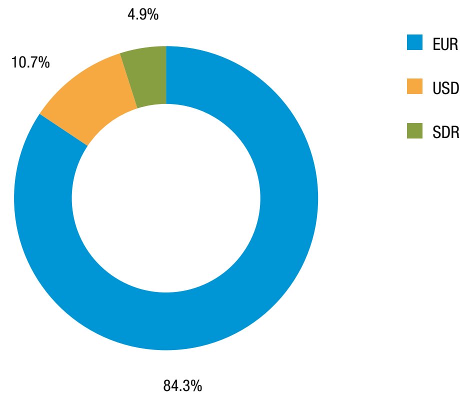
Note: Positive values refer to the purchase and negative to the sale of foreign exchange by the CNB.
Source: CNB.

Figure 11.3 Structure of international reserves investment
as at 31 December 2021



Source: CNB.

Figure 11.4 Currency structure of total international reserves
as at 31 December 2021



Source: CNB.

banks and foreign cash accounted for the largest share in the structure of international reserves investment at the end of 2021. One part of international reserves (1.2%) was also invested at the end of 2021 in environmental, social and governance investments. Environmental, social and governance (ESG) investment are investments in environmental protection and social and socially responsible investments. The CNB invests in green bonds, social bonds and sustainability bonds. In addition to these three types of bonds, there are also sustainability performance-linked bonds.

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 Fitch Ratings) and on an internally-developed creditworthiness assessment model.

At the end of 2021, approximately 70% of the CNB international reserves were invested in countries, banks and institutions within the two highest credit rating categories or invested in the BIS and the IMF or in foreign cash in the CNB vault.

The euro dominates the currency structure of international reserves. The share of the euro fell slightly in 2021, from 85.0% at the end of 2020 to 84.3% in 2021, mostly due to the increase in the share of SDRs on account of a large inflow under the IMF allocation and weakening of the euro against the US dollar, i.e. the SDR. The share of the US dollar also shrank, having fallen from 13.0% to 10.7%, among other reasons because the nominal amount of dollar investments was held stable amid rising net reserves. The share of SDRs in international reserves rose from 1.9% to 4.9% as a result of funds received under the general allocation in the amount of SDR 687.6m as assistance against the pandemic and supplement to the international reserves of IMF members.

11.2 Financial markets and international reserves management results in 2021

The developments in financial markets in 2021 were marked by high volatility caused by constant changes in the global fight against the COVID-19 pandemic. The recovery in global demand took place amid problems in global supply chains, which, combined with a steep rise in energy prices, led to the biggest jump in inflation in most developed economies in several decades. This fuelled expectations that the expansionary nature of monetary policies of leading central banks would decrease, an announcement about which being made towards year-end. As a result, the yields on European and particularly on US government bonds increased in 2021. The US dollar strengthened against the euro, while the majority of leading stock exchange indices reached record highs.

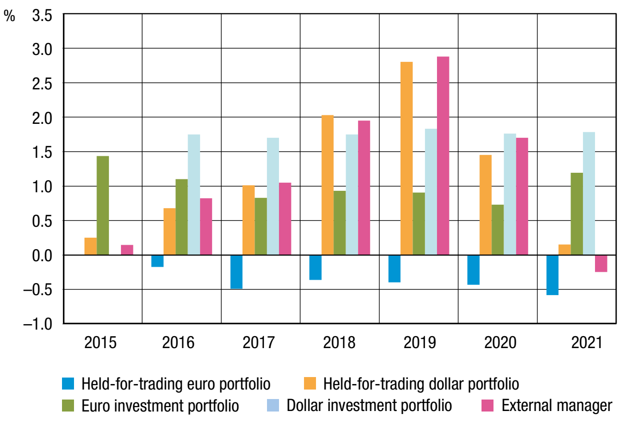
The yields on European government securities rose in 2021, particularly yields on longer maturities. However, towards year-end, 53% of government securities of euro area countries continued to have a negative yield. Towards the end of 2021, the German yield curve was in the negative territory even for maturities up to fourteen years.

The yield curve for US bonds of maturities up to ten years rose in 2021 from the end of 2020 by 60 basis points on average, spurred by expectations of monetary policy tightening in the conditions of robust economic recovery and fast acceleration of inflation.

Amid rising yields but also persistent predominantly negative yield rates on the European government securities market, international reserves management made adequate earnings. This continued the trend of positive results recorded in the previous years, with income from investment in 2021 amounting to EUR 70.8m or HRK 532.0m. The positive performance can be attributed to investment and tactical decisions made in 2021 as well as those made in the preceding years, with the main objectives of international reserves management, liquidity and safety, being successfully fulfilled.

In 2021, the annual rate of return on the entire euro portfolio of net reserves was 0.24%, while the rate of return on the entire US dollar portfolio totalled 1.20%. If held-for-trading and investment portfolios are observed separately, the euro held-for-trading

Figure 11.5 Annual rates of return of the CNB foreign currency portfolios from 2015 to 2021



Source: CNB.

portfolio generated a rate of return of –0.58%, while the dollar held-for-trading portfolio generated a rate of return of 0.15% in 2021. In 2021, the euro-denominated investment portfolio yielded a return of 1.19%, while the dollar-denominated investment portfolio yielded 1.78%. In 2021, the rate of return on the US dollar funds entrusted for management to an international financial institution was –0.25%.

The held-for trading portfolios, which are used for maintaining foreign exchange liquidity, accounted for some 39% of net reserves. Investment portfolios account for some 40% of net reserves, and just as in the previous years, they provided the bulk of CNB revenues, while foreign cash, which accounts for 21% of net reserves, diminished the impact of the negative yield on the euro held-for-trading portfolio on total earnings.

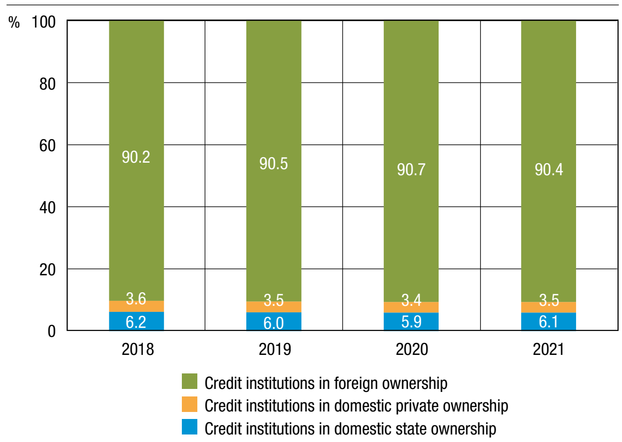
12 Business operations of credit institutions

The business performance of credit institutions recovered in 2021 from the pressure of the pandemic-related costs of increased credit risk.

The assets of credit institutions rose by HRK 38.4bn (8.3%), reaching a record high of HRK 500.8bn and the trend of asset quality improvement present for some years continued. At the end of 2021, all credit institutions combined operated at a profit, totalling HRK 5.6bn.

The strong capitalisation and high liquidity of the banking system facilitated stable and smooth operations in the second year of the COVID-19 pandemic, and business performance recovered in 2021 from the pressure of the costs of increased credit risk related to the pandemic. The assets of credit institutions continued to increase, mostly fuelled by growth in household deposits and deposits of non-financial corporations, while the positive effect of the further channelling of assets to cash is seen in the trends of most of the key performance indicators. However, the increase in cash amid low interest rates and muted credit activity continues to limit interest income, the key source of income. Nevertheless, credit institutions' profits increased from 2020, mostly owing to considerably less burdensome credit loss costs and growth in non-interest income. The years-long upward trend in the quality of total exposure persisted, mostly due to the impact of the fall in non-performing loans to non-financial corporates.

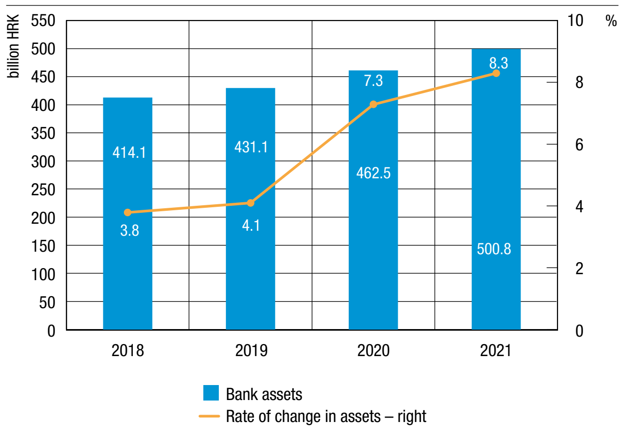
Figure 12.1 Ownership structure of credit institutions and their share in total assets of credit institutions



Source: CNB.

Banking system structure continues to be stable. At the end of 2021, there were 23 credit institutions operating in the Republic of Croatia: 20 banks and three housing savings banks, the same as at the end of each of the previous two years. In addition, there was one branch of an EU credit institution operating in the country, while some 200 institutions from the EU and the European Economic Area had notified the CNB of their intentions regarding the direct provision of mutually recognised services. Bank assets dominate the banking system: they accounted for 99.0% of total assets of credit institutions while the share of assets of housing savings banks continued to fall and stood at the remaining 1.0%. The share of assets of credit institutions in the majority ownership of foreign shareholders is also dominant and accounts for 90.6% of the total banking system assets.

Figure 12.2 Assets of credit institutions



Source: CNB.

In 2021, the assets of credit institutions rose by HRK 38.4bn (8.3%), standing at a record high of HRK 500.8bn. The increase in received deposits (HRK 29.3bn or 7.5%), primarily those in current accounts of households and non-financial corporations, is the biggest source of asset growth. A relatively big increase in debt securities (HRK 4.2bn) fuelled the growth in the sources of financing although it did not have any very great impact on the diversification of the total sources of financing.

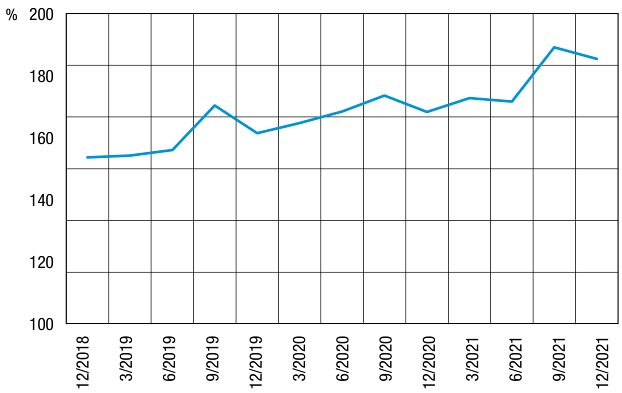
Due to uncertainties associated with the pandemic, credit institutions were cautious about taking on additional risks. This was mostly mirrored in increased assets in the form of highly-liquid monetary assets (HRK 24.8bn or 36.1%), which reached a high 22.6% of total assets. The increase in cash, especially in settlement accounts with the CNB, had a favourable impact on most key performance indicators of credit institutions, and was especially reflected in the high level of the liquidity coverage ratio, which, at 202.5%, was double the prescribed minimum of 100%, with all credit institutions meeting the prescribed minimum liquidity requirements.

When compared with the growth in cash, changes in other major assets items in 2021 were much smaller. Credit activity resulted in an increase in loans and advances[4] (net) of HRK 6.9bn (2.3%). The total change was mostly the result of growth in household loans (4.0%), particularly further growth of housing loans, supported by credit institutions' participation in the government housing loans subsidy programme. General-purpose cash loans to households, which had risen in the previous years at high growth rates, now rose only slightly, while all other major forms of household lending shrank. Loans to the general government rose by a small 2.0% and appropriated statutory reserve funds with the CNB rose by 13.0%. Loans to non-financial corporations rose by only 0.7%. However, it should be noted that credit institutions increased their support to non-financial corporations with guarantees and greater assumption of (contingent) financing obligations. Investments in securities, mostly bonds of the Republic of Croatia and bonds of domestic non-financial corporations, rose by HRK 6.6bn (10.4%).

The years-long trend of improvement in the quality of assets persisted owing to a fall in non-performing loans and the mentioned increase in cash. As a result, the non-performing loans (NPL) ratio fell from 5.4% at the end of 2020 to 4.3% at the end of 2021. The developments in total NPLs were largely influenced by their decline in the non-financial corporate sector, in which the NPL ratio fell from 12.5% to 9.9%.

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

Figure 12.3 Liquidity coverage ratio (LCR)



Source: CNB.

Improved loan quality was noticeable in loans to all major activities in that sector, with the exception of transport and accommodation activities, which are highly sensitive to economic disturbances. The share of NPLs in household loans fell from 7.1% to 6.6%, with the value of this share being mostly influenced by lower quality general-purpose cash loans. The improvement in credit quality was partly due to a further sale of non-performing receivables.

Despite the positive trend, the relative quality of total loans remained below the EU average. This is due to the share of NPLs[5] exceeding 5% in over a half of credit institutions. However, impairment for expected credit loss, i.e. the coverage of non-performing loans by impairment, stood at 63.2%, better than the EU average.

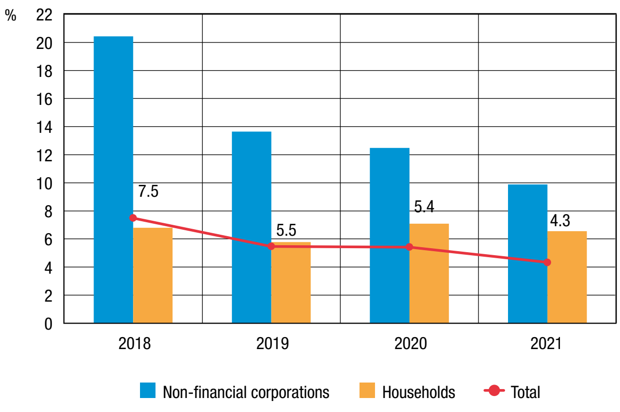
Despite improvement in the situation with NPLs, there is an increased level of credit risk recorded in the performing share of the credit portfolio that is yet not in default relative to the pre-pandemic period. Uncertainty about the pandemic and exposures covered by moratoria in 2020 resulted in a significant rise in credit risk, which was reflected in the increase in performing loans in value impairment stage 2[6]. With the expiry of almost all moratoria by end-2021, the assessed level of pandemic-related risk decreased, despite the fact that the pandemic persisted. The share of stage 2 in total loans and advances fell from 13.1% to 12.4%, which can be ascribed to a decline in the moratoria granted for the easing of household loans repayment and a fall in loans classified as stage 2 in that sector. However, credit risk and the share of stage 2 continued to increase in the case of loans to non-financial corporations, which ultimately leads to a heightened level of total loans and advances in stage 2 relative to the pre-crisis period.

At the end of 2021, all credit institutions combined operated at a profit, totalling HRK 5.6bn. Profits rose by HRK 2.9bn (108.8%) from the end of 2020, due to considerably lower expenses on impairment for credit loss, lower costs and the increase in net operating income. With increased profit, profitability indicators also increased – the return on assets (ROA) rose to 1.2% and the return on equity to 8.7%. The high level of impairment expenses in 2020 was due to the uncertainty surrounding the pandemic and even though credit institutions continued recognising credit loss, their

5 The threshold of 5% is a reference value by which EBA identifies a high NPLR, which triggers additional regulatory requirements related to a strategy to reduce NPLs and manage credit risk.

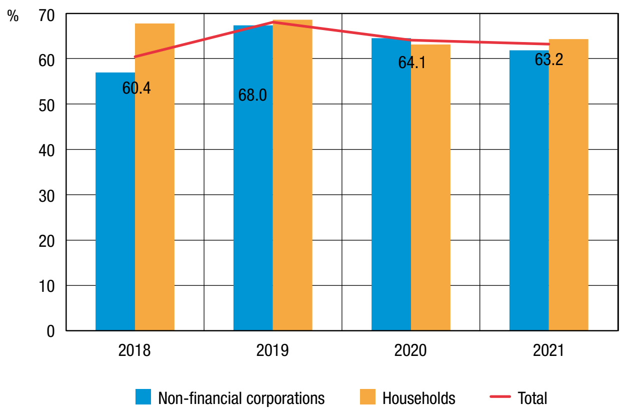
6 Each instrument that is subject to the calculation of expected credit loss, which includes all debt instruments measured at amortised cost and at fair value through other comprehensive income, is classified in one of the three stages of value impairment. Instrument is classified in stage 2 if there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

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



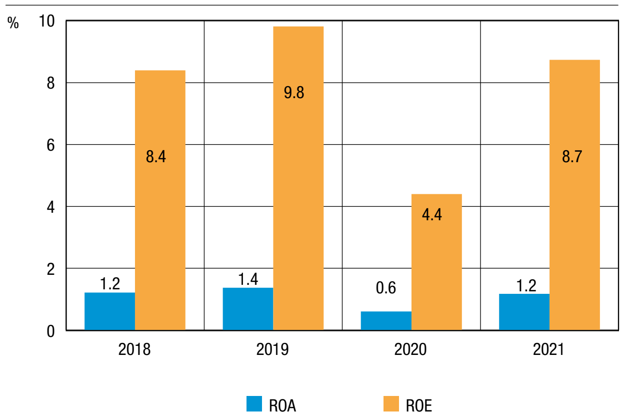
Source: CNB.

Figure 12.5 Coverage of non-performing loans by impairment



Source: CNB.

Figure 12.6 Bank return on assets (ROA) and return on equity (ROE)



Source: CNB.

costs decreased by a significant 83.8% in the observed period. Total net income rose by 8.5%, mainly owing to the recovery in income from dividends and income from fees and commissions. Interest income, as the main source of income, continued to decline under the pressure of low interest rates, muted credit activity and the increase in cash in the assets of credit institutions. Interest expenses, primarily expenses on household deposits with agreed maturities, also continued to trend downwards. Lower costs of deposit insurance generated savings in general operating costs, which, in addition to generating bigger profit, also contributed to an improved cost effectiveness, with the cost-to-income ratio shrinking and standing at 48.8%. Both this and the profitability indicator were under the key influence of leading banks.

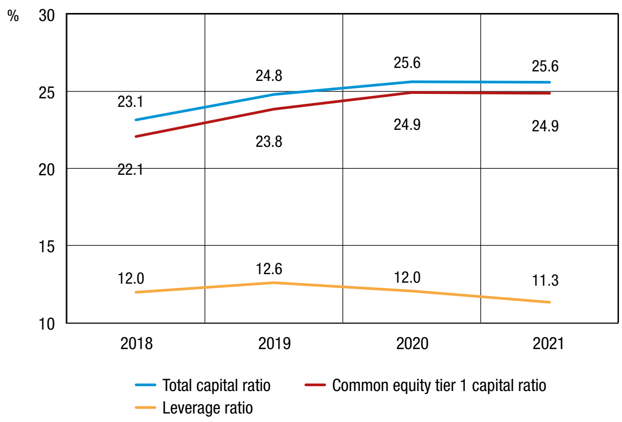
The movements in own funds and total risk exposures were very small in 2021 resulting, when combined with the effects of regulatory adjustments[7] and the macroprudential measures[8] taken to mitigate the effects of the pandemic, in persistently

7 See footnotes 14 and 15 (p. 46) in Semi-annual Information on the Financial Condition, the Degree of Price Stability Achieved and the Implementation of Monetary Policy in the Second Half of 2021.

8 Under the Decision on a temporary restriction of distributions (OG 4/2021), the CNB imposed a restriction on dividend distribution including the distribution of dividends and creation of obligations to make dividend distributions, redemption or purchase of own shares and award of variable remuneration, until 31 December 2021. In early September 2021, the CNB re-examined the grounds on which the Decision was based and concluded that the circumstances had changed to such an extent since the adoption of the Decision that early termination of the Decision from 1 October 2021 was warranted (OG 106/2021).

very high values of key indicators of banking system capitalisation. The total capital ratio held steady at 25.6%, ranking among the highest in EU member states. Increased channelling of exposures into low risk items played an important role in preserving high capitalisation, which resulted in a further fall in the value of the average credit risk weight, from 44.6% to 41.8%. All credit institutions reported a total capital ratio above the prescribed minimum of 8% and ten of them, which accounted for two thirds of the total system assets, boasted a total capital ratio of above 20%.

Figure 12.7 Key indicators of credit institution capitalisation



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
EC	– European Commission
ECB	– European Central Bank
EEA	– European Economic Area
EFTA	– European Free Trade Association
EMU	– Economic and Monetary Union
EU	– European Union
EUR	– euro
excl.	– excluding
f/c	– foreign currency
FDI	– foreign direct investment
Fed	– Federal Reserve System
FINA	– Financial Agency
f.o.b.	– free on board
GDP	– gross domestic product
GVA	– gross value added
HANFA	– Croatian Financial Services Supervisory Agency

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

Symbols

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

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