CROATIAN NATIONAL BANK

ANNUAL REPORT

2000

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Macroeconomic Developments

1.1 International Environment[1]

1.1.1 World

The world economic situation in 2000 was characterized by continued recovery from the Asian and Brazilian crises and the recovery of the Southeast European countries from the Kosovo crisis. At the same time, oil prices continued to increase ("third oil shock"), resulting in an oil price of almost $30 per barrel in the second half of 2000.

Despite concern expressed by most economic analysts, in 2000 there was no economic slowdown in the USA: growth continued at high rates. This was in fact the longest period of growth in the recorded economic history of that country (i.e. since the mid-19th century), lasting for almost 9 years or 29 quarters (it started in the last quarter of 1991). Investments on stock exchanges only dropped toward the end of the year. From January 1993 to November 2000, this "new economy" (meaning enormous productivity growth due to the expansion of the computer and telecommunications industries) resulted in an increase in employment from 110 million to 132 million (20%), and a reduction of unemployment to 3.9%, which is the lowest rate in the past three decades. The high growth rates throughout the decade were due to the restructuring of the US economy in the late 1980s and early 1990s, the developments in telecommunications, along with extensive use of the Internet, that started in the early 1990s, the strengthening of fiscal discipline in the early 1990s, the opening up of the American economy, and federal government investment in education. From January 1993 to November 2000, the Federal Budget deficit of USD 290bn (the largest in history) turned into a surplus of USD 237bn (the largest as a share of GDP since 1948). In the same period, the openness of the American economy, measured by share of foreign trade in GDP, grew from 21% to 26%, which can be accounted for by an increase in trade with Europe and other traditional trading partners, as well as by the establishment of NAFTA (North American Free Trade Area) with Canada and Mexico. Investment in education grew from USD 37bn to USD 75bn.

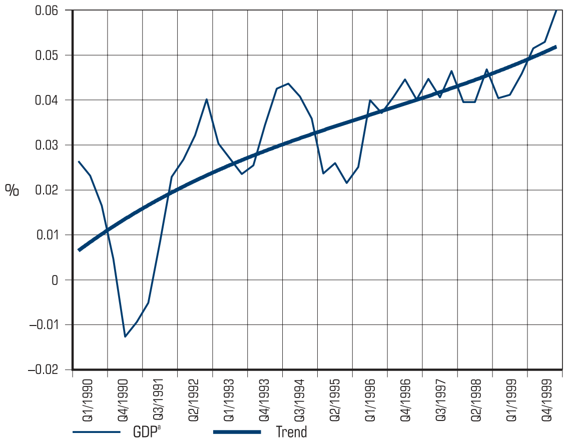
In the 1990s, there was an extraordinary growth of investment in new technologies. As a result, share prices in information and telecommunications companies grew enormously: the NASDAQ index, representing a great number of shares in this sector, doubled, while the DOW JONES index also reached record highs. The uncertainty caused by the Y2K problem additionally channeled investment into these activities. However, this growth was a consequence not just of the use of information and telecommunications technology but also of improved business efficiency, the introduction of new ideas, a reduction in the transaction cost of selling, and an improved organization of

[1] Sources: Deutsche Bundesbank, *Monthly Report,* miscellaneous issues, 2000 and 2001, Frankfurt; ECB, *Monthly Bulletin,* miscellaneous issues, 2000 and 2001, Frankfurt; IMF, *International Financial Statistics,* CD-ROM database; IMF, *World Economic Outlook,* October 2000, Washington D.C.; OECD, *OECD Economic Outlook,* December 2000, Paris.

procurement and sale. The extensive use of information technology resulted not only in increased income and sales for companies in that sector, but the "new economy", meaning a better organization of procurement and sale based on better Internet communications with other companies (B2B, business-to-business) and better Internet communications with consumers (B2C, business-to-consumer), produced positive effects on traditional areas of business, such as processing, industrial production, etc. This resulted in significantly improved productivity in the US economy, which continuously grew in the 1990s at a rate of 2% (in the 1980s and 1970s, the growth rate was about 1%, while in the late 1990s, the growth rate was even higher: 4-5%). These changes also resulted in a demand for a more sophisticated, better-educated and more highly skilled labor force and more flexible labor markets. Such developments in the US economy stimulated foreign investment in the American market, resulting in a US dollar appreciation and a price growth of securities on the stock markets. This also provided an incentive to the Fed to increase the interest rate (by 0.75% cumulatively) in order to prevent a possible escalation in inflation and a depreciation of shares on stock markets, particularly those of computer companies, without jeopardizing the investment activities of the private sector.

Figure 1.1

Three-month GDP Growth in the USA,
Q1/1990 – Q2/2000,
at constant 1996 prices



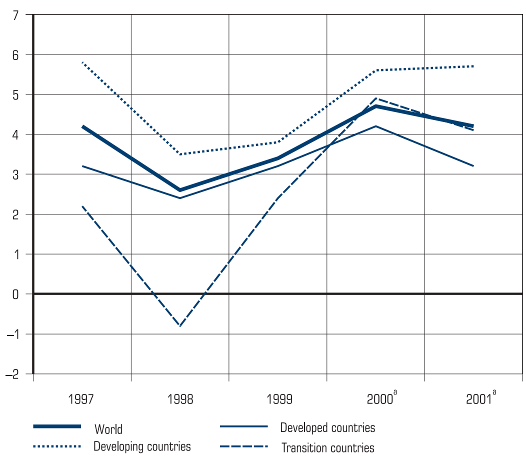
[a] GDP growth rates, rate of change compared to the same quarter previous year

Source: IMF, International Financial Statistics

Japan has seen a recovery since 1999, although with low growth rates (1-2%). The reason for such a modest recovery is slow financial sector consolidation, accompanied by an extremely slow exports recovery. This led to a review of macroeconomic policy measures in Japan. Specifically, the Bank of Japan reviewed the application of zero interest rates, because it turned out that the implementation of zero-rates prevented the Bank from reacting appropriately to a financial crisis and stimulating the post-crisis recovery. The high costs of financial system consolidation and the aging population called for fiscal restructuring in Japan.

Figure 1.2

Growth Rate of Output



[a] WEO estimate.

Source: IMF, World Economic Outlook, October 2000

Continued growth in the USA, recovery in Japan, and a significantly higher growth in Europe (which is further discussed in the following section) provided the basis for real growth in the world economy of over 3% in 1999, and, according to preliminary data, of as much as 4.7% in 2000, with developed countries recording a 4.2% growth rate, developing countries 5.6% and transition economies 5%

Thanks to the developing and transition countries' recovery from the Asian, Russian and Brazilian crises, as well as continued real growth in the developed countries, world trade also recovered, returning to the long-time average annual growth rate of 6-8%. However, the continued increase in oil prices will certainly not have a positive effect on further growth in world trade.

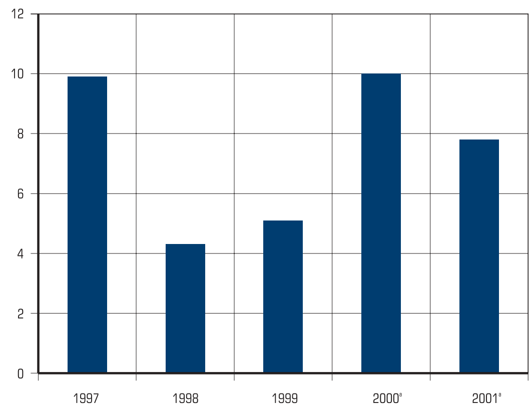
Due to reduced supply from the OPEC countries (and the extension of sanctions against Iraq, to keep the country out of the market), accompanied by great demand, the oil price reached $30 per barrel in the second half of 2000. This was the third highest oil price in the market; the highest was about $40 per barrel during the second oil shock in 1979/80, and the second highest was about $30 per barrel during the Gulf war in 1990. However, after the second oil shock, the use of more efficient and cost-effective technologies increased, which lessened the influence of oil prices on business activities. Accordingly, the third oil shock is not expected to influence strongly the global economic activity. Besides, in terms of purchasing power, $42 per barrel in 1980 and $30 per barrel in 1990 represent much higher prices than $30 in 2000: indexed to the price increase in the USA, $42 per barrel in 1980 equals a current price of about $87 per barrel, and $30 in 1990 equals about $40 in 2000. However, the IMF evaluation based on the MULTIMOD global macroeconomic model indicates that a 10% increase in oil prices results in about a 0.15% increase in consumer prices in the developed countries and a 0.1% decline in real economic activity. The 60% increase in oil prices in 2000 may result in a 1% increase in prices and a 0.6% decrease in real growth in the next period.

As a result of the low inflation rate and successful macroeconomic policy in the developed countries, as well as improved conditions in the countries affected by the Asian, Russian and Brazilian crises, world inflation dropped to less than 5% in 2000 (according to the preliminary data). The decline in world inflation was caused not only by low inflation in the developed countries (2.3%) and moderate inflation in the developing countries (6.2%) but especially by decreased inflation in the transition countries (where it dropped from 43.8% in 1999 to 18.3% in 2000), particularly in Russia. However, the high growth in oil prices in 2000 will certainly have adverse effects on price growth in the coming period.

As a consequence of the Asian, Russian and Brazilian crises, as well as continued real economic growth in the USA, investments moved to the US market. As a result, interest rates on financial instruments nominated in major world currencies (US dollar, euro and Japanese yen) dropped. A fear of a slowdown in the US economic growth and a preventive increase in interest rates resulted in increased interest rates at the world

Figure 1.3

Growth Rate of World Trade in Goods and Services

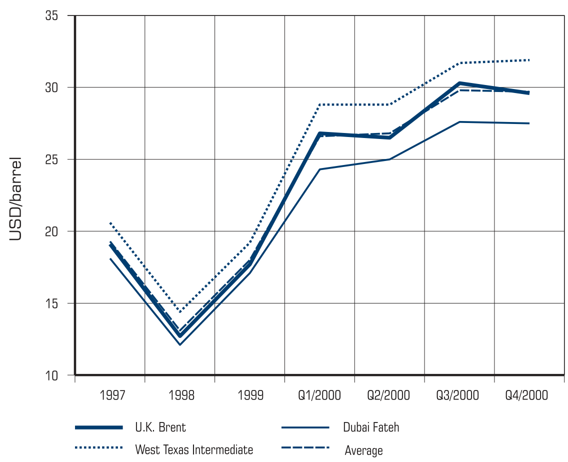


a WEO estimate.

Source: IMF, World Economic Outlook, October 2000

Figure 1.4

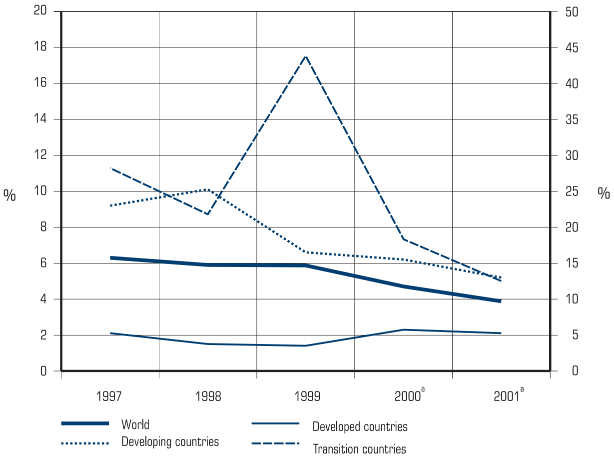
Movements in Market Oil Prices



Source: IMF, World Economic Outlook, October 2000

Figure 1.5

Retail Prices (CPI inflation)

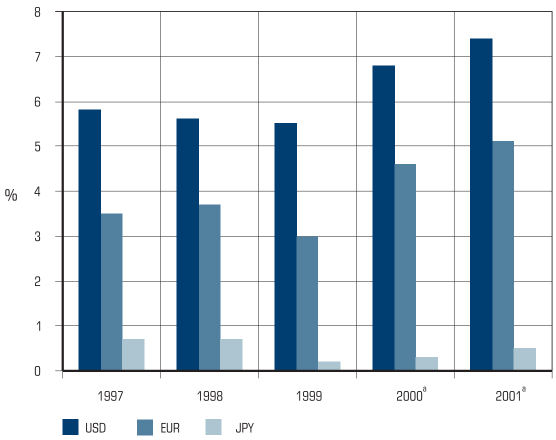


a WEO estimate

Source: IMF, World Economic Outlook, October 2000

Figure 1.6

Six-month LIBOR on Deposits in Various Currencies, on annual level



a WEO estimate

Source: IMF, World Economic Outlook, October 2000

level. The European Central Bank also decided to follow the interest rate growth in the USA in order to strengthen the euro against the dollar (see more details in the next section).

The emerging markets continued to recover from the financial crises, especially in Southeast Asia (due to further growth in the USA and a recovery in Japan) and in the Latin American countries (primarily due to a recovery in Brazil, the strongest economy in the region, but also to growth in Mexico, based on growth in the USA and the positive effects of NAFTA, and to recoveries in Argentina and Chile). The recovery was particularly rapid in the newly industrialized countries of Southeast Asia, the protagonists in the Asian crisis, such as Korea, mostly due to their export-oriented economic structures. Recovery was also recorded in the Near East and Africa, mainly due to oil price growth. African countries depending on exports of other raw materials (e.g. agricultural products such as cocoa, coffee, palm oil, etc., whose prices dropped by up to 20% in the world market) remained stagnant. Stagnation and decline also marked the African countries stricken by adverse events such as war (Congo, Eritrea, Ethiopia), political disturbances and coups (the Ivory Coast, Zimbabwe), and drought (Eritrea, Ethiopia, Morocco).

The world capital flows also recovered, particularly towards emerging markets: in the first half of 2000 they increased by 50% compared to the first half of 1999. If such trends continue, the capital flows may approach the levels of before the Asian, Russian and Brazilian crises.

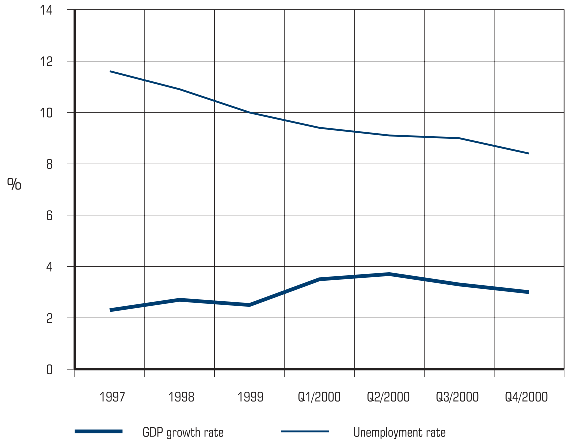
1.1.2 European Union and Eurozone

GDP growth in the Eurozone increased from about 2.5% in 1999 to more than 3% in the first three quarters of 2000. This was the result of an upturn in production, the consolidation and increased competitiveness of companies, and increased demand for export from the Eurozone countries. Exports from the Eurozone continued to rise due to recovery in the world economy and the depreciation of the euro against the US dollar and other major world currencies of 15% compared to its value in the first Euro-year. There is no doubt that continued growth in the USA and accelerated growth in the Eurozone will have positive effects on the further growth of the world economy and trade. Even if growth in the USA slows down, such developments will enable the Eurozone to support world growth, particularly because the share of the Eurozone in world trade exceeds the share of the USA (19% as opposed to 15%).

The accelerated growth in the Eurozone continued to reduce unemployment with the result that the average unemployment rate, which had fallen below 10% in late 1999, further dropped to below 9% in 2000, the lowest since the second oil shock (1979/80). While there are still considerable differences between the labor markets in individual EU member states, they become less striking due to the increased flexibility of the Eurozone labor markets (mainly as a result of increased labor mobility) and harmonization of business cycles in these countries.

Figure 1.7

Real GDP Growth and Unemployment in EU-11

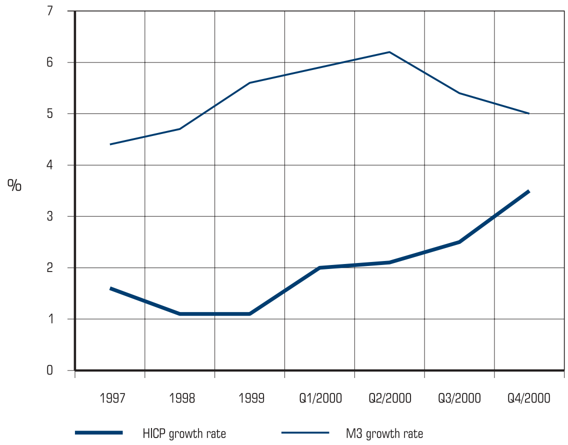


Source: European Central Bank

Consolidation of the financial sector also continued, thus reducing the number of depository and savings institutions; as a result, the interest rates for various maturities converged towards 5%. The consolidation and development of the European bond market also continued, as seen in the increased number of issued bonds; the share of foreign countries and individuals in the total bond issue was about 50%. There was also continued consolidation of the other European financial markets.

Figure 1.8

HICP and M3 Developments in EU-11



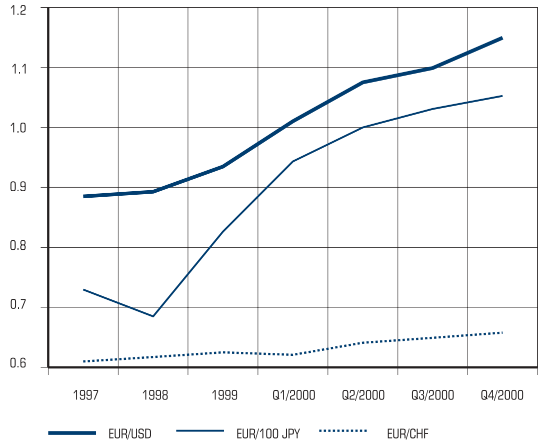
Source: European Central Bank

The second year after the introduction of the euro was marked by further weakening of the euro against the dollar, with significant fluctuations. The euro depreciated by 15% compared to its initial value but, according to the basic macroeconomic variables, it is undervalued by the same percentage. This depreciation, which will be further discussed later, is partly due to a lack of market confidence that the European Central Bank (ECB) can carry out monetary and exchange rate policies in the Eurozone as successfully as *Deutsche Bundesbank* had done in Germany (which had a significant impact on the other European countries and the European exchange rate mechanism).

In terms of inflation target, the ECB was successful in 2000, because the price increase as measured by HICP (harmonized index of consumer prices) amounted to 2-2.5%, which is in line with the declared medium-term target of maintaining 2% price growth, despite the significant growth in oil prices. However, the ECB management was concerned about the price growth trend in 2000, which exceeded 3% in the last quarter. As a result, the ECB increased interest rates in 2000 (by 1.75% cumulatively, i.e. from 2% to 3.75%, with the highest 0.5% increase in June) in order to control inflation

Figure 1.9

Nominal Euro Exchange Rate Movements



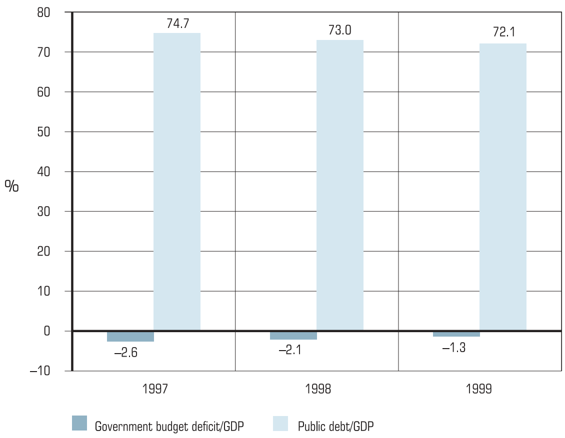
Source: European Central Bank

caused by the increase in oil prices and the increase in prices of internationally tradable goods and services resulting from the euro depreciation. The increases in interest rates were carried out very carefully to avoid jeopardizing growth. The European broadest monetary aggregate, M3, was somewhat above the declared 5% level in 1999, rose to about 6% in the first half of 2000 and dropped to 5% at the end of the year. However, it should be noted that the primary objective of the European Central Bank is price stability, whereas M3 growth is only a secondary objective.

Why has the euro depreciated for two consecutive years, dropping to a value 15% lower than indicated by basic macroeconomic variables, with signs of recovery only at the end of 2000? One of the reasons may be the difference in economic growth rates: for a few consecutive years the USA has recorded higher growth rates than Europe. Investment companies and markets expect that, judging by the actions taken by the governments and central banks in the USA and Europe, this trend will continue. Another reason is that long-term interest rates are higher in the USA (6%) than in Europe (5%), mainly due to increased investment in the USA; ever since the Asian, Russian and Brazilian crises, it has not been unusual for investors to “take refuge in the American dollar”, i.e. to increase investment in the USA in turbulent times. As the situation in the world financial markets calms down, it is expected that long-term interest rates in the USA and Europe will converge as investors transfer assets from the American to the European market to take advantage of the strong European bond market, which has good prospects for growth, a more rapid growth in the EU and a possible slow-down of growth in the USA, and profit opportunities from arbitrage transactions when investing dollars in undervalued euros. Another reason may be the rapid expansion of the Eurobond market, where Eurobonds issued by non-European governments and private entities (especially those in transition countries) account for one half of the total new issue, which leads to capital transfer from Europe. A weak euro is partly a consequence of a lack of market confidence that the ECB can continue the successful and reliable performance of the *Deutsche Bundesbank,* although, as mentioned, the ECB has not been unsuccessful in achieving the declared targets for price stability and M3 growth. Although a weak euro encouraged EU exports, it, together with a continued growth in oil prices, obstructs ECB monetary policy by raising the inflation rate in the Eurozone.

Figure 1.10

Government Budget Deficit and Public Debt in EU-11, as a share in GDP



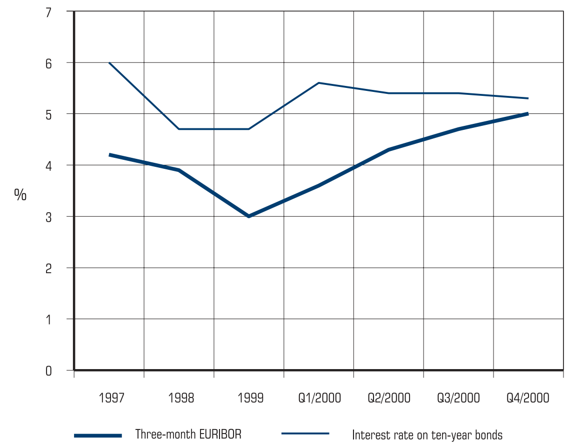
Source: European Central Bank

Despite the convergence of fiscal positions in the Eurozone countries, along with a reduction in government budget deficit as a percentage of GDP and a reduction in public debt as a percentage of GDP, major differences still persist. The convergence of fiscal positions is indirectly the result of harmonizing monetary and exchange rate policies and income and prices policies. However, the Eurozone countries still have much to do concerning fiscal and structural reform.

This recovery and consolidation in the real and financial sectors in Europe will undoubtedly facilitate future growth in the European Union and, consequently, provide an incentive for the development and growth of its trading partners. Furthermore, after completion of the financial sector consolidation and a reduction in yields and money prices, economic and financial relationships between the Central and East European countries and the EMU member states will continue to improve. Better development prospects in Europe have certainly contributed to the perception of Europe as a stable and safe investment area, thus stimulating the convergence of long-term and short-term interest rates towards 5%.

Figure 1.11

Interest Rate Movements in EU-11, on annual level



Source: European Central Bank

Due to the forthcoming admission of 13 European transition and developing countries to the EU (Poland, the Czech Republic, Hungary, Slovakia, Slovenia, Estonia, Latvia, Lithuania, Romania, Bulgaria, Cyprus, Malta and Turkey), the EU should be both reformed and restructured. The major part will concern improving European Commission efficiency, changes in the decision-making procedure of the Council of Ministers and the European Parliament (more decisions by qualified majority than by consensus, and reform of the number and methods of voting), improving labor market flexibility and reforming the rules for assistance to underdeveloped European regions and countries.

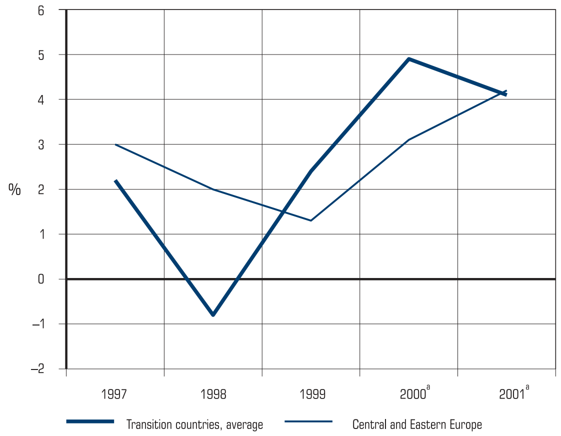
1.1.3 Transition Countries

The economic situation in transition countries was marked by a recovery in Russia and other transition countries from the Russian crisis and reduced tensions after the Kosovo crisis.

Since oil is one of the most important export products of the Russian Federation, the increase in oil prices in the world market greatly facilitated the economic recovery of Russia. As Russia is one of the strongest economies in the region, the movements in output and price in this country proved to be advantageous to both its neighbors and to those Eastern countries which have strong trade relations with Russia. As a result, the gap between the “successful” transition countries (Poland, the Czech Republic, Hungary and Slovenia) and the “less successful” became a bit narrower. In the case of the transition countries, the recovery is seen in their growth rate, which increased from 2.4% in 1999 to nearly 5% in 2000. Having recovered from the direct and indirect consequences of the Kosovo crisis, the Central and Eastern European countries progressed from 1.3% real output growth in 1999 to 3% in 2000.

Figure 1.12

Output Growth Rate in Transition Countries

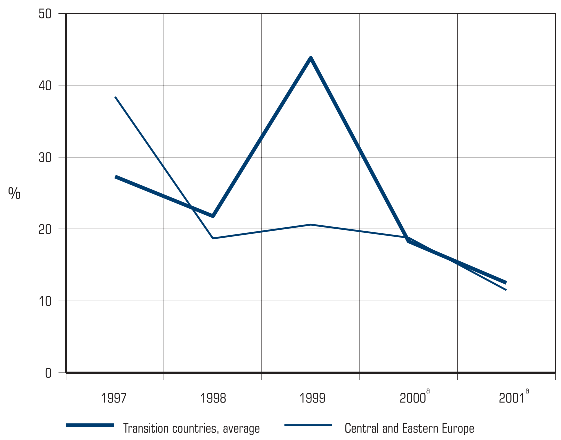


[a] WEO estimate

Source: IMF, World Economic Outlook, October 2000

Figure 1.13

Inflation in Transition Countries



[a] WEO estimate

Source: IMF, World Economic Outlook, October 2000

Hungary and Poland maintained their high growth rates of about 5%, as did Slovenia. The Czech Republic and Slovakia recorded low growth rates (about 2%), due to restrictive monetary and fiscal policies intended to correct fiscal imbalance.

By establishing the currency board in 1998, Bulgaria halted unfavorable economic developments and achieved high growth, which was again slowed down by the Kosovo crisis. However, in 2000 it reached a high 5% rate. Romania, Macedonia, Albania and Bosnia and Herzegovina are also recovering from the adverse effects of the Kosovo crisis (influx of refugees, a cut in trade, growing uncertainty and expenses caused by the nearby war activities).

The resolution of the crisis in Russia, which is the dominant economic power among the Eastern European transition countries, also contributed to halving the average inflation rate in transition countries from about 40% in 1999 to 18% in 2000. This downward trend should continue as the situation in countries with strong trade relations with Russia (mainly Eastern European transition countries) improves.

The transition countries started their reforms from various initial positions and carried them out at various speeds. The Central European transition countries (the Czech Republic, Poland, Hungary, Slovenia and Slovakia) had a large state-owned sector initially and are close to the European market. They carried out the reforms more rapidly and maintained their macroeconomic stability, which made them the most successful of all the transition countries and brought them towards admission to the EU. The transition countries of Southeast Asia (especially China) had a smaller state-owned sector initially, and the Japanese and the American markets in the neighborhood. However, while they maintained macroeconomic stability, their reforms were slower and more gradual and were therefore less successful than the Central European countries. The least developed transition countries are the Central Asian countries, having only one large market in the neighborhood – the Russian market. They were either inconsistent in carrying out their reforms, or gave them up, or changed the reform schedules without maintaining macroeconomic stability. Joining international organizations and associations may sometimes stimulate the continuation or acceleration of reforms, resulting in a more rapid transition to a market economy. The process of joining the EU or other international organizations (e.g. the WTO) is a key factor in speeding up reforms in the Central European countries. Before accession to the EU, these countries are supposed to strengthen their institutions responsible for the spread of democracy and the rule of law, to safeguard human and minority rights, and to provide for the good functioning of the economy, despite tough competition from Europe. Once the reforms have been carried through (by establishing the appropriate market economy institutions), the transition process should be completed, and the difficulties of the current transition countries will give way to the usual problems of development and growth.

1.2 General Characteristics of the Croatian Economy

The main characteristics of the Croatian economy during 2000 were: a return to economic growth, fueled by strong growth in consumption and net exports; a sharp improvement in the current account thanks to a goods tourist season and increased transfers; higher inflation, mainly due to increases in oil prices and excise taxes; fiscal consolidation and improved government financial discipline; strong growth in monetary aggregates and falling interest rates; and successful restructuring of the banking system.

During 2000, the Croatian economy emerged from recession and resumed economic growth. Real GDP increased by 3.7%, fueled by strong growth in personal consumption and net exports. Personal consumption grew after falling in the previous two years. This was partly due to the lagged effect of wage increases during 1999 and greater political stability. Fiscal consolidation meant that the contribution of government purchases of goods and services to GDP growth was actually negative. Investment also fell, mainly as a result of decreased government capital spending.

Importantly, the current account deficit was sharply reduced, particularly due to a strong tourist season and increased transfers. The value-added of exports grew strongly measured at constant prices in kuna (8.4%). Croatia's accession to the WTO (World Trade Organization) in 2000 was certainly helpful in this regard. In addition, a more favorable external political climate helped Croatia begin to overcome trade barriers, a process that will continue in 2001.

This strong export growth took place alongside a stable exchange rate and even a certain degree of kuna appreciation against the euro during the second and third quarters of 2000. Exchange rate stability is a cornerstone of the Croatian National Bank's monetary policy. During 2000, inflows of foreign exchange from tourism, privatization and government borrowing abroad created strong tendencies for appreciation, which the central bank partly offset. Market forces generally did note create pressures for depreciation, and the central bank only intervened twice, once in January and once in November.

Inflation rose in 2000, reaching its highest level since the stabilization program of 1993. Retail price inflation was 6.2%, two percentage points above 1999's 4.2%. However, this increase in inflation was caused by one-time effect: increased oil prices in the world market coupled with the strengthening of the dollar, and increases in certain administrative prices and excise taxes. Thanks to firm control of the exchange rate and relatively restrained wage increases, these one-off effects did not become ingrained.

Fiscal consolidation was a very important characteristic of 2000. For the first time, real government expenditure decreased. In addition, the government succeeded in settling a substantial portion of its arrears, thereby improving liquidity in the economy and improving financial discipline. Important changes were made in the tax system, including a 2 percentage points decrease in health fund contributions and increases in excise taxes on gasoline and tobacco.

Fiscal consolidation also included efforts to decrease the government's wage bill. Following very large pay increases for government workers in 1999, paychecks were cut by 5% in the beginning of 2000. Further cuts have been agreed for 2001. Wage restraint in the public sector is important in preventing cost push inflation and supporting the overall aim of decreasing the government's share in GDP, thereby decreasing the tax burden and providing space for the development of the private sector.

Fiscal consolidation also created more room for monetary policy in 2000. Shortly after the government budget was passed in March, the Croatian National Bank decreased its reserve requirement on kuna deposits by 2 percentage points. In addition, the Croatian National Bank took steps to simplify the reserve requirements by unifying the rate and accounting period on all types of deposits. This unification, which took place during November and December, brought the overall rate to 23.5%. Such developments, combined with the payment of government arrears, led to strong increases in deposits and bank liquidity. Much of this liquidity was invested in Ministry of Finance treasury bills (T-bills) and Croatian National Bank bills (CNB bills). Holdings of such bills grew by HRK 1,788m and HRK 1,320m between December 1999 and December 2000.

The rapid growth in deposits resulted in rapid growth in the monetary aggregates. The money supply (M1) grew by 30.1%, while the broadest money (M4) grew by 29.3%. These developments did not endanger price stability, however, since banks mainly invested in government securities or safe foreign assets. Lending grew very modestly, by 8.9%, with loans to households growing healthily and loans to enterprises stagnating. There were some signs of recovery in loans to enterprises towards the end of the year, but no definite signs of loan growth in this segment.

Strong bank liquidity also resulted in substantial decreases in interest rates. Interest rates on daytime loans in the money market decreased to 1.7%, while interest rates on T-bills fell to a range of 6.0% to 6.9% and on short-term loans to enterprises to 6%. In light of the stubbornly high interest rates of past years, these rates are extremely low. The spread between average lending and deposit rates fell to 7 percentage points, far below previous levels, even though the average lending rate is inflated by the high amounts of overdraft loans granted to individuals at very high interest rates.

Finally, during 2000 the privatization and restructuring of the banking sector took major steps forward. Three large banks that had undergone government rehabilitation procedures were successfully sold to foreign strategic partners. Foreign investors also bought four small to medium-sized banks, in one case merging three banks into one and, in another, two into one. Additional mergers and the liquidation or bankruptcy of several other banks brought the number of banks down from 53 in December 1999 to 45 in December 2000. More important than the simple decrease in the number of banks were the increase in the overall capital adequacy of the banking system and the strong profits generated in the banking system as a whole.

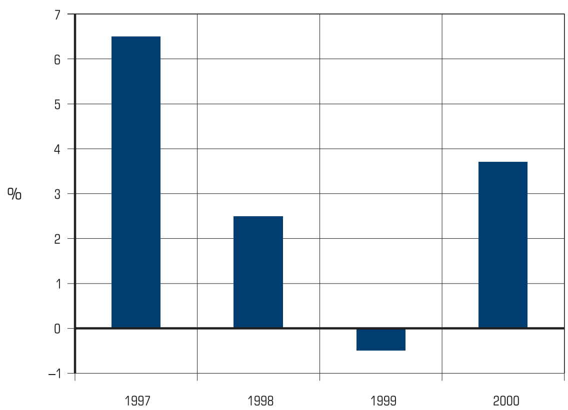
1.2.1 Economic Activity

The recovery in economic activity that began at the end of 1999 continued in 2000. The last quarter of 2000 was the fifth consecutive quarter in which GDP grew. It seems that the economy has emerged from the 1999 recession and resumed economic growth. While GDP decreased by 0.4% in 1999, its growth rate stood at 3.7% in 2000. This growth was fueled by a recovery in personal consumption, though partly offset by restraint caused by pre-election uncertainty about economic policy, and by a good tourist season.

Although both domestic and foreign demand contributed to the annual growth, they interchange as the main generators of growth in individual quarters. Foreign demand stimulated growth in the third quarter, in which the GDP growth rate stood at 4.1%. In contrast, domestic demand gave a small negative contribution to growth in the same quarter. Domestic demand stimulated growth more strongly than foreign demand in the first and the second quarters of 2000. In the fourth quarter of 2000, in which the GDP growth rate was at its lowest at 2.4%, the contribution of net exports was slightly negative.

Figure 1.14

Real Gross Domestic Product, annual rate of change



Source: CBS

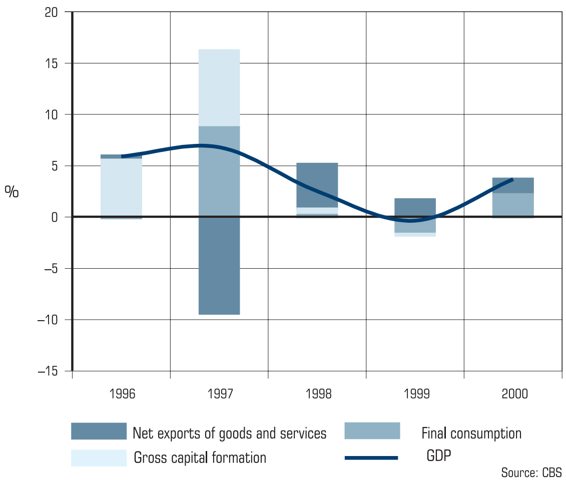
The foreign trade balance adjustment was carried out in conditions of simultaneous growth in exports and imports of goods and services. However, expressed in kuna and at constant prices, exports grew at considerably higher rates in all quarters. The annual growth in these rates amounted to 8.4%. This growth in exports was mostly due to a good tourist season that provided an increase in exports of services – tourist consumption and transportation. Measured in the same terms, imports grew at an annual rate of 4.2%. This enabled the foreign trade to contribute positively to growth in 2000. The individual components, structure and different measures of foreign trade and its impact on the balance of payments are described in detail in the relevant section.

Personal consumption was the second important category that generated the GDP growth. It grew by 4.1% and exceeded the 1997 level, after falling in the previous two years. This growth did not pose a threat to macroeconomic stability since it returned to the level recorded before the recession and was generated in conditions of lower imbalance in the current account, a modest increase in wages and fiscal restrictions. However, future growth in personal consumption, especially after the fiscal adjustment is brought to an end, cannot be the basis for sustainable growth.

Fiscal contraction resulted in a negative contribution of government spending to GDP, except in the first quarter in which the preliminary quarterly budget was executed. The expenditure side of the 2000 government budget included settlement of part of the government's arrears for goods purchased and services rendered in previous years that had also contributed to growth in these periods. Reduced government spending, measured at constant prices, amounted to 0.7% in 2000. Despite the temporary negative influences of fiscal reduction on production and income, the restriction on government spending is necessary for unburdening the economy and improving its efficiency and competitiveness in the future.

Figure 1.15

Contribution of Consumption Categories to GDP Changes, percentage points



In all four quarters of 2000, investment also gave a negative contribution to growth. Investment fell by 3.5% in real terms, considerably more than in 1999. GDP growth did not exert the expected positive effect on investment. Reduced government purchases of capital goods (i.e. reduced investment in reconstruction, road construction and other capital objects) were the main reason for the reduction in investment. Fiscal restrictions were focused on these expenditures because, from the political point of view, they were the easiest to reduce without exerting a one-off effect on wealth. Since government investment concerns projects with low interest rates and long repayment terms, their reduction will not significantly affect the growth rate. However, infrastructure quality is a very important factor in stimulating investment and should not be disregarded over the long-term. Reduced government investment did not bring about an increase in private investment, and it seems that entrepreneurs have postponed investment due to unknowns about the government's economic policy, especially the reform of the tax system that is one of its most important parts. Government debt repayment and the initiation of bankruptcy proceedings resulted in improved financial discipline. However, additional steps should be taken to guarantee legal recourse for investors.

Changes in stock were not high, in cumulative terms, during the year. However, due to their extremely cyclical nature and considerable fluctuations, the direction of movements in stock is often important to GDP growth rate. A significant increase in stock in the last quarter of 2000 contributed to a positive GDP growth in the said quarter and gave a positive contribution to growth at the annual level, but it was lower than the contribution of personal consumption and net exports.

Table 1.1 Structure of Gross Value Added by the National Classification of Economic Activities, at current prices, in %

	1997	1998	1999[a]	2000[a]
Agriculture, hunting, forestry and fishing	9.6	9.8	9.6	9.5
Mining and quarrying, manufacturing, electricity, gas and water supply	26.9	27.5	28.2	28.1
Construction	7.4	7.2	6.6	6.1
Wholesale and retail trade; repair of motor vehicles, motorcycles and personal and household goods	12.9	12.4	11.9	12.7
Hotels and restaurants	3.2	3.2	3.0	3.4
Transportation, storage and communication	9.0	9.1	8.8	9.0
Financial intermediation, real estate, renting and business activities	14.6	14.7	14.9	14.7
Public administration and defense, health and social work, other community, social and personal activities	20.2	20.0	20.6	20.2
Financial intermediation services indirectly measured	–3.8	–3.9	–3.7	–3.6
Gross value added	100.0	100.0	100.0	100.0

[a] Preliminary data; Source: CBS

According to the NCEA, trade contributed most to GDP growth in 2000, accounting for 12.7% of gross value added and increasing it by 1.2 percentage points. Until recently, trade was a source of nonpayment and high retail prices were often a target of criticism and resulted in long lines of vehicles at the border crossings. Moreover, several chains of stores failed due to bad financial results caused most frequently by unsuccessful attempts to establish conglomerates and by operations conducted contrary to law. It was therefore hard to expect a significant growth in this activity. However, the growth rate of gross value added in trade stood at 10.5% in 2000, increasing the total value added by 1.3 percentage points, while retail trade turnover grew by 14.7%. There were several reasons for this growth in trade. On the one hand, the growth in retail trade turnover was caused by an increase in the number of tourists, which generated additional foreign demand for products. On the other hand, the opening of an increased number of shopping centers resulted in a decrease in retail prices (for several reasons they rose less than producer prices in 2000), higher quality goods and services, and the retention of domestic buyers. Thus the mentioned problems in trade, which have not been completely resolved, are primarily the result of inefficient structure, badly conducted privatization, poor management and noncompliance with regulations rather than of macroeconomic instability.

Industry also contributed significantly to the growth in gross value added. Since industry accounts for the largest share in gross value added, the growth in production volume of 1.7% and in gross value added of 2.9% increased total growth by 0.8 percentage points. This growth was largely generated in the first half of the year, but industrial production stagnation and the higher level at the end of 1999 resulted in a lower contribution at the end of the year. The growth rate of total volume of manufacturing was higher than the growth rate of total industry and stood at 2.9%. The energy supply fell by 4.8% in 2000, contributing to lower growth in total industry. The main reasons for the decrease in electricity supply were the warmer weather at the end of the year and the fact that

Figure 1.16

Industrial Production, Employment and Productivity in Industry

Source: CBS

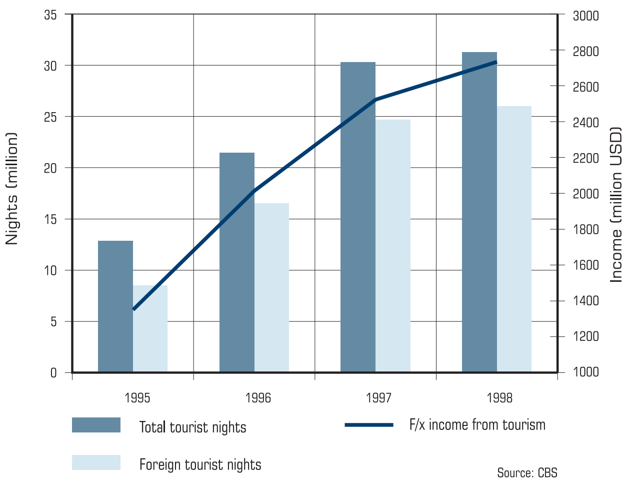
Croatia, in accordance with the agreement regulating the distribution of electricity generated in the Krško nuclear power plant, imported electricity from Krško in the last quarter of 2000, which was not the case in 1999. According to the main industrial groupings, capital goods grew by 7.2% and intermediate goods by 3.6%, while the production of durable consumer goods and energy fell by 3.8% and 2.4%, respectively.

The transportation, storage and communication contributed equally to the gross value added and grew at a rate of 6.3% in 2000. This growth resulted from different movements in individual types of transportation. The number of passengers carried rose by 3.8%, while goods carried fell by 4.2%. Telecommunication services grew at high rates in Croatia and in the world and formed a dynamic market segment applying modern technologies. The number of immobile network impulses rose by 12.6% in 2000, and the number of mobile network minutes consumed grew by as much as 60.3%.

Although hotels and restaurants accounted for only 3.4% of total gross value added, they contributed to the growth by 0.5 percentage points. The high contribution rate was caused by an increase in the number of tourist arrivals and nights (39.3% and 44.6%). The number of domestic tourists dropped by 1.9%, resulting in a 2.2% decrease in the number of domestic nights; however, foreign tourist arrivals rose by 55.0% and foreign tourist nights by 56.0%. The largest number of tourist nights were generated by tourists from Germany (22.8%), Slovenia (14.9%), the Czech Republic (14.2%), Italy (13.1%) and Austria (9.5%). The largest growth rates in tourist nights were generated by tourists from Poland (166%), Hungary (73%) and Slovakia (72%). The growth rates of tourist arrivals from West-European countries were not lower than average and their share did not decrease. The financial effects of tourism are further discussed in the section on the balance of payments.

Figure 1.17

Tourist Nights and Foreign Exchange Income from Tourism



Source: CBS

In 2000, construction was the only activity with a negative contribution to growth, due to the completion of reconstruction and to the fiscal restrictions on capital expenditures. Total volume and value added in construction fell by 9.1% and 4.5%, resulting in a negative contribution of 0.5 percentage points to the growth rate of total gross vale added.

1.2.2 Monetary Developments and International Reserves

The recovery of economic activity in 2000 was followed by accelerated growth in monetary aggregates. The annual growth rate of all monetary aggregates was above 12% (December 2000 compared to December 1999). Private sector kuna savings deposits grew the most (43%). Total liquid assets, the broadest monetary aggregate, rose by HRK 17bn or 29.3%; growing at the average monthly rate of 2.2%, this aggregate reached HRK 74bn at end-December. In 2000, the dynamics and the pace of movements in total monetary assets succeeded in reversing their downward trend that had started in the fourth quarter of 1997.

In 2000, the growth in monetary aggregates did not depart significantly from the figures in the monetary policy projections. The projection was based on the assumption that the fiscal policy envisaged by the government budget for 2000 would reduce government spending, balance out the consolidated central government deficit and provide settlement of government arrears to suppliers and other creditors, thus transferring liquid assets into the economy and increasing the liquidity of legal entities.

In 2000, reserve money (M0), the monetary aggregate under the direct control of the central bank, grew half as fast as the broader monetary aggregates. Reserve money rose by 13.6%, the money supply by 30.1% and total liquid assets by 29.3%. However, reserve money growth was higher than in 1999 (3.6%). This shows that there was a rise in both monetary multipliers.

In 2000, the increase in reserve money (M0), the central bank money, was caused by accelerated growth in both components of reserve money: currency in circulation and bank deposits with the CNB. The currency in circulation outside banks, which is a fully autonomous segment of reserve money, rose by HRK 0.7bn or 11.4% and was three times higher than in 1999, reaching HRK 6.6bn at the end of the year.

Banks' deposits with the CNB also grew by HRK 0.7bn, a very high rise of 16.5%, to HRK 5.1bn at the end of the year. The bulk of this increase relates to the growth in funds in reserve requirement accounts and settlement accounts (giro accounts of commercial banks with the CNB). In addition, banks directed the sur-

Figure 1.18

Year-on-Year Growth Rates of M0 and M1, rate of change compared to the same month previous year

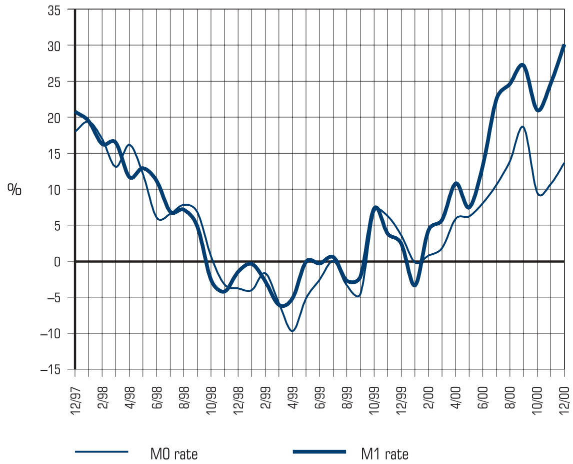


Figure 1.19

International Reserves of the CNB: Level and Year-on-Year Growth Rates

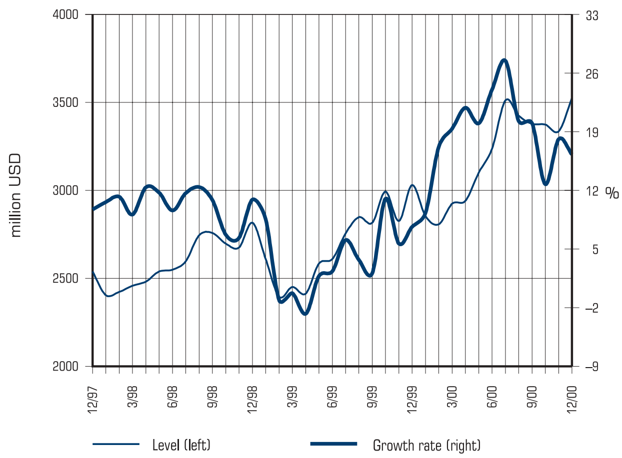
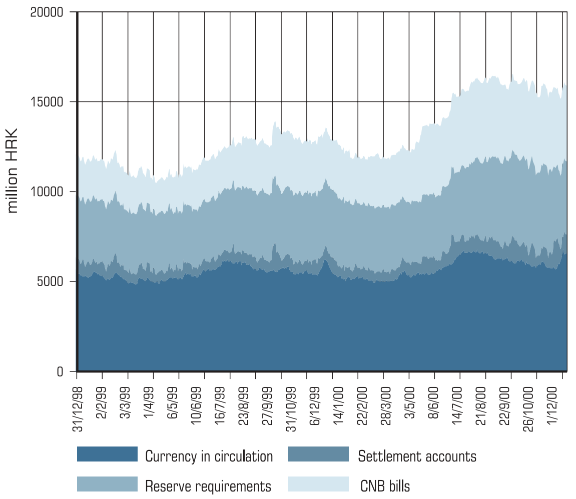


Figure 1.20

Structure and Daily Changes of Reserve Money and CNB Bills in 1999 and 2000

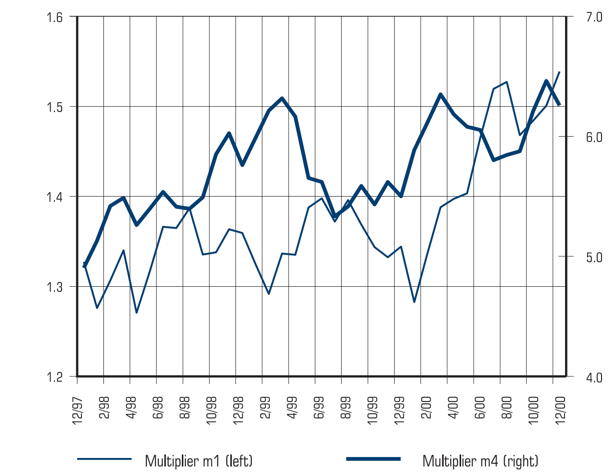


pluses of free reserves in settlement accounts into more profitable securities: CNB bills and T-bills (these two categories are not components of reserve money). The growth in allocations to the reserve requirements (please note that only the kuna reserve requirement is a component of reserve money, unlike the foreign exchange reserve requirement, which is recorded on the liabilities side of the central bank accounts but is not included in reserve money) shows that the kuna reserve requirement base rose significantly. The above-mentioned rise in kuna savings deposits, including a considerable increase in demand deposits of enterprises (for more details see 2.1 Monetary and Credit Aggregates) and other deposits that are included in the reserve requirement calculation base, brought about an absolute growth in the required reserves despite a continued decrease in the allocation rate.

As a result, reserve money M0, after stagnating nominally in the preceding two years (it fell by 3.8% in 1998 and rose by 3.6% in 1999) rose by HRK 1.4bn in 2000. Expressed in nominal terms, it went up by 13.6% and reached HRK 11.7bn at the end of the year. The 2000 dynamics of reserve money shows that it grew by 12.4% and 14.5% in the second and third quarters, after a seasonal fall of 11.5% in the first quarter. This boost was surely stimulated by the general economic growth and especially an increase in income from tourism. In the last quarter, M0 fell by 0.3%.

Figure 1.21

Changes in Multipliers m1 and m4

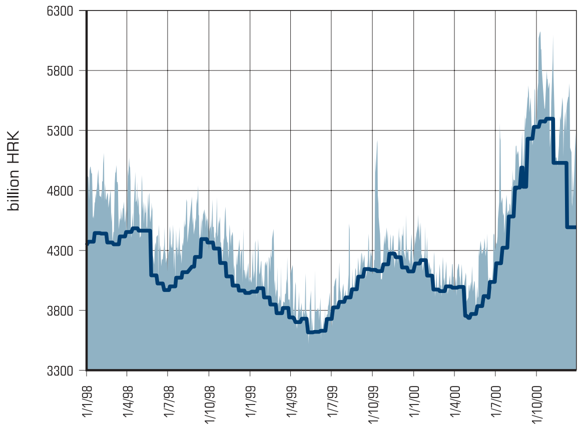


As already mentioned, the upward trend in the broadest monetary aggregates was much stronger than the growth in reserve money in 2000 due to strengthening of money multiplicity in conditions of economic and financial recovery and remonetized movements. The m1 monetary multiplier had fluctuated around the monthly value of 1.33 for three years, which means that a new unit of reserve money created in a certain period initiated the creation of 33% more units of M1 money supply. It grew continually until the end of the third quarter of 2000, when it suddenly dropped and again increased in the fourth quarter, reaching the value of 1.55. Consequently, one kuna of created central bank reserve money stimulated the creation of one kuna and fifty lipa of M1, thereby drawing near the value of monetary multipliers in developed countries. The m4 money multiplier also rose in 2000, confirming an increase in money multiplicity of almost one sixth.

The increased liquidity of the banking system and nonbanking sectors in 2000, together with the easing of pressure on the kuna (more pronounced at the very beginning and at the end of the year), enabled the central bank to devote its attention to improving the monetary policy instruments, especially the reserve requirement and the RR rate.

Figure 1.22

Maintaining Banks' Liqudity in the Period from 1998 to 2000



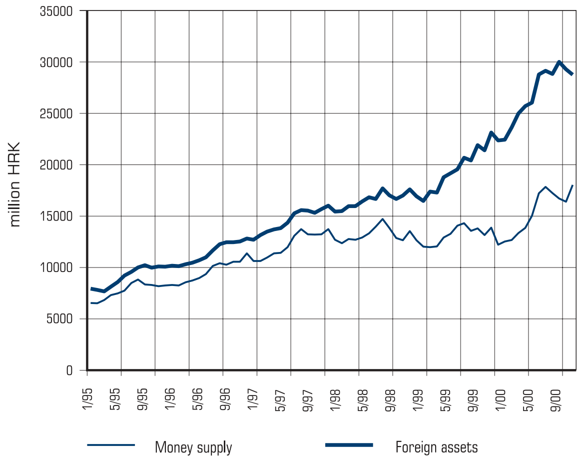
Immediately after the first quarter of 2000, the Croatian National Bank again decreased the reserve requirement rate on kuna deposits – from 30.5% to 28.5% (the first decrease was about a year ago). This was in response to the upward trend in economic activity and monetary aggregates that had become noticeable in that quarter, the stable exchange rate, and the fact that there were no fears that excess liquidity might result in an accelerated increase in prices. This measure, which freed up part of the bank liquidity in accounts with the CNB, was accompanied by a decrease in interest rates on kuna and foreign currency denominated CNB bills of all tenors in the second quarter of 2000. By doing so, the central bank signaled to the market that it should lower the price of money.

It became clear in the fourth quarter of 2000 that the accelerated growth in exports of goods and services would contribute to a further recovery of economic activity and that the reduction in government spending and the strengthening of its financial discipline would contribute to speedier settlements by the government and therefore improved liquidity in the economy and growth in the monetary aggregates. This development was also characterized by a constant inflow of foreign currency based on export payments, increased personal foreign currency savings, privatization receipts and borrowings by the government. All this helped the consolidation of the banking sector, which converted its net external debt of HRK 4.8bn recorded in its balance sheet as at 1999 into HRK 2.2bn of net foreign claims recorded in its balance sheet as at 2000. The banking system stability stimulated additional changes in bank lending policies. As a result, there was an increase in loans to domestic clients in the last quarter.

These developments provided the optimum base for a further decrease in the reserve requirement rate to 23.5% and gave impetus to the central banks to redesign and modernize the reserve requirement. The reserve requirement underwent the largest changes of all the monetary instruments in 2000 and fully produced the expected results. The timing of the unification of the kuna and foreign exchange reserve requirement base, the calculation rate, the calculation period and the maintenance period was very good and brought about results that were only slightly different from those expected. The funds allocated to the kuna reserve requirement account increased by HRK 400m or 10% (December 2000 compared to December 1999). The reserve requirement rate on kuna deposits decreased by 23% in 2000 (from 30.5% to 23.5%). However, the reserve requirement funds grew in net terms because the kuna deposits included in the reserve requirement calculation base rose considerably in 2000 (De-

Figure 1.23

The CNB Foreign Assets (International Reserves) and Money Supply M1



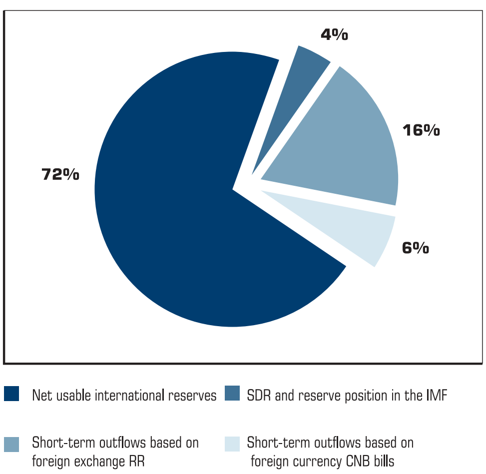
cember 2000/December 1999: 43%), reaching high growth rates of 16% and 20% in the second and third quarters of 2000. In addition, continued high liquidity and exchange rate stability encouraged banks to generate additional revenues from their surplus liquidity. They invested the funds freed up from the reserve requirement accounts and settlement accounts in the money market or in loans to nonbanking sectors, especially at the end of the year.

The movements in foreign exchange reserve requirement much resembled those described above but were of less intensity. Foreign exchange reserve requirement funds decreased slightly by HRK 70m in the fourth quarter of 2000, when the reserve requirement rates were unified and the foreign exchange reserve requirement rate fell from 55% to 23.5%. The lower rate was accompanied by a simultaneous broadening of the reserve requirement calculation base. Allocations to the kuna reserve requirement fell by HRK 0.7bn or 13.6% because, at the end of December, the banks substantially increased the level of that part of the kuna reserve requirement which can be maintained in the settlement account and in the vault in order to ensure the substantial liquidity needed in the last days of 2000 for paying out insured personal savings deposits.

Analysis of the formation and withdrawal of reserve money shows that foreign currency transactions by the central bank were the main source of reserve money in 2000. The high foreign currency liquidity of banks, primarily based on accelerated growth in foreign currency deposits by domestic sectors, accompanied by an inflow of foreign currency to the central government from the privatization of three banks, the sale of Eurobonds and Samurai bonds and a short-term bridging loan, enabled the central bank to purchase USD 432.5m net and to increase its international reserves by the same amount, which resulted in a positive monetary effect of 3.6bn newly created kuna.

Figure 1.24

Structure of Total International Reserves of the CNB, December 31, 2000

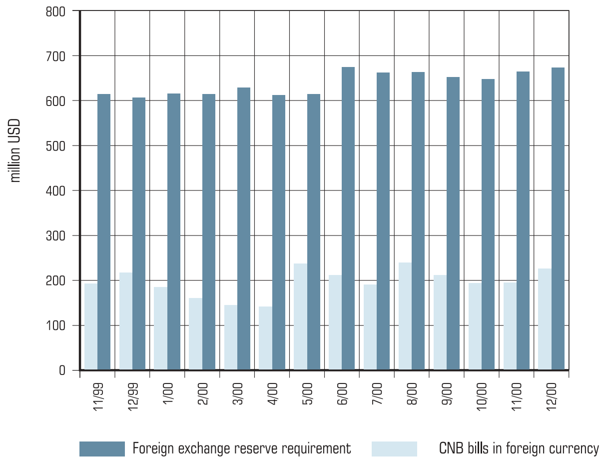


Of this amount, USD 105m net was purchased from commercial banks in seven auctions and swap transactions (USD 267m purchased and USD 162m sold), creating HRK 0.9bn. In addition, the CNB purchased USD 298m net from the central government on five occasions during the year, with a monetary effect of HRK 2.5bn. The remaining USD 30m was purchased from foreign banks by selling domestic currency cash in the amount of HRK 0.2bn.

In 2000, international reserves grew by USD 500m to USD 3,525m. This resulted from the purchase of foreign currency in the amount of USD 432.5m net, a USD 9m increase in CNB bills (from USD 216m at end-December 1999 to USD 225m at end-December 2000) and a USD 67m increase in the foreign exchange reserve requirement (from USD 606m to USD 673m), with a negative effect of net foreign exchange differences and net income of USD 8m.

Figure 1.25

Changes in Foreign Exchange Reserve Requirement and CNB Bills in Foreign Currency in 2000



The second standard source of reserve money – central bank loans to banks and the central government to increase their liquidity – experienced a substantial fall in 2000. Central bank claims on commercial banks stood at HRK 0.3bn at the end of 2000, which was one third of the amount recorded in 1999. This trend was present throughout 2000. The average balance in loans to banks fell from HRK 1.6bn in 1999 to HRK 0.4bn in 2000 due to a systemic decrease from an average of HRK 959m in the first quarter to HRK 169m in the fourth quarter of 2000. The government settlement of debts to banks stimulated a modest recovery of liquidity in distressed banks and in the banking system as a whole. During 2000, liquidity loans, intended for banks experiencing operating problems and without alternative sources of finance, were repaid in full. 7 banks made use of these loans in 2000. Thus, the average balance in liquidity loans decreased from HRK 928m in 1999 to HRK 339m in 2000. The good liquidity of the overall banking system contributed to a fall in the level of Lombard loans, which were utilized by all banks, from an average of HRK 155m in 1999 to HRK 57m in 2000. In addition, claims based on the repurchase of CNB bills dropped from an average of HRK 140m in 1999 to HRK 18m in 2000.

In 2000, the central government utilized only one bridging loan, in order to purchase foreign currency required for servicing the external debt to the London and Paris Clubs that fell due at the beginning of the year (HRK 0.4bn between mid-February and end-March).

These developments show that the central bank instruments that relate to its kuna activities in 2000 were much less used than in 1999, and that this source of reserve money was substituted by foreign currency transactions and a reduction in the reserve requirement rate.

The liabilities side of the CNB balance sheet for 2000 shows a significant increase in central government funds: central government deposits tripled to HRK 1.2bn at year-end, with the largest increase in the last quarter. The average amount of central government deposits increased from HRK 0.6bn in 1999 to HRK 0.8bn in 2000.

During 2000, the increased liquidity of the banking system was sterilized through a growth in deposits and a larger issuance of CNB bills. The amount of CNB bills issued grew by HRK 1.3bn or 45.7% during 2000 to HRK 4.2bn at the end of the year. CNB bills denominated in kuna grew by as much as HRK 1.1bn or 91.2% to HRK 2.4bn at the end of 2000 and comprised 57% of total CNB bills issued. Expressed in kuna, CNB bills denominated in foreign currency rose by HRK 178m or 10.9% to HRK 1.8bn or USD

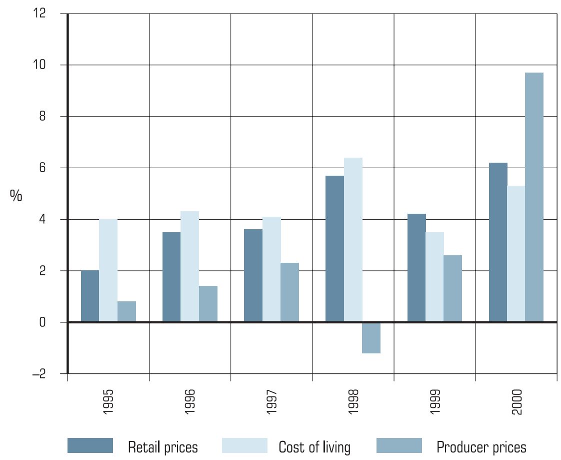
224.6m at the end of the year. The structure of purchased CNB bills shows that 61.9% of bills were denominated in the US dollar (USD 139m), while the remaining 28.1% of bills were denominated in the euro (USD 85.6m or EUR 91.9m).

1.2.3 The Aggregate Level of Prices and Exchange Rate

In 2000, average inflation measured by changes in the retail price index (RPI) reached 6.2%, which is 2 percentage points above the 1999 inflation rate of 4.2%. The cost of living rose on average by 5.3% in 2000 (3.5% in 1999). Looking at aggregate indicators of price changes, the year-on-year increase was the strongest in producer prices of industrial products; they grew on average by 9.7% or by 7.1 percentage points above the 1999 level of 2.6%.

Figure 1.26

Average Annual Growth in Retail Prices, Cost of Living and Producer Prices of Industrial Products

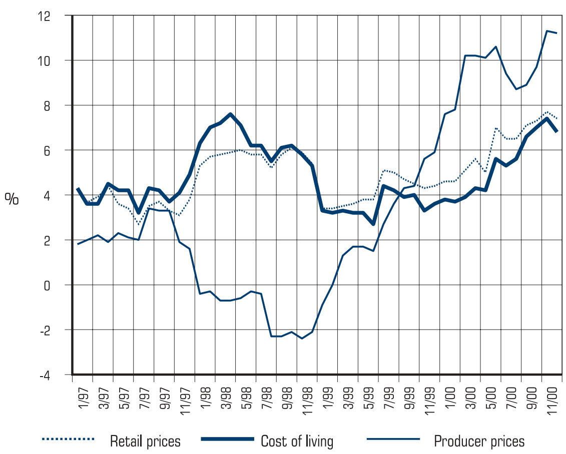


Source: CBS

However, if we exclude from the RPI the prices of agricultural products (which are highly volatile and influenced by weather conditions) and administrative prices (which in Croatia also include refined petroleum products prices), which are considered to poorly reflect demand side pressures on prices, the year-on-year indicator of core inflation is 4% in 2000 or 0.2 percentage points lower than in 1999. The core inflation rate recorded in Croatia in 2000 is still within what is considered to be the zone of stability for the general level of prices that applies to transitional economies like Croatia's.

Figure 1.27

Changes in Retail Prices, Cost of Living and Producer Prices, percentage change compared to the same month previous year



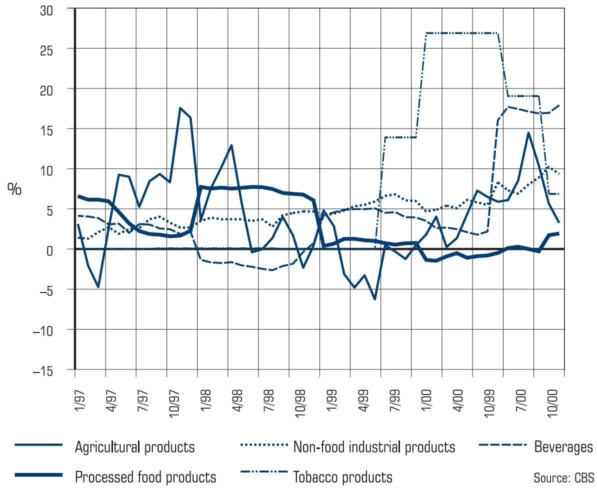
Source: CBS

The year-on-year inflation rate measured by the RPI rose from 5.1% at the end of the first quarter of 2000 to 7% at the end of the second, 7.1% at the end of the third, and 7.4% at end-December 2000 compared with same month of the previous year.

The accelerated growth in retail prices in 2000 was largely caused by a considerable depreciation of the kuna against the US dollar and an increase in prices of crude petroleum in the world market that spilled over into domestic sales prices of refined petroleum products. In addition, the Government decided to increase excises on refined petroleum products, alcoholic drinks, coffee and tobacco products in June 2000, and the Ministry of the Economy gave its approval for an increase in electricity prices. This resulted in a year-on-year growth (December 2000 compared with December 1999) in the prices of gasoline of 36.7%, transportation services of 9.8%, beverages of 17.9%, tobacco of 6.9% and electricity of 30.9%.

Figure 1.28

Changes in Prices of Goods within the Retail Price Index, percentage change compared to the same month previous year



Source: CBS

The prices of refined petroleum products rose on three occasions in the first half of 2000. INA was given permission to increase it sales prices in January and March 2000, which resulted in a monthly increase in the prices of gasoline and lubricants of 9% and 8.2% on average. In June, there was an increase in the prices of refined petroleum products of 23% due to a rise in excises, which had a significant one-off effect on increasing retail prices. After June, there was no increase in the retail prices of refined petroleum products. INA did increase its sale prices in November, but this was offset by a corresponding decrease in excises. However, certain postponed and indirect effects of the increased prices of refined petroleum products were observed in the following months (particularly in the prices of transportation services).

On the other hand, there were a certain number of factors that reduced the inflationary pressures. The most important were the continued stable exchange rate of the kuna against the euro, which had a stabilizing effect on inflationary expectations, and a slower growth in the total net wage bill of 2.7% in 2000 compared to 4% in 1999. By entering the WTO, Croatia assumed a commitment to gradually reduce custom duties, which increased the competitiveness of imported products in the domestic market. Competitiveness was also increased by an increase in the number of shopping centers in the domestic market. Together with weakened demand, this was one of the main factors that kept processed food products prices stable for two years in a row. They were 1.5% lower in December 1999 than in the same month the previous year, while they were 1.8% higher in December 2000.

The year-on-year inflation rate measured by the producer price index (PPI) rose from 10.2% at the end of the first quarter to 10.6% at the end of the second quarter. Producer prices fell to 8.9% at the end of the third quarter of 2000; they rose to 11.2% in December 2000 compared with the same month in 1999, due to an increase in electricity prices and the sale prices of refined petroleum products. This is 5.3 percentage points higher inflation than in 1999 (December to December).

Of the main industrial groupings, energy prices grew the most. December 2000 prices compared to December 1999 prices show an increase of 39.4% (15.4% in 1999). The effect of the increase in the prices of crude petroleum and refined petroleum products on the increase in the aggregate indicator of changes in the producer prices of industrial products is particularly evident in the data on individual NCEA sections. They show that the prices of domestic crude petroleum and refined petroleum products rose by 75.1% and 61.3% in 2000 (indicators for December 2000 compared to December 1999). This was due to the fact that domestic prices of oil and refined petroleum products were trying to keep pace with rises in the prices of these products in the world market (the average price of crude petroleum rose by 56.9% in 2000 compared with 1999) and to the depreciation of the kuna against the US dollar (the average rate of the kuna against the US dollar weakened by 16.3% in 2000).

The year-on-year increase in producer prices was much lower in the other industrial groupings. Producer prices of intermediate goods grew by 5.4% (3.7% in 1999), while producer prices of capital goods rose by 4.8% (5.7% in 1999). The considerable appreciation of the US dollar and the increase in prices of refined petroleum products, intermediate goods and capital goods did not have a significant influence on the prices of consumer goods. Prices of non-durable consumer goods rose by 3% in December 2000 compared to the same month the previous year (3.9% in 1999), while prices of durable consumer goods grew by only 1.4% (0.2% in 1999).

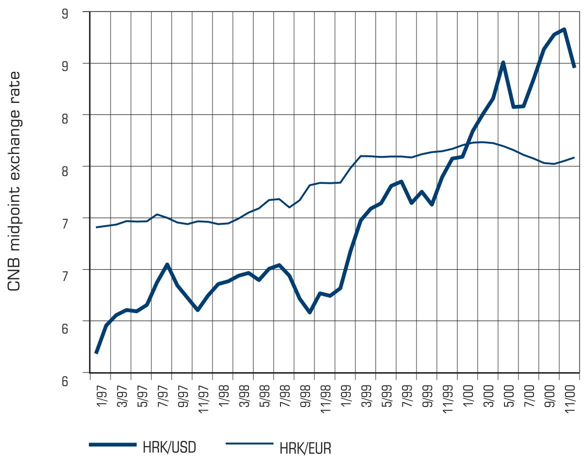
The stability of the exchange rate of the kuna against the euro was successfully preserved throughout 2000. The average nominal exchange rate of the kuna against the euro rose from 7.58 in 1999 to 7.63 in 2000, showing an average annual depreciation of the kuna against the euro of 0.72%. This was much less than a year ago, when the kuna depreciated against the euro by 6.20%. A comparison of exchange rates recorded at the end of the year shows that 2000 ended with a slight appreciation of the kuna against the euro, whereas a depreciation of 4.77% was recorded in 1999: one euro amounted to HRK 7.60 on December 31, 2000, or 1.05% less than in 1999, when it stood at 7.68. In 2000, the market abounded in a supply of foreign currency due to a successful tourist season, an inflow from government bonds issued abroad and a bridging loan, and receipts from the sale of banks and other enterprises to foreign investors. Moreover, part of the foreign currency deposits withdrawn during the banking crisis of 1999 returned into the banking system.

Comparing the nominal exchange rate of the kuna against the euro at end of one month with the end of the previous month, the kuna depreciated against the euro only in the first two months and in the last quarter of 2000. The kuna depreciated the most in January (0.53%) at the time of the parliamentary elections and the constitution of the newly elected government. In an effort to stabilize the exchange rate of the kuna, the CNB sold USD 108.6m at an auction in January 2000. In addition, clear statements by the new government that they intended to continue pursuing exchange rate and price stability certainly helped to decrease speculative demands for foreign currency; indeed, there was only a modest deprecation of the exchange rate in February 2000 (0.13%).

This was followed by seven months of a continuous nominal appreciation of the kuna against the euro. In this period, the kuna appreciated against the euro by 2.83%. The CNB tried to ease appreciation pressures on the kuna by buying foreign currency. From April to August 2000, the CNB purchased from commercial

Figure 1.29

Changes in the Average Monthly Nominal Exchange Rate – HRK vs. EUR and USD

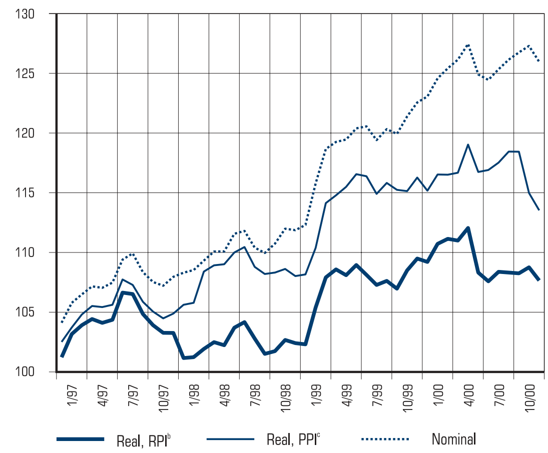


banks a total of USD 252.3m. The expected nominal depreciation of the kuna against the euro that usually takes place after the tourist season did not occur until mid-October 2000. A modest depreciation of the kuna continued until the end of 2000. The CNB sold USD 53.6m to commercial banks at an auction held at the beginning of November of 2000.

During most of the year (except in mid- and end-2000), the kuna depreciated against the US dollar, thereby following the changes in cross-currency relations between the euro and the US dollar at the Frankfurt exchange. The average annual exchange rate of the US dollar against the kuna rose from 7.11 in 1999 to 8.28 in 2000, representing an average annual depreciation of the nominal exchange rate of the kuna against the US dollar of 16.33% in 2000, compared to 11.84% in 1999. The kuna strengthened considerably against the US dollar in December 2000 (7.04% compared to the end of December last year), resulting in a depreciation of the kuna against the US dollar of only 6.64% compared to the end of the previous year: one US dollar amounted to HRK 8.15 on December 31, 2000 and HRK 7.65 in the previous year.

Figure 1.30

Changes in the Indices[a] of Nominal and Real Effective Exchange Rate of the Kuna with Retail Prices and Producer Prices, 1995=100



[a] A fall in the index denotes the appreciation of the kuna against the basket of currencies.
[b] RPI, Retail Price Index
[c] PPI, Producer Price Index

The index of the average nominal effective exchange rate of the kuna depreciated by 5.42% in 2000 compared to 1999. This was a result of a slight nominal depreciation of the average annual exchange rate of the kuna against the euro of 0.72% (which accounts for about 2/3 of the basket of currencies used in the calculation of the nominal effective exchange rate), a more pronounced depreciation of the kuna against the US dollar of 16.33% (which accounts for 30% of the basket), a depreciation of the kuna against the Swiss franc of 3.45% and the pound sterling of 8.90%, and an appreciation against the Slovenian tolar of 5.26%.

However, the real effective exchange rate of the kuna depreciated much less due to a faster increase in prices in the country compared to changes in prices abroad. The real effective exchange rate of the kuna depreciated by 1.98% (with producer prices) and by 1.72% (with retail prices), significantly improving the price competitiveness of domestic exporters.

1.2.4 Interest Rates

The downward trend in interest rates that started at the beginning of 1994 continued in 2000, with the exception of a slight increase at the time of the banking problems between spring 1998 and spring 1999. In 2000, interest rates reached their lowest levels in the money market since the start of statistical monitoring. They fell to only 1.7% in daily trading and were even below 1% in overnight trading. There was also a considerable decrease in interest rates on short-term securities in the primary market, stimulated by the fall in interest rates in the money market. Interest rates on kuna denominated CNB bills and on T-bills fell at the end of March 2000, depending on their tenor, to between 6.0% and 6.9%, converging to the same level after a long period in which their levels had varied (interest rates on T-bills up to more than 2 percentage points higher).

The average lending interest rates of the banking system fell to below 10% for a period. The average short-term interest rates on corporate loans fell to 6%. The average deposit interest rates on kuna and foreign currency time deposits fell to 7.2% and 4.0% respectively. Despite the fall in lending and deposit rates, bank loans did not increase as much as bank deposits. Bank loans rose by 8.9% in 2000, with an increase in corporate loans of only 0.9%, while bank deposits rose by 31.4%, with an increase in savings and time deposits of 28.9%.

Table 1.2 Comparison of Interest Rates in Selected Countries and EMU, on annual level, in %

	Germany	EMU	the Czech R.	Poland	Hungary	Slovenia	Slovakia	Croatia
June 2000								
Loans	8.39	6.56	6.85	19.70	12.10	15.60	10.91	9.98
Time deposits	3.66	3.49	4.37	13.60	9.20	9.90	8.99	6.80
Inflation rate (CPI)	1.90	2.40	4.10	10.20	9.10	12.20	15.40	7.00
December 2000								
Loans	9.12	7.16	6.51	20.90	12.80	16.30	10.74	7.38
Time deposits	4.19	3.96	3.95	14.10	9.90	10.90	6.84	6.89
Inflation rate (CPI)	2.20	2.60	3.90	8.50	10.10	10.60	8.40	7.40

Note: Data are taken from the monthly publications of the central banks and refer to short-term loans to enterprises and short-term (up to 3 months) household deposits, both categories denominated in the domestic currency.

A comparison of real interest rates in Croatia with those in its environment shows that real interest rates in Croatia were almost negative in 2000. However, this should be treated with caution, since it is difficult to find directly comparable categories for different countries. An analysis of lending rates shows that the rate on corporate loans is not that high. However, their share in total loans is on a steady downward trend in Croatia (they fell from 58.3% at end-1999 to 53.4% at-end 2000).

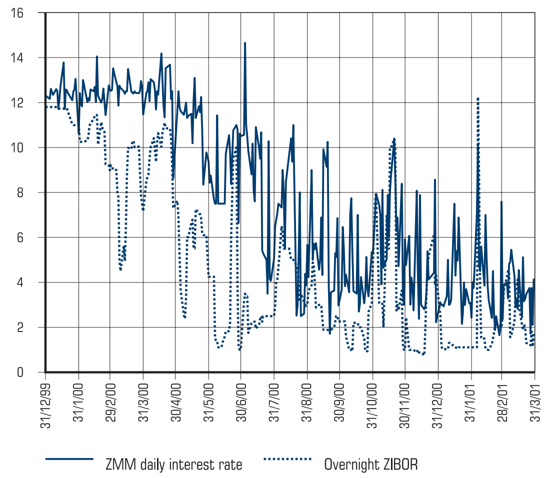
It is obvious that the level of interest rates is not a key factor in strengthening lending activity in Croatia but is outweighed by bank caution in the face of high-risk clients and bank perception that the loan demand is of poor quality. This is clearly confirmed by the high amounts of purchased CNB bill and T-bills. The amount of purchased kuna and foreign currency denominated CNB bills and T-bills rose by HRK 4,141.1m in 2000, while personal loans grew by HRK 4,048.6m and corporate loans by only HRK 272.5m.

The money market, above all characterized by a significant fall in interest rates in 2000, reflected the strong liquidity of the banking system. The reduction in the reserve requirement rates in April and again in the fourth quarter of 2000 contributed to the growth in liquidity and subsequently to a decrease in the interest rates in the Zagreb Money Market (ZMM) and inter-bank market. Interest rates decreased both in daily and overnight trading, and there was a multiple decrease in average overnight trading.

For example, the average overnight inter-bank trading was four times lower in February 2001 than in August 2000. At the same time, the share of daily trading in the money market rose from 3.9% in December 1999 to 23.7% in February 2001.

Figure 1.31

Average Daily Interest Rates on the Zagreb Money Market and Overnight ZIBOR

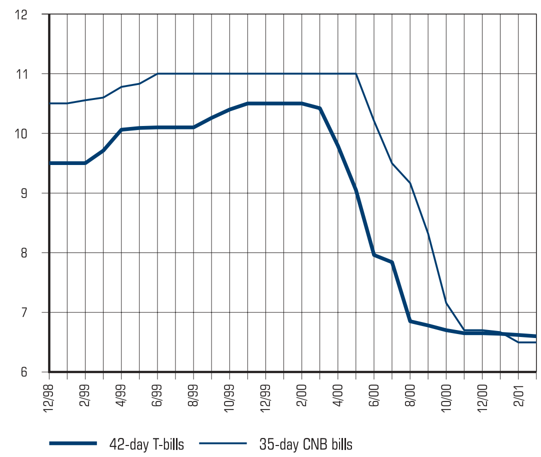


The average interest rates in daily trading decreased from a very high 12% to even below 4% in 2000, sometimes reaching 1.7% (usually on callable loans). However, despite these very low interest rates, the money market did not experience any growth; indeed, mostly bank cash surpluses were traded and the trading volume decreased significantly. The market participants are exclusively banks and savings banks and sometimes central government funds or insurance companies.

The short-term securities market forms an integral part of the money market. This segment of trading in Croatia concerns CNB bills and T-bills, and it is mostly conducted in the primary market. Secondary market trading is negligible, with its volume mostly ranging between 5% and 6% of the nominal purchase of kuna CNB bills and T-bills and less than 1% of the nominal purchase of foreign currency CNB bills.

Figure 1.32

Average Interest Rates on CNB Bills and T-Bills



In the introduction to this section, it was mentioned that the trading volume of these securities grew substantially in the primary market in 2000. The amount of purchased T-bills and kuna CNB bills went up by 239% and 102% respectively. There was slow growth in CNB bills in the first months of 2001 due to the substitution of kuna CNB bills with T-bills. At the same time, the tenor of kuna denominated CNB bills was shortened from 35, 91 and 182 days to 35, 70 and 105 days in February 2000, and it was announced that CNB auctions would be held less frequently. This decision is aimed at stimulating the development of the secondary market, and banks are no longer obliged to place their liquidity only in the primary market but may turn to the secondary market as well.

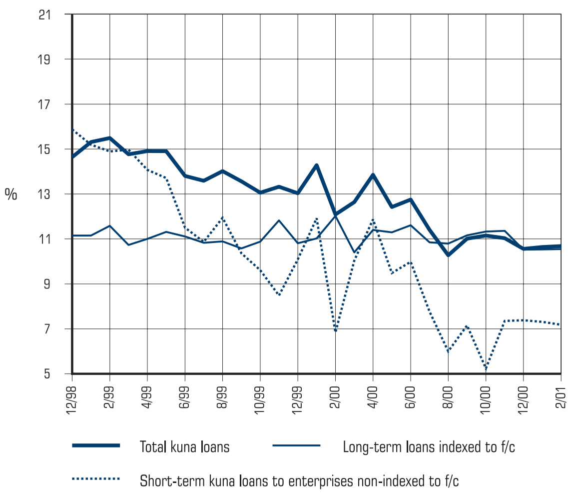
The last months of the observed period show that the tenor structure of these bills has clearly changed in favor of securities with longer tenors. 182-day T-bills were not purchased at all at the beginning of 2000. In contrast, they accounted for as much as 21.7% of the purchased amount at the end of 2000 and 50.9% at end-March 2001. 182-day kuna CNB bills rose from only 7.8% of total kuna CNB bills purchased to 17.7% at the end of the year; although these bills are no longer traded, their share stood at a very high 12.7% at end-March 2001. The new 105-day CNB bills (currently with the longest tenor) comprise 20.4% of kuna bills purchased. Some banks are turning to this safer way of gaining a return on their investment than the private sector provides.

There was also an increase in purchased foreign currency CNB bills, but by only 25.9%. This central bank instrument was not strongly influenced by the increase in banks' foreign currency liquidity, since banks preferred to place their funds abroad rather than in domestic securities denominated in foreign currencies

The fall in interest rates in the money market and on short-term government and CNB securities and the strong liquidity of the banking system resulted in a further decrease in the interest rates of commercial banks that were already on a steady downward trend over the previous years. The average lending rates stood at about 14% at the beginning of 2000 and fell to 10.5% during the year. A comparison of interest rates by sectors to which loans were extended shows that the fall in interest rates was even larger. Since the calculation of the total average lending rate in the banking system includes interest rates on corporate and personal loans, the movements in interest rates cannot be clearly shown. The average interest rate on short-term corporate loans (usually without a foreign currency clause) that comprise about 40% of newly granted loans per month fell from about 11% to about 6.5%. Short-term overdraft facilities to individuals (agreed overdrafts based on current accounts) also accounted for a substantial share in newly granted loans (19%). The average interest rate on this type of facility stood at about 20.5% and has not changed for years.

Figure 1.33

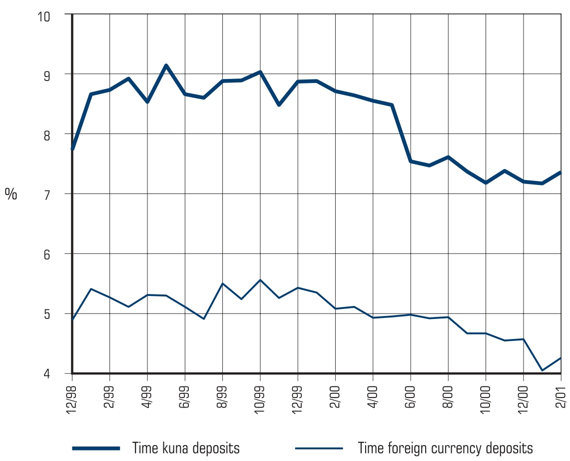
DMBs' Average Interest Rates on Loans



Long-term loans comprised only 17% of newly granted loans (95% of which are loans with a foreign currency clause). The interest rate on these loans is on a steady downward trend. The average interest rate decreased from 11.5% to 10.6% over 2000.

Figure 1.34

DMBs' Average Interest Rates on Deposits

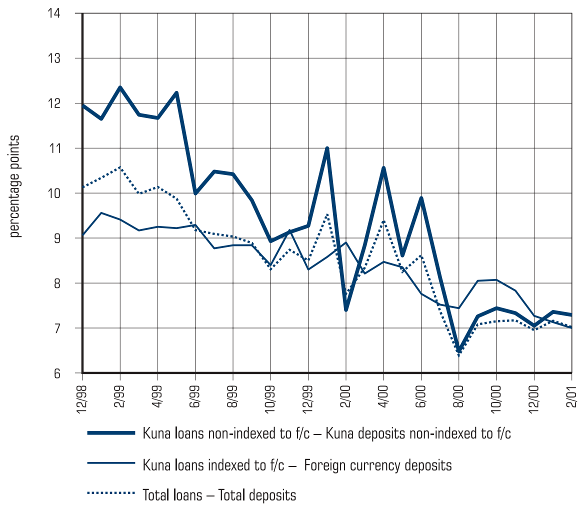


The difference between commercial bank interest rates on short-term corporate loans and interest rates on short-term kuna securities is negligible. The interest rate on T-bills and CNB bills with longer tenors (182 and 105 days, bearing interest from 6.9% to 7.15% according to recent auctions) is very favorable considering the lower risk of investing in these bills as opposed to granting corporate loans. The commercial banks avoid high risk, having learned from the banking crises of 1998/1999 and the problem of non-payment. While it does not help Croatian enterprises, it is understandable that the banks are placing their funds in these bills, especially those with longer tenors, rather than in corporate loans.

The fall in bank lending rates was followed by a decrease in interest rates on deposits. The result of this was twofold. Firstly, the banks decreased their costs without influencing the inflow of deposits (an increase of 31.4%), which have a 60% share in total banking liabilities; this had a positive effect on their operating results since interest expenses decreased. Secondly, the banks in this way compensated for the fall in lending rates.

Figure 1.35

Difference between DMBs' Average Lending Interest Rates



Competition between banks to attract deposits by decreasing deposit rates is gradually losing in importance. The banks are putting more stress on product range, safety and trust. However, the average deposit rate on kuna and foreign currency deposits fell below 3.5%.

When analyzing interest rates, it is important to pay attention to the structure of deposits. Kuna deposits (28% of total deposits) are primarily sight deposits (current account, giro account and savings books comprise as much as 65.3% of these deposits). They bear an interest rate of between 1.3% and 1.6%, which decreases the average rate to 3.5% despite the high interest rate on time deposits (7.4%). However, foreign currency deposits have a different structure and bear a lower average interest rate (3.2%). The average interest rate on sight deposits was below 1% (they comprise about 30% of foreign currency deposits), while the interest rate on time deposits fell to 4%. The difference between the average interest rates on kuna and foreign currency time deposits has not managed to reverse the trend for depositors to keep their savings in domestic currency.

Since average interest rates (if absolute levels of interest rates are compared) fell more on loans than on deposits, the difference between them is reducing. This difference has fallen to about 7 percentage points; if only corporate loans to total deposits are compared, the difference is less than 4 percentage points.

1.2.5 Balance of Payments

In 2000, the current account deficit decreased for the third consecutive year to USD 531.0m, or about 3% of GDP. In 1997, the deficit had reached a peak of USD 2.3bn, or about 12% of GDP. This large deficit was the result of domestic credit expansion. Because of structural problems on the supply side in Croatia, and because of the effects of the war, demand for goods was largely satisfied by imports. Auto imports were particularly important, and were often financed by the credit expansion. In addition, the impending introduction of the value-added tax at the beginning of 1998 induced a spurt of imports at the end of 1997. During 1998, as a result of the Asian and Russian crises, the embargo placed by German banks on lending to Croatian banks after the bankruptcy of Glumina banka and restrictive monetary policy, the current account deficit decreased to about 7% of GDP. This was mainly due to a substantial decrease in imports. In 1999, the downward trend in net merchandise exports, despite decreased tourist revenues due to the Kosovo crisis, resulted in a decrease in the absolute value of the current account deficit, while the ratio of the current account deficit remained at

Table 1.3 Balance of Payments of the Republic of Croatia, million current USD

	1997	1998	1999	2000	Index 2000/1999
A. CURRENT ACCOUNT (1+6)	–2,325.1	–1,530.6	–1,522.6	–531.0	34.9
1. Goods, services and income (2+5)	–3,194.5	–2,236.6	–2,022.9	–1,289.9	63.8
1.1. Credit	8,578.4	8,963.5	8,370.0	9,018.5	107.7
1.2. Debit	–11,772.9	–11,200.1	–10,392.9	–10,308.4	99.2
2. Goods and services (3+4)	–3,172.0	–2,072.6	–1,673.4	–980.3	58.6
2.1. Credit	8,214.6	8,568.6	8,117.8	8,651.3	106.6
2.2. Debit	–11,386.6	–10,641.2	–9,791.1	–9,631.7	98.4
3. Goods	–5,196.2	–4,147.4	–3,298.6	–3,237.4	98.1
3.1. Credit	4,210.3	4,604.5	4,394.7	4,567.1	103.9
3.2. Debit	–9,406.5	–8,751.9	–7,693.3	–7,804.5	101.4
4. Services	2,024.2	2,074.8	1,625.2	2,257.1	138.9
4.1. Credit	4,004.3	3,964.1	3,723.0	4,084.3	109.7
4.2. Debit	–1,980.1	–1,889.3	–2,097.8	–1,827.1	87.1
5. Income	–22.4	–164.0	–349.5	–309.6	88.6
5.1. Credit	363.8	394.9	252.2	367.2	145.6
5.2. Debit	–386.2	–558.9	–601.7	–676.8	112.5
6. Current transfers	869.4	706.0	500.3	758.9	151.7
6.1. Credit	964.0	919.1	835.2	966.4	115.7
6.2. Debit	–94.6	–213.1	–335.0	–207.6	62.0
B. CAPITAL AND FINANCIAL ACCOUNT	2,651.6	1,469.0	1,484.2	337.9	22.8
B1. Capital account	21.5	19.1	24.9	20.5	82.5
B2. Financial account (excl. reserves)	3,058.2	1,601.5	1,887.8	899.4	47.6
1. Direct investment	346.7	834.9	1,444.6	827.9	57.3
1.1. Abroad	–186.1	–97.5	–34.4	–23.8	69.2
1.2. In Croatia	532.9	932.4	1,479.0	851.8	57.6
2. Portfolio investment	577.0	14.9	574.0	732.5	127.6
2.1. Assets	11.1	–0.1	–0.3	–0.1	33.3
2.2. Liabilities	565.9	15.1	574.3	732.6	127.6
3. Other investment	2,134.4	751.7	–130.8	–661.0	505.5
3.1. Assets	171.3	348.8	–588.4	–1,082.1	183.9
3.2. Liabilities	1,963.2	402.9	457.7	421.2	92.0
B3. Reserve assets (CNB)	–428.0	–151.5	–428.5	–582.1	135.8
C. NET ERRORS AND OMISSIONS	–326.5	61.7	38.4	193.1	502.4

about 7%. The deficit in 2000 was the smallest in the last five years. It was characterized by a decrease in the merchandise trade deficit, an increase in the surplus on the services account, growth in net current transfers and an increased deficit on the income account. When interpreting these data, it is useful to keep in mind that a new methodology was introduced in the first quarter of 1999. This methodology covers merchandise trade, services, current transfers and the capital and financial accounts. The CBS has also revised its methodology regarding merchandise trade statistics by introducing a new tariff declaration and new methodology for analyzing the data starting in the beginning of 2000.

Several factors were behind the decreased merchandise trade deficit in 2000. The EU unilaterally lifted quantitative restrictions on certain Croatian exports, mainly textiles, in the context of help given through the Stability Pact. Also, Croatia joined the WTO in July. These effects were felt by the end of 2000, and had a favorable effect on merchandise exports. Exports f.o.b. grew by 3.0% in USD terms due to this effect. Imports c.i.f. grew by 1.6%, with a growth in the trend becoming visible in the third quarter, mainly due to WTO accession. Another factor decreasing imports was decreased "shopping" by Croatian citizens abroad. Shopping decreased by 1.0%, from USD 423.2m in 1999 to USD 419.1m in 2000.

Growth in tourism was the main cause of the increase in net service income. Tourist revenues have grown rapidly since 1996, with a small fall during 1999 due to the Kosovo crisis. Data on registered tourist night-stays suggest increased tourism activity. Tourist expenditures (expenditures by Croatian citizens on foreign travel) decreased by 24.4% in 2000. This fall was especially strong in the first and fourth quarters, when expenditures fell by about 35% compared to 1999. To some extent this can be explained by decreased expenditures on skiing vacations due to a mild winter. On the revenues side, the most important items among other services were construction and communications services, while on the expenditures side business services accounted for the largest share. The net effect was a continuation of the gradual fall in the deficit in other services.

The income account includes compensation paid by non-resident employers to domestic employees, as well as income from direct, portfolio and other investment. The increased deficit on this account was mainly caused by increased interest payments on external debt. External debt has been growing (for further discussion see the section on external debt). Also, we can expect that the income account deficit will increase substantially in the medium term due to income flows from direct and portfolio investment. The item net employee compensation grew 14.7% in 2000, resulting in a positive balance of USD 69.7m. This represented a continuation of the previous mild upward trend. Net income from direct investment was USD – 131.2m, a net outflow. We can say that income from direct investment has basically stagnated in the last three years. By contrast, the outflows based on portfolio investment income have been growing strongly since 1997, when Croatia received an investment grade credit rating and interest payments of Croatian government bonds to foreign investors began. The sharp decrease in the deficit on other investment from USD 211.1m to USD 69.9m is accounted for by increased income from foreign investments (reserves) of commercial banks during 2000. Banks increased their reserves as a way of decreasing risk after the banking crisis of 1998/99.

The current transfers account, which is traditionally in the black, showed a surplus of USD 758.9m in 2000. This was the result of increased pension payments in the government and private transfers account, as well as the decrease in the outflow of funds from Croatia under the heading of intergovernmental donations (especially donations to Bosnia and Herzegovina). It should be mentioned that the surplus on the current transfers account is expected to increase in the medium term because of expected increases in pension payments to Croatian citizens from foreign countries.

Capital and Financial Account

The capital and financial account registered net inflows of USD 337.9m in 2000. This was 77.2% less than in 1999, which reflects the decreased need for financing the current account deficit. The capital transactions account, including capital transfers, emigrant transfers and other items, has shown a surplus of about USD 20m each year.

The financial transactions account includes financial transactions classified according to the type of investment. In addition to the international reserves of the CNB, this account includes direct, portfolio and other investment. The structural changes seen in this account in 1999 continued in 2000. Above all, the reliance on direct and portfolio investment to finance the current account deficit increased, with a decrease in other investment (foreign borrowing).

Net direct investment fell by 42.7% in 2000, mainly due to the postponement of the privatization of Croatian Telecom. About 70% of the direct investment inflows, which amounted to USD 827.9m, derived from privatization of banks (Privredna banka Zagreb, Splitska and Riječka banka). 5% came from crude petroleum and gas extraction. At the same time, Croatian investment abroad fell by 30.8%, to USD 23.8m.

Portfolio investment grew by 27.6% in 2000. It also had grown rapidly in 1999, after a sharp fall in 1998 due to the financial crises in Asia and Russia. Portfolio investment includes equity investments amounting to less than 10% of a firm's capital, as well as foreign purchases of Croatian government securities. This explains the sensitivity of this kind of investment, as well as its tendency to disappear more rapidly than foreign direct investment. However, the majority of foreign portfolio investment in 2000 was investment in Eurobonds and Samurai Bonds of the Republic of Croatia. Some EUR 500m, or approximately USD 500m, of Eurobonds were sold in March at an interest rate of 7%. Some JPY 40bn, or USD 300m, of Samurai bonds were sold in July at an interest rate of 3%.

Other investment is a category that includes all those items not included in direct and portfolio investment, as well as changes in international reserves. On the asset side, Currency and deposits showed the strongest growth. Outflows on this basis grew by 246.4% compared to 1999. The reasons for this come from changing trends in the banking sector, as well as the continuation of practices in other sectors (but it should also be mentioned that there was a change in methodology here as well.) Commercial banks increased their foreign assets in 2000 by USD 849.3m. The fact that the banks kept such large reserves reflects their improved liquidity positions on the one hand, and their greater caution regarding lending to Croatian firms and households after the banking crisis of 1998/99 on the other hand. On the liabilities side of Other investment, which includes foreign borrowing in the form of loans, a decrease of 8.0% was registered in 2000. In other words, other sectors in Croatia increased their borrowing by USD 421.2m in 2000. As was mentioned earlier, thanks to increased foreign direct investment, foreign borrowing is no longer the main source of financing the current account deficit. There were changes in the structure of foreign borrowing in 2000. Usage of trade credit increased to USD 222.7m, from USD 36.8m in 1999. Use of loans decreased by 21.3%. This latter figure mainly includes bridging loans granted to government and long-term loans to other sectors.

External Debt

Table 1.4 External Debt by Debtor Sector, million current USD

Debtors' sector	1996	1997	1998	1999	2000	Index 2000/1999
Monetary sector	208.0	232.0	234.0	197.0	159.0	80.7
Government	2,433.0	2,906.0	3,333.0	3,973.0	4,749.0	119.5
of which: London Club	1,462.0	1,428.0	1,405.0	1,381.0	1,255.0	90.9
Banks	1,570.0	2,216.0	2,290.0	1,955.0	1,562.0	79.9
of which: Currency and deposits	499.0	790.0	615.0	538.0	433.0	80.5
Other sectors (enterprises)	1,096.0	2,098.0	3,494.0	3,208.0	3,313.0	103.3
Direct investment	0.0	0.0	238.0	540.0	1,015.0	188.0
Total	5,308.0	7,452.0	9,588.0	9,872.0	10,798.0	109.4

At the end of 2000, the total external debt of the Republic of Croatia amounted to USD 10.8bn (Table 1.3). This was mainly the result of current account deficits from 1995 onward, as well as better access to global capital markets since 1997.

This figure includes about USD 5bn of debt inherited from the former Yugoslavia. The other USD 5.8bn have been incurred since 1996, after Croatia reached agreement with the Paris and London Clubs about its allocation of the obligations stemming from the former Yugoslavia.

Until 1996, the main debtor was the banking sector. After 1996, because of the government's assumption of some of the Paris Club obligations and all of the London Club obligations, as well as expansive fiscal policy, the government's share of the debt rose to nearly 50%. The shares of enterprises and households also increased.

The rapid growth of borrowing in 1997 was stopped in 1998. Very important in this change was the virtual ending of banks' short-term borrowing, thanks to restrictive measures taken by the CNB. In addition, the negative effects of the Asian and Russian crises on Croatia's ability to place its government bonds and the moratorium on lending to Croatian banks put in place by foreign banks because of the banking crisis (especially German banks because of Glumina banka) decreased borrowing.

Because of fiscal expansion, the increase in borrowing continued in 1999 and 2000. In 2000, the total external debt grew by 9%. The structure of total borrowing changed, with government increasing its share due to the sale of EUR 500m of Eurobonds, JPY 40bn (about USD 300m) in Samurai bonds and the acceptance of a short-term bridging loan of USD 360m. The bridging loan is intended to be repaid with revenues from the second phase of the privatization of Croatian Telecom. Other sectors (banks, monetary sector) decreased their foreign borrowing or kept them at the same level as the previous year.

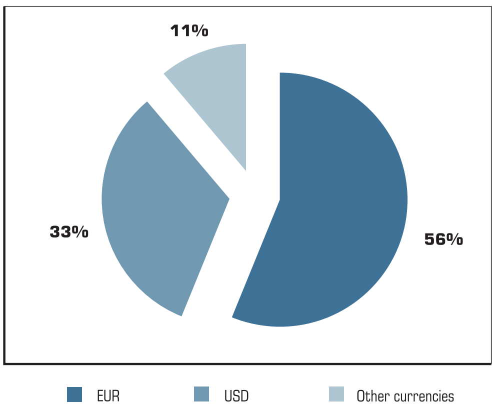
The new methodology of compiling the external debt recommended by the IMF, which includes foreign currency and deposits of non-residents, as well as revisions in the data base on foreign credit relations and the inclusion of valuation changes arising due to exchange rate changes and other changes provides a more accurate figure for the external debt. The debt at the end of 1998 is now calculated to have been USD 9.6bn. This methodology continues to be applied, so that data for 1999 and 2000 are comparable with that from 1998, but data from previous years is not completely comparable.

In the medium term, improvements in the current account deficit should lead to a decrease in the foreign imbalances created by fiscal imbalances. The result of this would be that the external debt would stop growing.

In addition to all of this, the strengthening of the US dollar against the euro and other currencies has had a strong effect on the external debt figures. Since 56% of the Republic of Croatia's debt is in euros, and only 33% in US dollars, with 11% in other currencies, weakening of the euro against the dollar decreased the total external debt by about USD 478m in 2000. That is, the debt would be that much larger if it had been totally denominated in US dollars. In the past year, the issue of USD 500m of Eurobonds has further improved the currency structure of the external debt, with the euro share rising from 54% to 56%, the dollar share falling from 37% to 33%, and the share of other currencies rising from 9% to 11%. This change in structure brings the currency structure of the external debt closer to the currency structure of foreign trade, which is approximately 70% to 75% in euro.

Figure 1.36

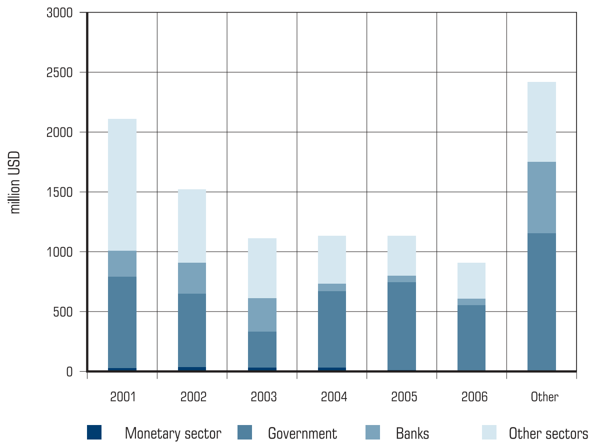
Currency Structure of External Debt in 2000



Total repayments of external debt in 2000 exceeded USD 2bn. According to projections for 2001, about USD 2.1bn will be repaid this year, of which about 500 million is for short-term loans. In 2002, repayments would fall to USD 1.5bn, and in the ensuing years until 2006, repayments would be in the vicinity of USD 1bn per year. On the assumption that no further borrowing will be undertaken, these repayments could be financed by foreign direct investment inflows, or further restructuring of the current account, in particular merchandise trade. Such changes are especially important in light of the expected "drying up" of privatization revenues after 2002.

Figure 1.37

Projected Future Payments of External Debt



One of the main debt indicators, the ratio of total repayments to exports of goods and services, increased from about 20% in 1998 to almost 30% in 1999, but then returned to 20% in 2000.

Merchandise Trade

Merchandise trade data compiled by the Central Bureau of Statistics differ from the import and export components of the balance of payments. The latter figures are shown on an f.o.b. (free on board) basis. That is, prices of goods include production costs and expenditures associated with the transportation and insurance of the goods up to the border of the exporting country. Furthermore, balance of payments data include further estimations of the amount of imports created by residents' purchases ("shopping") abroad. This represents a further refinement of the methodology of the balance of payments.

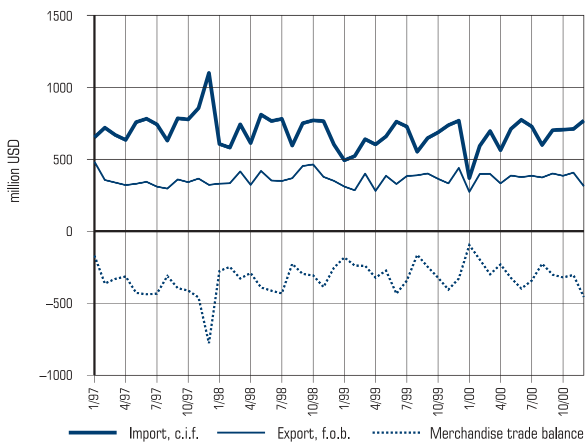
Starting on January 1, 2000, a new unified tariff declaration was introduced. The method of compiling merchandise trade data was adjusted accordingly. Monthly data on merchandise trade include all declarations that show that they were processed by the customs services during that month. Previously, monthly merchandise trade data covered declarations that were received during that month, whether or not the declarations were processed and tariffs were calculated and imposed during that month. Because of these changes, only data from 1999 and 2000 are fully comparable.

In general, we can say that the trend of exports in US dollars has stagnated, while the trend of imports began to rise at the end of 2000 as a result of changes in the value of the dollar. The picture looks different if we compare export and import data in kuna. In this case, both imports and exports show mild trend growth, with the growth of exports actually a little stronger. If we compare trends in the merchandise trade deficit in dollars and kuna, we notice a typical business cycle with a peak deficit at the end of 1997, a large decrease in the deficit in 1998 and 1999, and a new increase in the deficit during 2000. Total merchandise trade grew by 2.1% to USD 12,355m in 2000. This included exports f.o.b. of USD 4,431.7m and imports c.i.f. of USD 7,922.7m. These developments resulted in a deficit of USD 3,491.0m, a decrease of 0.15%. The coverage of imports by exports increased from 55.2% in 1999 to 55.9% in 2000.

It is expected that Croatia's full accession to the WTO, the unilateral lifting of EU restrictions on Croatian exports within the Stability Pact and the signing of free trade agreements in 2001 with Hungary and the EFTA countries will give a boost to the further improvement of Croatia's merchandise trade balance.

Figure 1.38

The Republic of Croatia's Merchandise Trade



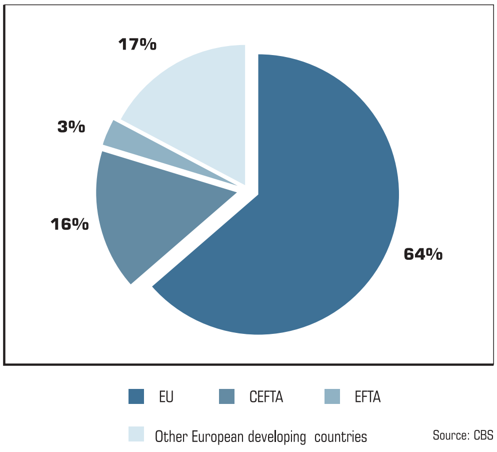
Source: CBS

85% of Croatia's total merchandise trade was with European countries, 6% with Asia, 4% with Africa, and the other 5% was distributed between North, Central and South America and Oceania.

Croatia's main trade partners in Europe are members of the EU. These countries take 65% of Croatia's exports (USD 6,821m). Next are CEFTA members with 17%, other European developing countries (above all Bosnia and Herzegovina and Russia) with 16% and EFTA

Figure 1.39

The Share of European Partners in Merchandise Trade with Croatia in 2000



Source: CBS

members with 2%. The trend to increase the share of exports going to EU members has continued, with the share rising from 48% in 1998 to about 54% in 2000. Imports from the EU were roughly twice as large as exports in 2000, amounting to USD 4,405.2m. The trend of imports from the EU is falling, and the share of the EU in Croatian imports has decreased from 59% in 1996 to 55% in 2000. Croatia's merchandise trade deficit with the EU decreased by 13.7% in 2000, ending up at USD 1,989m, while Croatia's deficit with CEFTA members increased by another 12.2%.

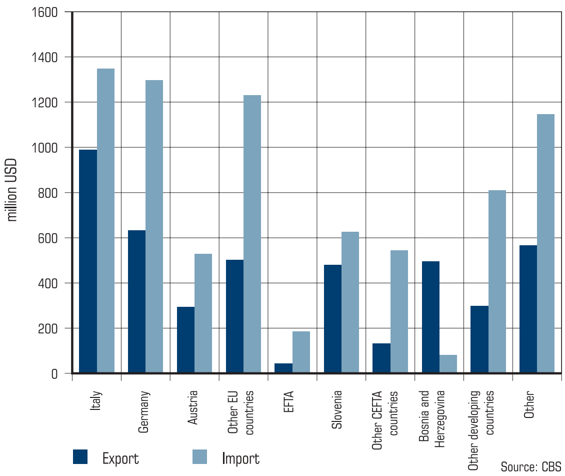
Croatia's exports are more concentrated among a smaller number of trading partners than its imports.

The six main markets to which Croatia exports more than USD 100m account for 68% of total Croatian exports. The Italian market was the largest in 2000, taking USD 989m, an increase of 27.7% compared to 1999. Next was Germany, with USD 632m, a decrease of 6.5%. Slovenia and Bosnia and Herzegovina took USD 480m and USD 495m respectively, representing an increase of 5.7% and a decrease of 9.3% respectively. The Austrian market accounted for USD 293m of exports, and the French market USD 126m.

On the import side, the six largest sources account for 62% of total imports. The leading exporters are also the leading importers. Italy provided Croatia with USD 1,348m of imports in 2000, an increase of 8.7%, while Germany provided USD 1,297m, a decrease of 10.0%. The high value of mineral fuels and lubricants placed Russia among the leading exports to Croatia in 2000, with a total of USD 671m, the same as in 1999. Imports from Slovenia grew 1.7% to USD 627m, and imports from France grew 11.2% to USD 436m. Imports from Austria fell by 5.2% to USD 529m.

Figure 1.40

Structure of the Republic of Croatia's Merchandise Trade by Country



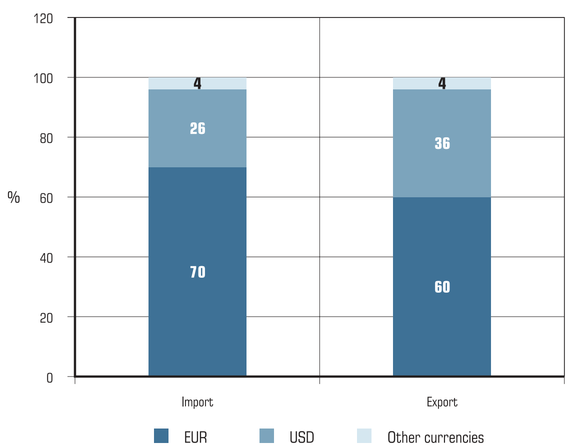
Source: CBS

During 2000, merchandise trade took place in a context of depreciation of the kuna relative to the US dollar by 16.3%, alongside a slight depreciation of the kuna against the euro of 0.72%. The real effective exchange rate of the kuna depreciated by 1.98% in 2000 compared to 1999. It should be noted that the depreciation of the kuna did not have an equal effect on exports and imports in light of the currency structure of merchandise trade. The currency structure of merchandise trade was dominated by the currencies of EMU member countries such as the Austrian schilling and German mark. Exports paid for in currencies of EU member states accounted for 60% of the total, while exports in dollars accounted for 36%. This implies an increase in the dollar component of 3 percentage points. 70% of imports were paid for in currencies of EU member states, while only 26% of imports were paid for in dollars. On both the export and import sides, other currencies accounted for 4%. Since the euro accounts for 60% of exports and 70% of imports, and the dollar appreciated against the euro by about 13% during the year, we can say that the dollar value underestimates the physical value of merchandise trade. The difference in the share of merchandise trade with EU countries classified by country of origin and the share of merchandise trade classified by currency of payment can be explained by the fact that international transactions with countries of Central and Eastern Europe are made in European currencies.

When looking at exports by the National Classification of Economic Activities, manufacturing industry accounted for 96% of total exports in 2000. Within this, other transport equipment, which includes shipbuilding, was the largest branch, exporting USD 640m, 11.2% less than in the previous year. Exports of chemicals and chemical products grew by 8.6% to USD 535m, while exports of the coal, oil products and nuclear fuels benefited the most from the appreciation of the dollar. Exports of these goods grew by 39.1%, to USD 454m. Exports of clothes decreased by 13.8% to USD 394m. Exports of food and beverages decreased by 20.7% to USD 264m. Turning to imports, 12.3% of imports are accounted for by crude petroleum and natural gas extraction. Imports in this sector accounted for USD 971m in 2000. The largest importer among manufacturing industry was chemicals and chemical products, whose imports rose by 6.8% to USD 964m, along with food and beverages, which remained just about at its 1999 level of USD 474m.

Figure 1.41

Currency Structure of Exports and Imports in 2000



According to the Standard International Trade Classification, Croatia had a surplus (greater exports than imports) during 2000 only in the beverages and tobacco industries. The surplus was USD 42m. In other sectors, imports exceeded exports. The greatest deficit was in the machine and transport equipment sector, which stood at USD 1,411m. Of this, a third relates to imports of road vehicles, which rose by 5.1%, and 12% to general use industrial equipment, which decreased by 18.2%. Products classified by materials had a deficit of USD 721m. The largest imports were of yarn, cloth and textile products, which had net imports of USD 249m, a growth of 55.5%. Next were imports of iron and steal, which had net imports of USD 244m, a growth of 15.4%. Mineral fuels and lubricants had a deficit of USD 658m, and the chemical products sector had a deficit of USD 451m.

Foreign Direct Investment

Foreign direct investment amounted to about USD 870m in 2000, while ownership investment (direct investment from which retained earnings and other investment have been excluded) amounted to about USD 600m. Foreign direct investment decreased by 40% in 2000. As was mentioned above, 71.7% of equity capital direct investment went to financial intermediation, 5.4% to extraction of crude petroleum and natural

Table 1.5 Foreign Direct Investment in the Republic of Croatia by Country of Origin, million USD and %

	1993	1994	1995	1996	1997	1998	1999	2000	Total	Share
Total	120.3	117.4	114.2	511.1	536.8	932.9	1,479.3	869.7	4,680.5	100.0
United States	4.9	3.0	–15.5	292.7	87.4	503.9	142.2	99.0	1,117.5	23.9
Germany	53.4	8.4	21.8	2.6	–67.2	62.5	948.6	67.7	1,097.7	23.5
Austria	5.0	47.9	6.8	57.0	275.9	212.1	173.9	141.8	920.6	19.7
Luxembourg	3.8	0.0	0.0	0.3	16.0	4.0	–10.7	305.6	319.0	6.8
Netherlands	4.8	3.5	4.5	9.9	11.9	–1.1	19.1	40.5	93.1	2.0
Italy	12.0	3.5	4.3	9.9	11.1	–1.1	19.1	64.7	123.5	2.6
Sweden	0.5	0.0	37.3	7.8	8.9	24.8	17.0	22.0	118.4	2.5
Switzerland	10.1	18.8	13.7	22.7	–15.0	8.0	5.5	39.2	102.9	2.2
United Kingdom	0.7	0.7	0.3	0.2	54.5	3.6	20.5	22.3	102.8	2.2
EBRD	0.0	0.0	0.0	43.1	41.6	–39.4	31.0	22.7	99.0	2.1
Slovenia	4.5	0.3	3.5	2.9	10.3	32.1	17.6	22.6	93.7	2.0
Other countries	20.7	31.5	37.4	61.9	101.4	123.4	95.7	20.2	492.3	10.5

gas, 3.3% to cement production and 20% to other sectors. European Union countries invested the largest amount in 2000, 77.0% of the total, followed by other developed countries with 16.1%, other European developing countries with 3.4%, international financial institutions with 2.6% and other developing countries with 1.0%. Significant increases in foreign direct investment are expected from the completion of telecoms privatization (the second round of the privatization of Croatian Telecom) and the privatization of shipyards and hotels.

Between 1993 and 2000, Croatia received USD 4,680m of investment. Of this, 80% was equity investment in shares, 5% was retained earnings and 15% other investment. 23.7% of the total was invested in telecommunications (the first round of privatization of Croatian Telecom and the founding of VIP), 20.9% was invested in other financial in-

Table 1.6 Cumulative Ownership Investment in the Republic of Croatia by Activities in the Period from 1993 to 2000, million USD and %, preliminary data

Activity	Amount	Share
Total ownership investment	3,740	100.0
Telecommunications	886	23.7
Other financial intermediation	781	20.9
Pharmaceuticals	734	19.6
Extraction of crude petroleum and natural gas	131	3.5
Cement	119	3.2
Other wholesale trade	72	1.9
Bricks and roof tiles	70	1.9
Industrial gas	49	1.3
Beer	47	1.3
Mineral water and soft drinks	46	1.2
Other	803	21.5

termediation, 19.6% in the production of pharmaceutical products, 3.5% in crude petroleum and natural gas extraction, 3.2% in the production of cement and other 29.1% in other sectors.

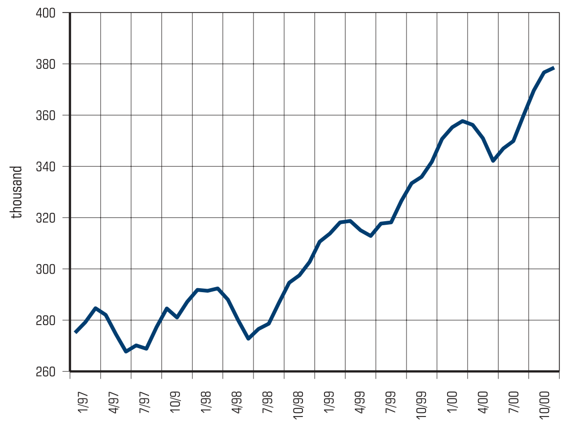
Croatian foreign investment during 1993 to 2000 amounted to USD 397.6m. It should be mentioned that such investment has been steadily falling since 1997. The most important recipient has been Poland with 40%, followed by Bosnia and Herzegovina with 29% and Slovenia with 9%.

1.2.6 Labor Market

The recovery of economic activity during 2000 brought about several positive developments in the labor market. These developments include more employment of people previously on the unemployment register, and signs of decreases in the number of people formally working but actually not receiving pay. However, because of the many problems built up in certain companies and the beginning of badly needed restructuring processes, registered unemployment continued to trend upward during the year. The latest labor force survey data on the active population in the first half of 2000 confirm that unemployment increased in this period, but much less than the figures of the Croatian Employment Institute suggest.

Figure 1.42

Registered Unemployment

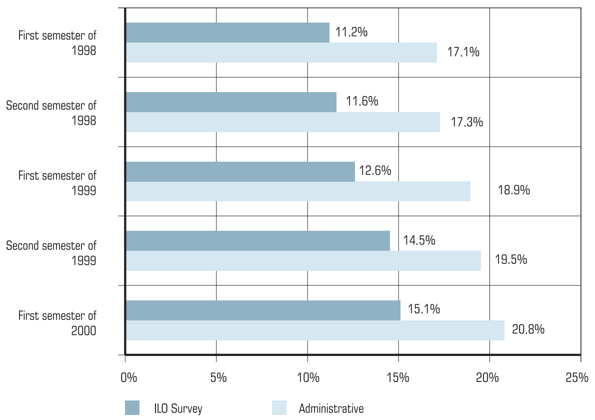


Total inflows into the CEI's rolls during 2000 amounted to 262 thousand, 5.2% more than in 1999. Almost all of the increase in inflows to registered unemployment were generated by registration of previously employed workers. 191,000 previously employed workers registered as unemployed in 2000, 6.8% more than in the previous year. 118,000 people who had been registered as unemployed received jobs and were removed from the rolls during the year. This was an 11.7% increase over 1999, when the CEI advertised 148,000 open job positions. This means that more than a fifth of the total job vacancies were not realized through the CEI. 107,000 people were removed from the register for other reasons, most frequently for failure to report to the CEI in the required time. This often occurs when people are employed in either the formal or informal sectors of the economy. Removals were up 2.6% compared to 1999. Total removals from the register, including removals due to employment and other reasons, increased by 7.2%. This slowed the growth of registered unemployment, which amounted to a little less than 37,000 or 10.8%.

According to the final figures of the CBS, 1,321 thousand people were employed at the end of 2000, a decrease of 12 thousand or 0.9%. Given that total employment decreased by 33 thousand in 1999, it is evident that the economic recovery that began at the end of 1999 is affecting employment. Some 78% of employees worked in legal entities at the end of 2000. Employment in crafts and free professions amounted to 207 thousand, 16% of the total, while active farmers, according to the employment data, amounted to 79 thousand or 6% of total employment. Employment in legal entities fell by 8 thousand or 0.8%, but this was almost completely offset by increased employment in crafts, which grew by 4%. The largest decrease, in both absolute (11 thousand) and relative terms (12.5%), was in agriculture. Since the CBS takes the data on agricultural employment from the Croatian Pension Insurance Institute, the statistical decrease in agricultural employment is most likely the result of the decrease in the number of farmers who paid pension contributions. Those who did not pay contributions were removed from the Insurance Institute's register.

Figure 1.43

Administrative and ILO Survey Unemployment Rate



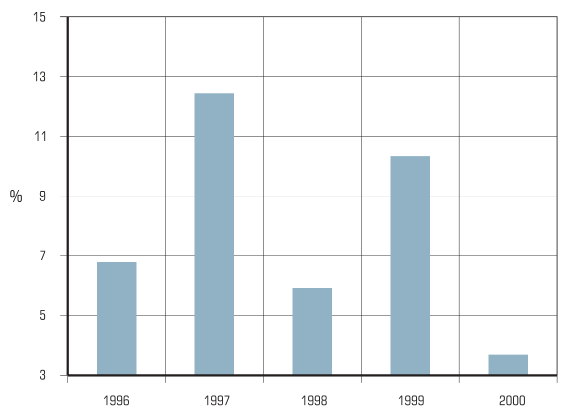
Since the growth of registered unemployment exceeded the decrease in employment, the labor force increased by 25 thousand or 1.5% in 2000. If we take into account the fact that the majority of farmers who were removed from the employment statistics probably did not in fact stop practicing their professions, the increase in the labor force would be even larger in 2000. These flows of total employment and registered unemployment determined the rate of registered unemployment, which reached 22.3% at the end of the year, 1.9 percentage points higher than in 1999.

The most recent labor force survey was carried out in the first half of 2000. It confirms the tendency for unemployment to increase during the period. Because of differences in coverage, it is not possible to directly compare the levels found in the survey and administrative aggregates. But examination of certain ratios provides some insight into dynamics. The rate of activity was 50.4% in the first half of 2000, 1.4 percentage points less than in the same period in 1999, and 1.5 percentage points less than in the second half of 1999.

Decreased activity levels, when measured according to internationally comparable criteria, was mainly caused by decreased rates of employment. The unemployment rate was 15.2% in the latest survey, 1.6 percentage points higher than in the previous survey from the second half of 1999 and 2.5 percentage points higher than in the survey from the first half of 1999. Of 273 thousand unemployed in the latest survey, 216 thousand were registered at the Croatian Employment Institute, while 57 thousand were not registered. The survey also showed that 136 thousand people who were registered as unemployed by the CEI are not considered unemployed by the survey methodology. These people account for 38.6% of registered unemployed during the period. Some 80 thousand of these people are considered inactive, since they have not been actively seeking work or were unwilling to ac-

Figure 1.44

Rate of Change of Average Real Net Wages

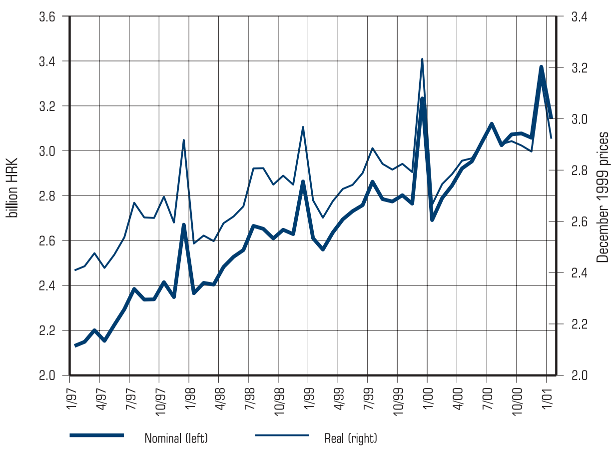


cept jobs offered to them, while the other 56 thousand are considered employed since they stated that they are working.

Wage increases decreased during 2000, while GDP grew. Pay has been more under the influence of collective bargaining and the political cycle than real economic trends. Average net wages in 2000, according to CBS statistics, amounted to 3,305 kuna, 9.1 more than in 1999. Real net wage growth, after correction for increases in the cost of living, amounted to 3.5%, roughly equal to the real growth of GDP. Increases in average gross wages were lower than increases in net wages, because of the decrease in the cost of labor caused by the decrease in required payroll contributions. Gross wages grew 7.7% in nominal terms and 2.2% in real terms. The moderation in wage growth is even more visible if we compare the end of 2000 to the end of 1999, when the effects of the large increase in public sector wages just before the January 2000 elections and the large decrease after the election becomes clear. Average net wages in December 2000 were 8.4% higher in nominal terms and only 1.3% higher in real terms than in December 1999. In the same period, net wages in the government sector decreased by 0.9%, while wages in the health services grew by 3.9%. Only in the education sector did wages rise faster than the average, at a rate of 9.3%. These data clearly show that the Government's wage policy in government services and in government companies managed to reverse the fast wage growth of previous years, even if it was not always well received by the public.

Figure 1.45

Wage Bill Paid through the IPT



The net wage bill paid via the Institute for Payment Transactions was 8.3% greater in nominal terms and 2.7% greater in real terms than in 1999. Part of this growth came about due to the 0.4% increase in the number of people who were paid via the Institute for Payment Transactions. The increase in the number of people receiving pay via the Institute for Payment Transactions confirms the thesis that the decrease in employment shown by the CBS data is actually a result of a decrease in the number of people counted as employed, but who had not been paid for a long time. The enterprises involved also had not fulfilled their other financial obligations either.

Changes in unit labor costs in industry suggest decreasing wage pressure. Unit labor costs fell by 7.4% in nominal terms and 4.7% in real terms in 2000. The main causes of this fall were the real decrease in the wage bill in industry and the rapid rise in producer prices.

Employment of the previously registered unemployed, although increasing in 2000, was still less than inflows to registered unemployment. This resulted in an increase in registered unemployment. Also, the majority of the newly employed were employed for a limited period, which suggests the existence of dualism or segmentation on the labor market. The differences in status between these two categories of employees turns our attention to the fact that employers must take into consideration the difficulties they would eventually have in decreasing employment in a future business downturn before hiring workers on a permanent basis. In this way, rigid labor laws, which are designed to protect workers and their jobs, in fact result in less new employment and in the emergence of differences between permanent workers and workers hired for limited periods. The latter group forms a buffer for adjustment of employment in the future.

1.2.7 Government Finance

The year 2000 represented a turning-point in fiscal policy. The tax burden on the economy was decreased, government expenditure was cut in real terms, and the outstanding unpaid obligations from previous years were settled.

Changes in the tax system were undertaken in two phases. In the first phase, in the beginning of April 2000, the previously announced tax decrease was implemented through increasing the basic tax exemption from 1,000 kuna to 1,250 kuna. To partially offset the effects of this measure on government revenues, minimum wages were raised from 1,500 to 1,700 kuna, and wages of those paid by the state budget were decreased by 5%. In the second phase, in May and June 2000, changes were undertaken to lower the gross costs of labor and increase enterprise liquidity. The rate of payroll contributions to the pension fund (CPII) and health fund (CIHI) were decreased by 2 percentage points, and the period for paying VAT was increased by 20 days, from the 10th of the month to the last day in the month). In this case, it was necessary to implement compensating measures on the revenue side. Excise taxes on oil products, alcoholic beverages, beer, tobacco processing, automobiles and coffee were increased. On average, the increase in excises on gasoline and tobacco products, two products that account for 90% of excise revenues, were increased by 55% and 8% respectively, unweighted.

In November 2000 a rebalance of the central government budget was passed. The rebalance proved necessary because of changes in the tax system, the postponement of the privatization of Croatian Telecom and changes in the Law on Child Benefits. The most important element in the shortfall in total revenues, which amounted to HRK 3.0bn or about 6.5%, related to shortfalls in capital revenues of about HRK 5bn, a 60% decrease. This decrease in capital revenues was partially made up for by HRK 1.8bn or 4.8% greater tax revenue than planned, and the increase in excises. The excise increase came into effect in June 2000. The planned increase in total expenditures amounted to about HRK 2.3bn or 4.7% and was mainly due to increased current expenditures and increased borrowing net of repayments. The rebalance resulted in a planned total deficit of HRK 6.6bn or 4.1% of GDP.

In fact, the actual budget deficit of the central government was HRK 6.1bn or 3.8% of GDP in 2000, 0.3 percentage points less than planned. The current deficit amounted to HRK 2.7bn and was HRK 0.9bn less than planned. Revenues were HRK 44.6bn, 1.4% greater than planned. Revenues rose because of increased tax revenues of 2.6%. Total expenditures amounted to HRK 49.6bn, and were 0.7% less than planned because of savings of 8% on capital expenditures.

Realized revenues of HRK 44.6bn were 3.7% lower than in 1999, when they had been HRK 46.4bn. The decrease in total revenues can be completely attributed to decreased capital revenues, since current revenues rose by HRK 1.5bn or 3.7% in 2000. That is, in 1999 the first round of the privatization of Croatian Telecom was carried out. In 2000, the planned second round was postponed, but Privredna banka Zagreb (two thirds of the shares of PBZ were sold to an Italian strategic investor for EUR 300m) was privatized in the first quarter, and Splitska and Riječka banka were privatized in the second and third quarters of 2000. The growth in current revenues was the result of a 4.2% increase in tax revenues and a 7.5% increase in non-tax revenues.

Table 1.7 Government Budget and Extrabudgetary Funds Outturn (unconsolidated), million HRK

	1997	1998	1999	2000	Index 2000/1999
Government budget					
Total revenues and grants	33,846	43,809	46,357	44,636	96
Total revenues	33,846	43,809	46,357	44,636	96
Current revenues	33,385	42,019	40,046	41,535	104
Tax revenues	31,775	40,327	38,318	39,939	104
Non-tax revenues	1,609	1,692	1,728	1,596	92
Capital revenues	461	1,789	6,311	3,101	49
Grants	–	–	–	–	–
Total expenditures and net lending	35,006	42,552	48,879	50,744	104
Total expenditures	34,395	41,473	47,380	49,567	105
Current expenditures	29,580	34,883	38,476	44,237	115
Capital expenditures	4,815	6,590	8,904	5,330	60
Lending minus repayments	611	1,079	1,499	1,176	78
Current deficit/surplus	3,805	7,136	1,570	–2,702	–172
Overall deficit/surplus	–1,160	1,257	–2,522	–6,108	242
Financing abroad	2,986	–9	4,615	6,921	150
Domestic financing	–1,826	–1,248	–2,093	–814	39
Extrabudgetary funds					
Total revenues and grants	27,677	31,011	34,995	36,986	106
Total expenditures and net lending	28,145	31,398	35,313	38,602	109
Overall deficit/surplus	–467	–387	–319	–1,617	507
Total revenues and grants	61,523	74,820	81,351	81,621	100
Total expenditures and net lending	63,151	73,950	84,192	89,346	106
Overall deficit/surplus	–1,628	870	–2,841	–7,724	272

Source: Ministry of Finance

VAT revenues were HRK 21.8bn, 10.1% more than last year, while revenues from excises grew by 26.0%. Revenues from other taxes, except for property taxes, which increased by 4.7%, fell mildly. Income taxes fell 10.4%, in part because of the increase in the basic exemption, and also because of the new system of distribution of the income tax, in which the share of local government and administration was increased. Revenues from taxes on international trade fell by 12.2%. Croatia's entry to the WTO and the implementation of free trade agreements contributed to a decrease in customs revenue of 11.5%. In addition, the value of automobile imports fell, as did the value of taxes on automobiles, which fell 32.3%. Revenues from profit tax fell by 29.3%, since enterprises' financial results were generally poorer in 1999 than in previous years. Also, payments of estimated tax fell in 2000. It should, however, be mentioned that certain tax revenues, such as VAT and excises, are not completely comparable with revenues from previous years since some of these revenues were realized through compensation arrangements. In particular, revenues from VAT and excises are actually lower than

Table 1.8 Consolidated Central Government, million HRK

	1997	1998	1999	2000	Index 2000/1999
Total revenues and grants	53,345	65,111	67,542	66,735	99
Government budget	33,846	43,809	46,357	44,636	96
Extrabudgetary funds	19,499	21,302	21,186	22,099	104
Total expenditures and lending minus repayments	54,932	64,229	70,343	74,432	106
Government budget	29,409	34,125	35,979	36,731	102
Extrabudgetary funds	25,522	30,103	34,364	37,701	110
Overall deficit/surplus	–1,587	882	–2,801	–7,697	275

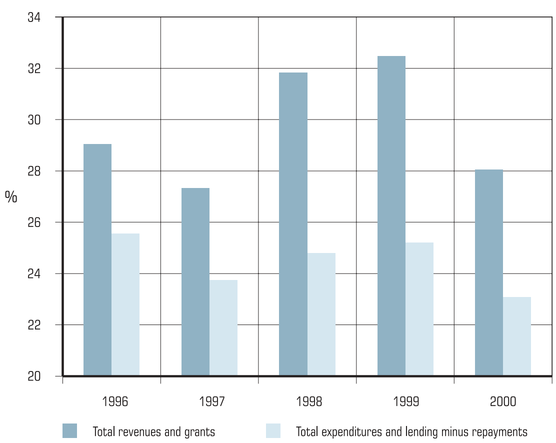
Source: Ministry of Finance

shown here because, due to the non-transparent manner of recording compensation, it is not possible to distinguish between revenues raised in cash and revenues raised through compensation.

Budgetary expenditures were HRK 49.6bn in 2000, a 3.8% increase. Despite increased expenditures, the share of government consumption in GDP decreased from 34.3% in 1999 to 31.9% in 2000. Current expenditures increased their share in total budgetary expenditures by 15% or HRK 5.8bn. This resulted from a 15.0% or HRK 2.2bn increase in purchases of goods and services, a 23.8% or HRK 0.5bn increase in interest payments, and a 21.2% or HRK 3.0bn in subsidies and other current transfers. The 15% increase in current expenditures in 2000 should be considered taking into account the fact that data on current and capital expenditures in 1999 and 2000 are not comparable since, in 1999, capital expenditures included HRK 2.1bn of capital transfers to extrabudgetary funds. In this sense, current expenditures in 1999 are underestimated, and capital expenditures overestimated by HRK 2.1bn. If a correction were made for analytical purposes, current revenues would not grow by HRK 5.8bn, but only by HRK 3.7bn in 2000. At the same time, the fall in capital expenditures would not be HRK 3.6bn (40%), but only HRK 1.5bn. If data on the repayment of unpaid outstanding obligations from before 2000 were included (HRK 4.1bn were rapid, some within current revenues and some within capital revenues), the picture of expansion of expenditures would be much less dramatic, and it would be possible to discover the actual situation, a real decrease in expenditures.

Figure 1.46

Revenues and Expenditures of the Government Budget (consolidated, share of GDP)



The central government budget deficit was completely financed by foreign funding. In 2000, the central government borrowed HRK 6.9bn in foreign markets, and at the same time repaid HRK 0.8bn of domestic debt. The external debt was incurred through the issuing of HRK 6.6bn of long-term securities, short-term borrowing of HRK 3.4bn and net repayments of long-term foreign loans of HRK 3.1bn. On the domestic market, the government issued a net value of HRK 1.6bn of short-term securities and bonds, and incurred HRK 0.3bn of short-term debt with commercial banks net. At the same time, the government repaid long-term loans and bonds worth HRK 2.7bn to domestic agents.

The deficit of consolidated government was HRK 7.7bn in 2000. This was a result of a surplus of the government budget of HRK 7.9bn and an aggregate deficit of the extrabudgetary funds of HRK 15.6bn. The deficit of the extrabudgetary funds increased by 18.2%, confirming that the state of the funds continues to worsen. The main generators of the deficit were the CPII (HRK 8.9bn), the CIHI (HRK 5.0bn) and the Child Benefit Fund (HRK 1.2bn). The size of the aggregate deficit of the extrabudgetary funds is a serious obstacle to any further decreases in the tax burden. The establishment of the single government treasury at the beginning of 2001 and the inclusion of all levels of government in the treasury, along with the implementation of pension and health care reform, are necessary steps in establishing control of expenditures and overcoming the deficit in the extrabudgetary funds. The measures set out in the stand-by arrangement should also be helpful in this regard. Overall structural measures in the fiscal sector include the functioning of the government treasury and the unified account of central government, reform of health care, measures related to pension reform, preparation and implementation of a regulatory framework for public enterprises, the privatization of public enterprises and enterprises owned by the Croatian Fund for Privatization and measures to restructure other public monopolies.

The total domestic public debt of central government was HRK 18.5bn at the end of 2000, an 11.6% increase. The share of medium-term and long-term debt decreased from 95.1% to 86.1%, while the share of short-term debt of central government relating to issues of Ministry of Finance T-bills increased from 4.9% at the end of 1999 to 13.9% at the end of 2000. This increase in share was the result of a 283% increase in the stock of T-bills in 2000. The amount of T-bills outstanding grew from HRK 0.8bn in 1999 to HRK 2.6bn in 2000.

Figure 1.47

Extrabudgetary Funds Revenues and Expenditures (consolidated, share of GDP)

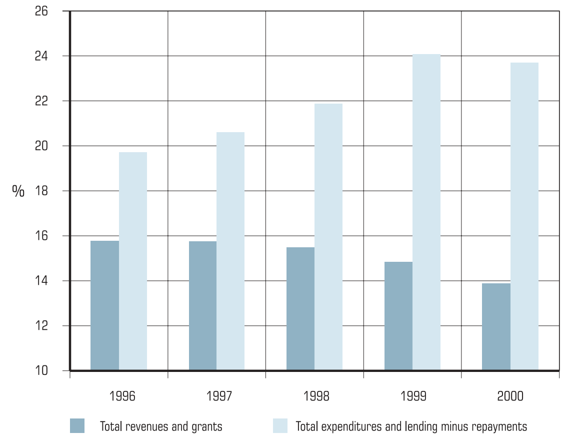
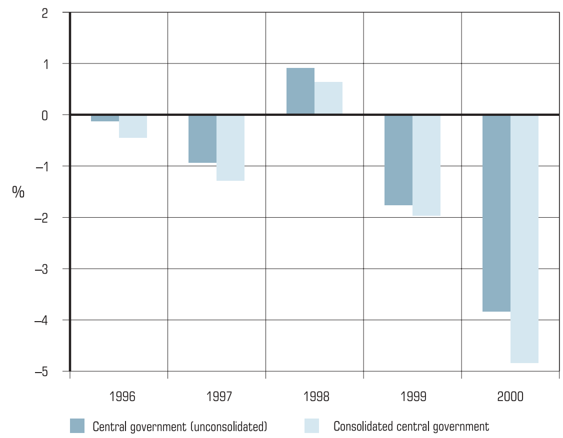


Figure 1.48

Overall Deficit/Surplus (share of GDP)



2

Monetary Policy

2.1 Monetary and Credit Aggregates

2000 was a year of recovery in real economic activity, along with a corresponding accelerated growth in monetary and lending flows. The growth in monetary and credit aggregates was due to real GDP growth, exchange rate stability, fiscal balancing and consolidation of the banking system.

2.1.1 Total Liquid Assets

All components of total liquid assets grew in 2000. The recovery of the money supply during the first half of 2000 is particularly pronounced when compared to the same period in 1999, when this monetary aggregate plummeted owing to banking system problems, the depreciation of the kuna and a general recessionary environment.

Table 2.1. Monetary and Credit Aggregates

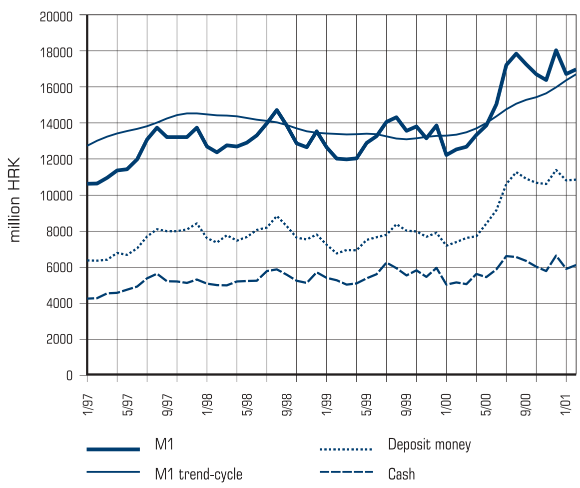
	RESERVE MONEY (M0)	TOTAL LIQUID ASSETS						NET DOMESTIC ASSETS (NDA)	NET FOREIGN ASSETS (NFA)
		Money supply (M1)			Savings and time deposits	Foreign currency deposits	Total (M4)		
		Currency in circulation (C)	Deposit money (D)	Total (M1)					
in billion HRK									
December 31, 1998	10.0	5.7	7.8	13.5	5.8	38.0	57.3	44.6	12.7
December 31, 1999	10.3	6.0	7.9	13.9	5.9	37.0	56.7	40.0	16.7
December 31, 2000	11.7	6.6	11.4	18.0	8.4	46.9	73.3	44.0	29.3
Growth rate Dec.-to-Dec.									
1998	–3.8	7.7	–7.3	–1.5	6.1	21.4	13.0	31.9	–24.8
1999	3.6	4.2	1.1	2.4	0.6	–2.6	–1.1	–10.4	31.3
2000	13.6	11.4	44.7	30.1	42.8	26.9	29.3	10.1	75.4
Monthly average									
1998	–0.3	0.6	–0.6	–0.1	0.5	1.6	1.0	2.3	–2.4
1999	0.3	0.3	0.1	0.2	0.1	–0.2	–0.1	–0.9	2.3
2000	1.1	0.9	3.1	2.2	3.0	2.0	2.2	0.8	4.8

Money Supply

In the first six months of 2000, the money supply grew by HRK 1.2bn (8.5%), while it had decreased by HRK 0.5bn (3.4%) in the same period in 1999. In the second half of 2000, the money supply continued its strong upward trend, which resulted in an annual growth of HRK 4.7bn or 30.1%. At end-2000, the money supply stood at HRK 18.0bn. The money supply fell considerably at the beginning of 2000, reflecting an unstable environment during the change of government. The new government had left much room for speculation on monetary policy by its initial contradictory statements regarding future policy. Households reacted as expected, and within a month the money supply declined by HRK 1.6bn or 12%. This decrease in the money supply and kuna deposits was accompanied by an almost equal increase in foreign currency deposits, giving a clear signal to the government that households and enterprises preferred a stable kuna exchange rate. Shortly afterwards, the government committed itself to maintaining a stable exchange rate, and the kuna began its return to the banking system. Between February and June 2000, not only was the January decrease offset but there was a significant growth in the money supply. This increase also resulted from a decrease in the reserve requirement rate on kuna deposits, which was lowered from 30.5% to 28.5% in April. It was further lowered in December, when the reserve requirement rate on kuna and foreign currency deposits was lowered to 23.5%, with a unification of the calculation base and maintenance period. The increase in demand for money by the private sector was in conformity with other indicators that showed that the period of recession had ended, such as an upturn in personal consumption and an increase in industrial production and the number of tourist nights.

Figure 2.1

Money Supply



In addition to the dynamics of economic activity, the strengthening of the domestic currency against the euro in the second quarter and high expectations for the entire third quarter had a positive impact on the demand for money by the private sector. Exchange rate stability aided the recovery of domestic demand, and of demand for money by the private sector. This demand was not curbed by public debate on the exchange rate at the end of the third quarter and a slight exchange rate slide in the fourth quarter.

Currency in Circulation

In January 2000, currency in circulation decreased considerably, as did all kuna components of total liquid assets, by HRK 0.9bn or 12%. It rose moderately in the first two quarters, reaching the December 1999 level at end-June 2000. From the third quarter it grew at a higher pace. The tourist season was much better than expected, which had positive monetary effects. The growth in foreign exchange inflow from tourism, which is monetized through the financial system, accelerated the growth in currency in circulation. This resulted in an annual growth rate of 11.4%, with currency in circulation reaching HRK 6.6bn at the year-end.

The end of recession and the recovery of GDP growth in 2000 resulted mostly from stronger personal consumption (and net exports), whereas government spending and investment weakened (see the section on GDP). Also, the 1999 recession was actually a collapse in personal consumption for several reasons (banking crisis, exchange rate depreciation, growing government spending). Currency in circulation is closely correlated to personal consumption, so the recovery in personal consumption in 2000 triggered household demand for currency in circulation.

Table 2.2 Total Liquid Assets M4, end of period, million HRK and %

	AMOUNT			SHARE		
	1998	1999	2000	1998	1999	2000
TOTAL LIQUID ASSETS (M4)	57,340.2	56,698.5	73,312.6	100.0	100.0	100.0
1. Money supply	13,531.4	13,858.9	18,031.2	23.6	24.4	24.6
1.1. Currency in circulation	5,718.8	5,958.9	6,636.4	10.0	10.5	9.1
1.2. Dep. money of other dom. sectors	7,812.6	7,900.0	11,394.8	13.6	13.9	15.5
2. Non-monetary deposits (quasi-money)	43,808.8	42,839.6	55,281.3	76.4	75.6	75.4
2.1. Savings and time deposits	5,837.9	5,873.6	8,389.7	10.2	10.4	11.4
2.2. Foreign currency deposits	37,970.9	36,966.0	46,891.7	66.2	65.2	64.0
SECTORAL STRUCTURE OF M4						
Local government	719.1	627.4	966.9	1.3	1.1	1.3
Enterprises	10,057.2	9,503.3	15,277.2	17.5	16.8	20.8
Households	45,298.3	44,558.7	54,413.2	79.0	78.6	74.2
Other banking and financial institutions	1,265.5	2,009.2	2,655.3	2.2	3.5	3.6
TOTAL	57,340.2	56,698.5	73,312.6	100.0	100.0	100.0

Deposit Money

Deposit money developments, especially in the corporate sector, crucially influenced the money supply throughout 2000. In 1998 and 1999, when economic activity decreased, enterprises' deposit money was the component of total liquid assets which fell the most. This negative trend coincided with the beginning of an imbalanced fiscal policy. At end-1998 and during 1999, consolidated central government revenues (without privatization receipts) were lower than expenditures, and the government entered the zone of fiscal imbalance, unsustainable in the long term. This critical period, when revenues irretrievably fell below expenditures, was the end of 1998, when economic activity decelerated and recession began. (Subsequent developments showed that, in the given circumstances, an expansive fiscal policy that generates a budgetary deficit has pro-recessionary effects). One way of deficit financing was non-payment of liabilities to suppliers, so the private sector was forced to extend credit to government. All this significantly contributed to reduced liquidity in the private sector and a sizable decline in deposit money and consequently in the money supply.

During 2000, the central government's settlement of a major portion of its liabilities that had come due prior to December 31, 1999 led to a related steep growth in enterprises' deposit money. By the end of the third quarter of 2000, the government had settled all arrears projected in the 2000 budget, thus introducing considerable funds into the financial flows of the economy. HRK 4.2bn was repaid either via direct debt payment or tax compensations. HRK 1.7bn of Croatian Institute for Health Insurance bonds, which can be added to this amount, also greatly improved liquidity in the economy. At the end of the year, the government settled its debt to the household sector concerning insured savings in bankrupt banks.

Due to the settlement of government arrears, deposit money grew quickly in the second and third quarters. However, this growth ended at the year-end, and money supply growth decelerated. Original data showed a decline in enterprises' deposit money. Although the inertia of the previous periods was strong, with deposit money trends indicating that growth continued at the beginning of 2001, the original values of deposit money are slowly decreasing. Reduced government spending and the repayment of arrears to enterprises had a one-off positive effect on currency in circulation developments, but this was of limited duration because it was not followed by a sizable growth in loans, with the result that enterprises' liquidity stagnated. Still, enterprises' deposit money showed a 50.9% growth at the annual level, the strongest growth of all the components of the monetary and credit aggregates, with an average monthly trend growth rate of 2.9%. Deposit money stood at HRK 11.4bn at the year-end.

These developments confirm that fiscal policy has a greater influence on private sector liquidity than does monetary policy. Government spending financing had been very non-transparent over the previous years and had seriously affected liquidity in the economy. This trend was reversed in 2000. The 2001 budget, which is tighter than the 2000 budget in both nominal and real terms, can be viewed as a continuation of a favorable trend, but only if the government succeeds in maintaining expenditures within planned amounts and without generating new arrears. The size of the government sector and its timeliness in meeting obligations crucially affect the recovery/weakening of the private sector both directly and indirectly. Directly, because private sector liquidity is closely related to the timely settlement of government obligations; and indirectly, because monetary policy can be as relaxed as fiscal restrictions are tight. The reductions in the reserve requirement rates in November and December 2000, which freed substantial liquid funds of banks, should be considered in this light.

Table 2.3 Net Domestic Assets, end of period, million HRK

	AMOUNT			GROWTH RATES		
	1998	1999	2000	1998	1999	2000
Net domestic assets	44,626.8	40,003.8	44,043.9	31.9	–10.4	10.1
1. Assets						
1.1. Claims on central government (net)	9,916.3	12,899.2	13,666.7	4.1	30.1	6.0
1.2. Placements	59,792.0	55,875.8	60,863.3	22.4	–6.5	8.9
1.3. Other assets (net)	–25,081.5	–28,771.2	–30,486.1	2.1	14.7	6.0
2. Liabilities						
2.1. Total liquid assets (M4)	57,340.3	56,698.6	73,321.4	13.0	–1.1	29.3
2.2. Foreign liabilities (net)	–12,713.5	–16,694.8	–29,277.5	–24.8	31.3	75.4

Foreign Currency Deposits

At the beginning of 2000, the trend in foreign currency deposits was the reverse of the trend in the kuna component of total liquid assets. The January drop in M2 (kuna liquid funds) was accompanied by a strong growth in foreign currency deposits. In addition, foreign currency that had been withdrawn during the period of undermined confidence in the banking system began to return to the banking system in the first quarter. The growth in foreign currency deposits of HRK 2.9bn in the first six months almost equaled the decrease recorded in the first several months of 1999 (HRK 3.0bn). The return of the foreign currency which had "run away" in 1999 ended in the first quarter of 2000, and foreign currency deposits grew at a somewhat slower rate afterwards, moving in accordance with seasonal characteristics. The average growth in foreign currency deposits was stable in the third quarter, HRK 0.3bn a month on average, without extreme fluctuations, while it was considerably boosted in the fourth quarter by the payment of insured deposits in bankrupt banks. Foreign currency deposits reached HRK 46.9bn at the end of the year.

The frequent debates in the media in the third quarter on the need to devalue the kuna did not shake the currency structure of savings. In previous periods, the possibility of a kuna "devaluation" had occasionally been felt as real, so outflows of kuna into foreign currency and the related increase in foreign currency deposits were momentary and significant, as was the case in January 2000. However, when the Croatian National Bank sold USD 53.6m in November, thus demonstrating clearly its commitment to a stable exchange rate policy, individuals, enterprises and banks did not convert their kuna funds into foreign currency but even increased their kuna savings with banks. The slight kuna slide was perceived as temporary and of a seasonal character that is usual in that part of the year. Seven years of exchange rate and price stability have made interpretation of economic developments easier and stiffened resistance to the ever-present debate on the equilibrium exchange rate.

The 2000 growth in kuna savings and time deposits was satisfactory. They grew by 42.8% or HRK 2.5bn to HRK 8.4bn at the year-end. Their share in total liquid assets even slightly increased. Although the share of kuna savings in total savings has never been large, their growth indicates a (short-term) lack of fear of domestic currency depreciation.

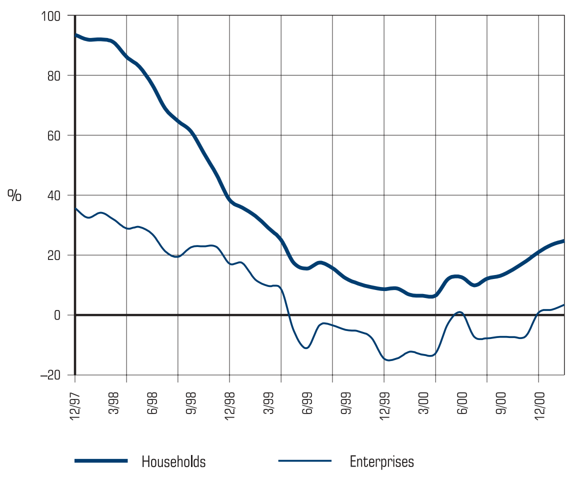
Loans

Loans grew very slowly throughout 2000. In the period between the beginning of the year and the end of the third quarter, their growth totaled 3.5%, whereas it accelerated in the fourth quarter to 5.3%. At the year-end, placements reached HRK 60.9bn, 8.9% higher than at the end of 1999. Loans to the household sector grew by 21%, while loans to enterprises were almost stagnant (0.9% growth).

Placement developments should be viewed in a broad context. The central government had accumulated arrears to suppliers in the previous years, thus draining liquidity from the economy and forcing suppliers to supply credit. In 2000, in contrast, the government injected liquidity to enterprises by reducing accumulated unpaid bills. Such liquidity flow from the government to enterprises, reflected in strong deposit money growth, acted as a substitute for bank loans to enterprises and resulted in a somewhat lower demand for loans. Consequently, although the growth in loans to enterprises was minimal, the final effect is more positive if relations between the government and enterprises are taken into account. In addition, the increased liquidity of their clients strengthened the position of banks.

Figure 2.2

Loans to Households and Enterprises, rate of change compared to the same month previous year



On the supply side, banks were more than cautious in extending loans. The banking industry focused more on its own restructuring than on extending loans to clients. Expecting a stronger recovery of economic activity and a return of good clients, banks were disinclined to lending. A weakened transmission mechanism prevented an adequate transmission of sound banking system liquidity and low money market interest rates to an increase in placements to the economy. Real, structural limitations were present, so that an attempt to boost credit by freeing additional bank liquidity would have failed. A slight reversal of a downward trend in loans to enterprises occurred in the third quarter. Data indicated that the credit contraction had bottomed out and a slight upturn was discernible. There was a slight growth in loans to enterprises in the fourth quarter, and there were strong signs of faster growth in the first quarter of 2001.

A serious obstacle to greater lending activity is that domestic bank liabilities are mostly short-term, so their strong liquidity is mostly short-term as well. Domestic savings is generally of short-term maturity, as are most foreign loans. Although banks can transform the maturity structure of sources into assets of longer maturity, prudential regulations stipulate a maximum permitted maturity mismatch that must be observed by banks. Thus, strong liquidity need not automatically signify a higher lending potential of banks, especially since the Croatian economy is seriously deficient in long-term sources of finance. The most permanent source is, of course, equity capital. However, asset quality had deteriorated during the recession (some loans to enterprises were reclassified to higher risk categories), thus impairing capital adequacy.

Central Government

Net bank claims on the central government rose by HRK 0.8bn or 6.0% in 2000, reaching HRK 13.7bn at the year-end. This is a very heterogeneous aggregate, in which various items and factors interact. Bank claims concerning bonds for frozen foreign currency savings decreased by HRK 0.9bn to HRK 4.5bn at the end of 2000. Other bank claims on the central government (excluding savings bonds) increased by HRK 1.9bn and mostly relate to bank placements in government securities, primarily T-bills. The central government's relations with the monetary authorities changed at the beginning of 2000, when the CNB stopped granting loans from the primary issue to the government. The new Law on the CNB forbids such loans. Thus, the increase in claims on the central government, or more precisely, claims on the consolidated central government, which comprises the central government and extrabudgetary funds, concerns only commercial bank claims.

Bank claims on extrabudgetary funds considerably affected the dynamics of this aggregate's movements. Several banks extended bridging loans to the Croatian Institute for Health Insurance in the second quarter of 2000, as an advance until the issue of its bonds. The loan was repaid in the third quarter, upon the formation of claims based on the Croatian Institute for Health Insurance bonds, in which banks placed their free reserves. At the year-end, just before Christmas, commercial banks granted a loan to the Croatian Pension Insurance Institute. Total bank claims on extrabudgetary funds rose by over HRK 1bn in 2000. Bank claims on the central government itself increased by HRK 2.5bn. Although this amount is a result of various developments throughout the year, it is equal to the amount of government bonds issued for the payment of insured deposits in bankrupt banks. To repay the insured savings, the government incurred debt with commercial banks by issuing bonds. However, the banks' balance sheet remained balanced because their liabilities rose to the extent to which individuals redeposited their savings into banks (and they mostly did). Central government and fund indebtedness to commercial banks shows that the funds are crucial to fiscal spending. The increase in bank claims on the central government was partly offset by an upturn in central government deposits with banks and a rise in central government funds deposited in accounts with the CNB. Total net claims of the banking system on the central government rose by HRK 0.8bn.

Net Foreign Assets

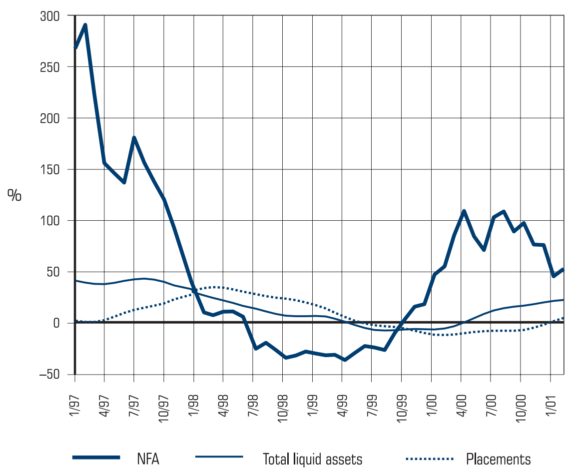
At the beginning of 2000, net foreign assets rose mostly due to an increase in commercial bank net foreign assets. Banks were not interested in placing their funds in domestic sectors and invested abroad. As the gap between increasing bank liquidity and stagnant placements grew wider, banks looked for alternative investment areas for their free funds. The domestic securities market is shallow and of low liquidity, and the supply of CNB bills and T-bills was insufficient to absorb the sizable excess liquidity at the beginning of the year. On the other hand, security-holders are reluctant to sell before maturity because they do not know where to place this excess liquidity, and the interbank market can only partially absorb the surplus supply.

As the interbank and securities markets were insufficient to "swallow" the increased liquidity, banks placed their funds abroad. The potential for placement abroad is also limited, because this area is strictly regulated by foreign exchange and prudential regulations (exposure to currency risk, and the currency and maturity match between assets and liabilities). However, banks used this opportunity to a maximum, so net foreign assets grew considerably in the first two quarters. The growth in foreign currency deposits of the private sector also accelerated, causing commercial bank foreign assets to grow due to their obligation to redeposit these foreign currency deposits abroad.

The situation changed at the end of May. Demand for the kuna rose in the tourist preseason, and banks used their kuna liquidity to satisfy the increased demand for kuna by purchasing foreign currency through exchange offices. As the supply of kuna liquidity quickly dried up, the central bank intervened by purchasing foreign exchange. Three major central bank interventions (May: USD 79.1m, June: USD 89.5m, and July: USD 77.8m) changed the structure of the foreign asset growth in favor of an increase in international reserves of the central bank, which grew steeply at the end of the second and beginning of the third quarter. This large foreign currency inflow, monetized by the CNB interventions, considerably increased kuna liquidity, which was partially sterilized by a rise in kuna CNB bills purchased by banks.

Figure 2.3

Net Foreign Assets, Total Liquid Assets and Bank Placements to the Private Sector, real trend value growth rate compared to the same month previous year, December 1999=100



The foreign currency purchase of July 5, 2000 was the last CNB intervention of this type in 2000. Estimating that the kuna liquidity of the banking system was sufficient to absorb surplus foreign currency over the summer period, the CNB stayed out of the foreign exchange market until the November sale of foreign exchange. The CNB's restraint from more active intervention was based on its assumption that a balance had been established in this market and that the kuna exchange rate would not fluctuate significantly. This assumption proved to be true.

To sum up, the growth in foreign assets throughout 2000, with a slight increase in domestic assets, was the dominant flow in creating total liquid assets.

2.2 Monetary Policy Instruments

The Croatian National Bank, in accordance with monetary policy projections for 2000, considerably changed the set of instruments used in implementing monetary policy tasks. The reserve requirements in kuna and foreign exchange were unified and the reserve requirement rate was lowered to 23.5%. Surplus kuna liquidity, created mostly by the repurchase of foreign exchange and a decrease in the reserve requirement rates in the second half of the year, was sterilized by market instruments, primarily an increased sale of kuna CNB bills. 2000 was also characterized by reduced borrowing from the central bank by banks, savings banks and government. Moreover, when faced with temporary liquidity needs, banking institutions relied more on much cheaper funds in the money market, where the surplus of supply over demand led to a marked decline in interest rates. In accordance with the downward trend in the market interest rates, the Croatian National Bank adjusted its interest rates over the year.

2.2.1 Relations with Government

The Croatian National Bank, in accordance with Article 58 of the Law on the Croatian National Bank, granted short-term loans to the central government during 2000 to help bridge temporary imbalances between budgetary revenues and expenditures. These loans were granted at a discount rate that decreased in April from 7.9% to 5.9%.

Since the 2000 government budget financing was oriented toward foreign markets via placements of bonds, there was no great need for additional borrowing from the central bank. The Croatian National Bank granted the government three short-term loans in the period between the end of January and beginning of May 2000; average borrowing amounted to HRK 400.1m.

2.2.2 Relations with Commercial Banks

The sound liquidity of the banking system, especially in the second half of 2000, resulted in increased reliance on sterilization instruments of the central bank. However, in the attempt to minimize the role of reserve requirements, excess liquidity was sterilized mostly through a larger issue of kuna CNB bills.

In 2000, despite a favorable liquidity position at the level of the system, some institutions strove to solve their liquidity problems through short-term liquidity loans extended by the central bank. In addition, the Croatian National Bank extended Lombard and intervention loans, and organized repo auctions, especially in the first part of the year.

Table 2.4 Stock of Croatian National Bank Loans, end of period, million HRK

	1999	2000			
	December	March	June	September	December
LOANS GRANTED TO BANKS	1,125.4	299.6	277.5	209.5	313.6
Lombard loans	176.7	126.8	0.8	0.0	0.0
Short-term liquidity loans	929.0	56.5	266.0	208.5	0.0
Intervention loans	19.7	115.1	9.7	0.0	14.0
Repo arrangements	0.0	0.0	0.0	0.0	299.6
Other loans	0.0	1.2	1.0	1.0	0.0
LOANS GRANTED TO THE MoF	24.1	28.6	34.4	5.3	0.0
Bridging loans	0.0	0.0	0.0	0.0	0.0
Other loans	24.1	28.6	34.4	5.3	0.0
TOTAL	1,149.5	328.2	311.9	214.8	313.6

Lombard Loans

In 2000, banks and savings banks could use Lombard loans for the maximum of 15 working days in a month, in the amount up to 50% of the nominal value of purchased kuna CNB bills, Ministry of Finance bills and promissory notes, and up to 30% of the nominal value of purchased foreign currency CNB bills. The interest rate charged on this loan was 13% at the beginning of 2000 but was lowered to 12% in April in line with the downward trend in money market interest rates.

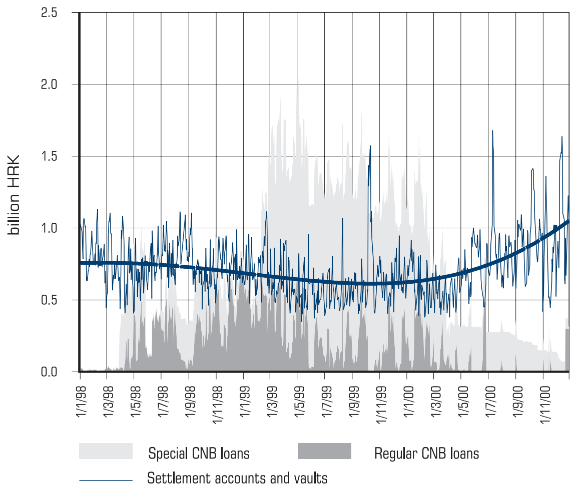
The average annual amount of Lombard loans used by banks and savings banks in 2000 was HRK 74.3m, whereas the average monthly amount ranged between HRK 0.3bn and HRK 220.4bn. The use of this liquidity source by banks and savings banks was much lower in the second part of the year, both in terms of loan amounts and number of utilization days.

Short-term Liquidity Loans

Owing to unsolved liquidity problems, seven banks relied on the central bank as lender of last resort in 2000. The average monthly use of short-term liquidity loans ranged between HRK 74.8m and HRK 911.9m, while the annual average was HRK 346.5m. It should be noted that the use of this loan was considerable in the first quarter (HRK 738.5m), while the average amount used in the rest of the year was three times smaller (HRK 215.8m).

Figure 2.4

Banks' Settlement Accounts with the CNB and Liquidity Loans



The interest rate on short-term liquidity loans depends on the utilization period. For utilization periods up to three months, the interest rate was the interest rate on Lombard loans plus 0.5 percentage points. When the utilization period was longer than three months, the interest rate was the interest rate on Lombard loans plus 1 percentage point. The conditions for granting short-term liquidity loans did not change in 2000.

Intervention Loans

The Croatian National Bank abolished intervention loans by its decision of December 2000 that came into force in February 2001. Thus, banks and savings banks will not be able to use this loan after the introduction of the National Clearing System.

The average monthly use by banks and savings banks of intervention loans was HRK 22.5m in 2000. This amount relates to five banks and two savings banks that operated in the whole or in part of 2000. Only two of these institutions used intervention loans at the end of 2000, totaling HRK 14.0m. However, the total amount of intervention loans used at end-2000, which includes loans to bankrupt banks and savings banks that were excluded from the statistical records, was considerably larger – HRK 142.6m.

The interest rate charged on intervention loans to banks and savings banks was lowered in April 2000 from 19% to 18%.

Repo Auctions

Owing to the sound liquidity of the system in the first half of 2000 and excellent liquidity in the second half, repo auctions were not much needed. In 2000, the Croatian National Bank held only seven repo auctions of CNB bills and T-bills, of which six in the first half of the year (by comparison, 34 repo auctions were held in both 1998 and 1999). The average issue at auctions was HRK 247.4m. The average weighted interest rate quoted at the first four auctions was 12.50%, falling to 6.07% at the last auction (in December). It was 10.61% at the annual level. On average, six banks participated in each auction.

Table 2.5 Survey of Repo Auctions Held in 2000, thousand HRK and %

Date of the auction	Total amount of offers accepted	Weighted interest rate (%)
January 27, 2000	351,048	12.50
January 31, 2000	318,475	12.50
February 4, 2000	392,347	12.50
February 15, 2000	285,837	12.50
April 21, 2000	74,465	11.70
June 20, 2000	10,235	6.50
December 21, 2000	299,629	6.07

Croatian National Bank Bills

Croatian National Bank Bills in Kuna

The sound liquidity of the system and the money market surplus of supply over demand for funds, accompanied by less interest in other forms of investment, resulted in a considerably increased purchase of Croatian National Bank bills denominated in kuna in 2000.

The Croatian National Bank auctioned kuna bills in nominal amounts of 100,000.00 kuna through the multiple-price method with discount. In addition to regular weekly auctions of bills with maturities of 35, 91 and 182 days, the central bank issued bills with adjusted maturities at three additional auctions. The average monthly stock of purchased kuna CNB bills ranged between HRK 1.4bn and HRK 2.8bn.

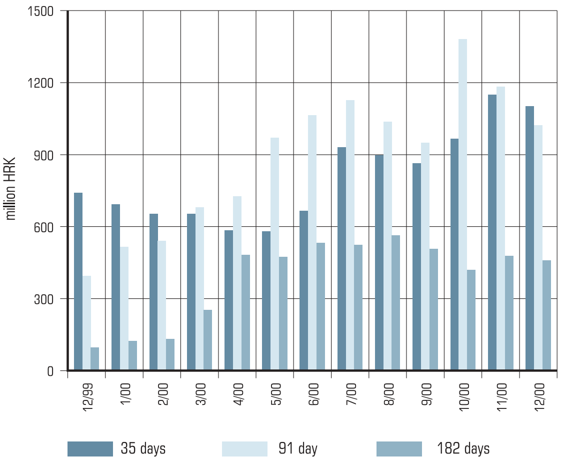
At CNB bills auctions, the Croatian National Bank followed the downward trend in market interest rates over the year. The average interest rates on kuna CNB bills thus declined by 3.85 percentage points on 35-day CNB bills, 4.55 percentage points on 91-day CNB

Table 2.6 Survey of Purchased Croatian National Bank Kuna Bills by Maturity, nominal value, end of period, million HRK

Month	Maturity (regular auctions)			Maturity (regular auctions)							Total
	35	91	182	33	34	37	89	93	96	187	
December 1999	741.5	394.3	97.0		41.3				3.5	2.5	1,280.1
January 2000	692.8	516.2	124.0	70.0			40.0			2.5	1,445.5
February 2000	653.3	541.1	131.0				40.0			2.5	1,367.9
March 2000	653.7	681.1	253.7				40.0			2.5	1,631.0
April 2000	585.7	726.2	483.6								1,795.5
May 2000	580.6	970.7	474.6								2,025.9
June 2000	667.5	1,065.1	533.6								2,266.2
July 2000	931.7	1,126.9	524.6	279.0			4.4				2,866.6
August 2000	898.5	1,038.3	565.1				4.4				2,506.3
September 2000	864.7	949.8	507.5				4.4				2,326.4
October 2000	966.0	1,381.7	419.6			103.0		3.0			2,873.3
November 2000	1,150.6	1,183.9	479.6					3.0			2,817.1
December 2000	1,103.0	1,022.3	458.6					3.0			2,586.9

Figure 2.5

Survey of Purchased Croatian National Bank Kuna Bills
by Maturity, nominal value, end of period



bills, and 4.80 percentage points on 182-day CNB bills in the January-December period. In the last two months of 2000, they were 6.65% on 35-day bills, 7.00% on 91-day bills and 7.70% on 182-day bills.

2000 was characterized by greater interest in bills of longer maturities. Contrary to previous years, when 35-day bills prevailed, most bills purchased in 2000 were 91-day bills, while 182-day bills were not neglected either. In addition to the above stated reasons, this reversal of the trend can be explained by the stabilization of the banking system, improved market security and increased secondary market trade.

Reserve Requirements

To increase the use of market-oriented instruments of monetary policy and to reduce reliance on use of the reserve requirements, significant changes occurred in the reserve requirement instrument in 2000. The kuna reserve requirement rate was lowered from 30.5% to 28.5% (applied since end-April) and to 23.5% at the end of 2000.

Owing to changes made in September, the reserve requirement instrument obtained a completely new dimension, which includes plans to create business conditions similar to those in the European Monetary Union. The unification of the kuna and foreign currency reserve requirements, a considerable reduction in the reserve requirement rate, and the extension of the calculation base for the foreign exchange reserve requirement to include all foreign exchange sources of funds except foreign loans, initiated a decline in the dominance of the reserve requirement instrument in the set of monetary policy instruments used by the Croatian National Bank. Other changes relating to the unification include the definition of a unique calculation period (from the first to the last day in a calendar month) and the definition of the maintenance period (1 month, from the 8th calendar day in a month to the 7th calendar day in the following month). In addition, the maximum percentage of the calculated reserve requirement which can be maintained by the average daily balances in the accounts of liquid claims was increased to 50%, while the rest must be set aside in reserve requirement accounts with the CNB.

The reduction in the reserve requirement rate on the foreign exchange component of the reserve requirements from 55% to 23.5% was offset by an extension of the reserve requirement calculation base. The reduction in the reserve requirement rate on the kuna component from 28.5% to 23.5% was mitigated by the introduction of a transitional period in which this rate was 26.5%. The provisions concerning the kuna component have been in force since November, and those concerning the foreign exchange component since December 2000.

Until November 2000, the Croatian National Bank paid a remuneration rate of 5.9% on the kuna reserve requirement deposited with the CNB and on the funds that banks were required to maintain in their settlement accounts. In line with the mentioned changes in the reserve requirement instrument, from November onwards the CNB paid interest only on the deposited kuna component of the reserve requirements, at a lower remuneration rate of 4.5%. Regarding the foreign exchange component of the reserve base, the CNB continued to calculate and pay interest only on the deposited part of the foreign exchange reserve requirement, at a rate based on the remuneration rate, which is determined in accordance with the market interest rate earned by the CNB on the portfolio of foreign currency reserves deposited by banks and savings banks.

Deposits on Foreign Financial Loans, Foreign Currency Deposits and Issued Guarantees

Banks authorized for external operations were obliged to place kuna deposits in accounts with the Croatian National Bank in the amount of: 30% of received foreign loans for conversion into kuna with maturity up to 1 year, 10% of issued guarantees for foreign financial loans for conversion into kuna with maturity up to 1 year, and 15% of the average daily balance of foreign currency deposits of foreign banks with maturity up to 1 year. The deposit on a loan is repaid 12 months after its placement, provided that the loan has been fully repaid, and the deposit on issued guarantees is returned 12 months after placement.

The obligation to place kuna deposits on foreign currency loans received ceased on December 8, 2000, when the provisions of the Decision on Reserve Requirements started to be applied also to the foreign exchange component of the base, which was extended to include all foreign currency deposits.

2.2.3 Croatian National Bank Interest Rates

The sound liquidity of the system and the decline in money market interest rates were also reflected in changes in the interest rates of the central bank. In April 2000, interest rates were lowered from 13% to 12% on Lombard loans, and from 19% to 18% on intervention loans and on inaccurately calculated or non-allocated reserve requirements, while the discount rate fell from 7.9% to 5.9%. A general downward trend in interest rates was also present at the Croatian National Bank repo auctions. The average weighted interest rate earned on the first four repo auctions was 12.50%, falling to 6.07% at the last auction (in December). The average annual weighted interest rate at repo auctions was 10.61%.

Corrections were also made on the liabilities side. The remuneration rate on the kuna component of the reserve requirements was reduced from 5.9% to 4.5% in November, but the interest based on the new rate was calculated only on the deposited kuna component of the reserve requirements. In the January-December period, the average interest rate on kuna CNB bills decreased from 10.50% to 6.65% on 35-day bills, from 11.55% to 7.00% on 91-day bills and from 12.50% to 7.70% on 182-day bills.

3

International Relations

3.1 Relations between the Republic of Croatia and the International Monetary Fund (IMF)

Cooperation with the International Monetary Fund concerning information exchange and IMF support for the Republic of Croatia's economic and financial policy intensified during 2000. Within the framework of this cooperation, numerous contacts were made with the experts from the International Monetary Fund, both through this institution's representation office, which opened in Croatia in 1995, and through repeated visits by the IMF to Croatia.

In addition to the regular annual consultation related to Article IV of the Articles of Agreement of the IMF held in November 2000, especially intensive were contacts with the IMF related to preparations for the new Stand-By Arrangement.[1]

The executive director of the IMF Constituency representing the interests of the Republic of Croatia in the decision-making bodies of the IMF also paid a visit to Croatia in June 2000. Representatives of the Republic of Croatia participated in the work of IMF management bodies. In particular, this relates to the participation of Croatian National Bank representatives in the work of the Annual Meeting of the Board of Governors of the International Monetary Fund held in Prague where Croatian representatives held a number of successful meetings with representatives of international financial institutions, commercial banks and investment houses.

In 2000, two major IMF Missions visited the Croatian National Bank in connection with technical assistance in the relationship between the CNB and the Ministry of Finance, the Law on the Croatian National Bank, the Banking Law, instruments of monetary policy, international reserves management, debt management, money market and balance of payments statistics.

3.1.1 Participation of the Republic of Croatia in IMF Activities

In an effort to coordinate its role in the supervision of member countries where there is the need for the timely release of information on these countries, the IMF has reached many decisions and launched a number of projects with the aim of enhancing its own

[1] The new Stand-by Arrangement was approved for the Republic of Croatia on March 19, 2001. In view of Croatia's relatively high level of international reserves, favorable balance of payments outlook and good standing on international capital markets, this arrangement was concluded as a "cautionary measure".

transparency and the transparency of member countries. In line with these efforts, Croatia first joined the project of Special Data Dissemination Standard (SDDS), and then, on a voluntary basis, a project for publishing annual reports on the economies of member countries, published by the IMF on the basis of consultations pursuant to Article IV of the Articles of Agreement of the IMF. The first report of this type on Croatia was published on the IMF web site and the CNB web site at the beginning of 2000.

In joint efforts to strengthen the structure of the international financial system, the IMF and the World Bank launched a project in 1999 entitled the Financial Sector Assessment Program (FSAP). The purpose of this program is to assess the financial sectors of member countries, enable the early detection of weaknesses in their financial systems, ensure coordinated and efficacious dialogue with the national governments and identify development and technical assistance needs of member countries. For the time being, FSAP is only a pilot project joined on a voluntary basis. The Republic of Croatia applied to join the project in November 2000 and the first activities related to the project are expected to take place during 2001.

In anticipation of the new arrangement with the IMF, the financial relief review conducted by the IMF in 2000 with the aim of its adjustment to the global economic environment was especially interesting for the CNB. Within the framework of these activities, the CNB underwent reliability assessment by the IMF in line with the policy introduced by the IMF in 2000 of assessing central bank reliability of countries applying for an IMF arrangement.

3.1.2 Financial Transactions

As the fiscal agent of the Republic of Croatia and a depository of the International Monetary Fund, the Croatian National Bank keeps the deposit accounts of the International Monetary Fund and regularly services the obligations based on the arrangements that the Republic of Croatia concluded with the IMF: the Systemic Transformation Facility (henceforth STF, approved in 1994, SDR 130.80m), and the Extended Fund Facility (henceforth EFF, approved in 1997, SDR 353.16m). During 2000, SDR 6.95m in interest was paid on these two arrangements; SDR 21.80m in principal was paid on the STF arrangement. As a member of the Special Drawing Rights Department (of the IMF),

Balance on December 31, 2000

GENERAL RESOURCES ACCOUNT	SDR (million)	% Quota
Quota	365.10	100.00
IMF Holdings	486.37	133.22
SDR DEPARTMENT	SDR (million)	% neto cumulative al.
Net cumulative allocation	44.21	100.00
Holdings of Croatia	113.01	255.64
LIABILITIES PAID IN 2000	SDR (million)	–
Repayment of principal – STF arrangement	21.80	–
Interest payment on all arrangements	6.95	–
SDR Department membership fee	0.01	–
Net cumulative allocation costs	1.89	–

Croatia has regularly repaid its obligations based on the inherited obligations related to the allocation of the special drawing rights. During 2000, SDR 1.89m was paid on this basis.

Since the Republic of Croatia's admission as an IMF member, all its obligations towards the IMF have been regularly fulfilled, in accordance with existing legal provisions.

3.2 Activities of the CNB concerning the Relations between the Republic of Croatia and International Development Banks

The World Bank Group (IBRD, IFC, IDA, MIGA), European Bank for Reconstruction and Development (EBRD), Inter-American Development Bank (IDB)

a) Pursuant to the Law on Accepting Membership of the Republic of Croatia in the International Monetary Fund and Other International Financial Organizations on the Basis of Succession (official gazette *Narodne novine*, No. 89/1992), the Law on Accepting Membership of the Republic of Croatia in the European Bank for Reconstruction and Development (official gazette *Narodne novine*, No. 25/1993) and the Law on Accepting Membership of the Republic of Croatia in the Inter-American Development Bank (official gazette *Narodne novine*, No. 94/1993), the Croatian National Bank is the depository, i.e. it keeps all deposit accounts owned by these international financial organizations, in the name and on behalf of these financial institutions, and performs financial transactions with these organizations as the payment agent of the state – the Republic of Croatia. During 2000, the Croatian National Bank regularly executed payments for shares for which the Republic of Croatia assumed obligation according to the repayment plan accepted by each international financial organization.

b) The use and repayment of the loan pursuant to the Agreement signed on June 4, 1997 between the Republic of Croatia and the International Bank for Reconstruction and Development on the Enterprise and Financial Sector Adjustment Loan (EFSAL) of DEM 160m (official gazette *Narodne novine*, No. 17/1997, "International Agreements") have been made through a special account at the Croatian National Bank.

Payments Executed in 2000 on the Basis of Membership of the Republic of Croatia in International Financial Organizations

Name	Amount paid and currency		Balance of promissory notes issued by the Ministry of Finance	
EBRD	EUR	1,133,666.67	EUR	1,107,000.00
IDB	1) HRK	1,769,091.98	USD	429,459.00 (Ordinary Capital)
	2) EUR	205,886.50	DEM[a]	1.985,898.00 (Fund for special operations – FSO Notes)
IBRD			HRK	82,180,412.73
IDA			HRK	437,666.65
MIGA			USD	202,334.00

[a] Notes are cashed in euro.

3.3 Relations between the Croatian National Bank and the Bank for International Settlements (BIS)

The Croatian National Bank continued its cooperation with the Bank for International Settlements in 2000, after having gained full membership in mid-1997. Multilateral negotiations between the representatives of successor states' central banks aimed at resolving the issue of succession to financial assets of the former SFRY with the Bank for International Settlements continued during the year. It is expected that a solution to the issue of succession to shares, deposits and gold of the former National Bank of Yugoslavia will be found in June 2001.

The Governor and the Deputy Governor of the Croatian National Bank attended regular meetings of central banks governors, as well as the Annual General Meeting, making numerous important contacts with senior officials of the BIS and other central banks that are the members of the BIS.

The Croatian National Bank participated in the activities of the Bank for International Settlements aimed at coordinating technical assistance provided by the G-10 central banks to the central banks in Central and Eastern Europe. Several bilateral contacts were made, and various forms of technical assistance were agreed on in principle.

3.4 Cooperation between the Croatian National Bank and Other International Institutions

The Croatian National Bank cooperated with numerous other international financial institutions during 2000. For instance, the Japanese Center for International Finance, (JCIF) held in Zagreb in June 2000, in cooperation with the CNB, the second seminar on the Japanese financial and banking system, development funding system and bank supervision (the first seminar of this type was held in 1998). The aim of this seminar was to transfer knowledge and share experience on issues which might benefit transition economies such as Croatia. The seminar was entirely sponsored by the Japanese Ministry of Finance.

After many years of preparations and negotiations in which CNB representatives also took part, the Republic of Croatia gained membership in the World Trade Organization in 2000.

3.5 Activities of the CNB concerning the Relations between the Republic of Croatia and the European Union

The relations between the Republic of Croatia and the European Union intensified at the beginning of 2000, following the political changes which took place in the Republic of Croatia at the beginning of the year. The EU-Croatia Joint Consultative Task Force met several times during the year to produce a feasibility study. Representatives of the Croatian National Bank took part in areas of the study covering banking, the foreign exchange system and macroeconomic policy.

After the negotiations on the Stabilization and Association Agreement formally opened in November of 2000, representatives of the Croatian National Bank, within their jurisdictions, took part in the work of technical task forces with the aim of providing technical support to the Negotiating Team of the Republic of Croatia.

3.6 International Payment Operations and Relations with Foreign Banks

3.6.1 International Payment Operations

The scope and dynamics of international payment operations intensified significantly during 2000. Orders for payments abroad were executed daily, both for the purposes of the CNB and the Ministry of Finance (nostro and loro remittances). The inflows to the Croatian National Bank from abroad (loro remittances) resulted from the sale of coins and commemorative coin editions.

The introduction of the euro as the common currency of the European Union in 1999, led to an increase in international payments in euro. During 2000, the Republic of Croatia consolidated the existing current accounts of the Croatian National Bank kept abroad. Pursuant to the decision by the Committee on International Reserves, accounts in the national currencies of EMU members in three banks were closed (one account in U.S: dollars, one account in French francs and one account in Italian lira) and an account in one bank in the United States of America was also closed (an account in U.S. dollars). The Croatian National Bank has 15 current accounts kept abroad: seven accounts in euro, four accounts in U.S. dollars and one account in each of the following currencies: Austrian schillings, Japanese yens, Swiss francs and British pounds.

In addition to current accounts, the Croatian National Bank has six custody accounts for keeping securities in four states (with central banks, commercial banks and with Clearstream Banking, Luxembourg, the international depositary institution), which ensures the more efficient and safer investment of international reserves of the Republic of Croatia in foreign securities.

In view of the planned introduction of the State Treasury in 2001, operative and technical preparations were made to enable the execution of payments abroad on behalf of the Ministry of Finance of the Republic of Croatia and other government bodies on the basis of all the instruments of the international payment system.

3.6.2 Relations with Foreign Banks and Credit and Financial Relations

The Croatian National Bank continued to monitor economic and financial developments in certain countries and regions of special interest for both the Croatian National Bank and the Croatian banking system and the economy as a whole. Countries and financial institutions whose risk and credit rating are monitored can be divided into three different groups. The first group consists of banks (commercial and investment banks) which are business partners and potential business partners of the Croatian National Bank. Economic developments in their home countries are also monitored and lists of financial institutions and countries fulfilling the criteria for cooperation of the Croatian National Bank are also made.

The second group consists of banks fulfilling criteria pursuant to the Decision on the Reserve Requirements of banks and savings banks. This group comprises countries and banks with which the Republic of Croatia, i.e. Croatian commercial banks, maintain good and advanced business relationships, which are further intensifying (CEFTA countries). Closely monitored were also developments and changes in economies and banking sectors of countries with which the Republic of Croatia and the Croatian commercial banks have started establishing economic and business relations again.

After the United Nations sanctions on FRY were lifted and the country became a member of the IMF, the World Bank and the EBRD, international trade between the Republic of Croatia and the Federal Republic of Yugoslavia started again, inevitably calling for the regulation of payment systems between the two countries. In view of these developments, an annex will be added to the Trade Agreement between the Republic of Croatia and the FRY which will regulate that the succession issues be dealt with separately from issues of current payment transactions.

The third group for monitoring credit standing comprises all other countries and their banking sectors monitored by the Croatian National Bank for its own purposes or on demand by the Croatian government and its ministries, the Croatian Parliament and its committees, as well as for the purposes of cooperation with the Croatian Bank for Reconstruction and Development with which the CNB actively participates in the work of the Interministerial Committee for Export Insurance.

During 2000, over 120 meetings were held with representatives of foreign banks (both central and commercial), investment funds, credit rating agencies, and other institutions including domestic commercial banks and foreign embassies of the most significant partner countries of the Republic of Croatia. Forecasts on Croatia's economic development and development of its financial sector generated large interest and foreign strategic investors also showed increased interest in investment or the purchase of certain Croatian commercial banks.

In addition to resolving the issue of succession to the former SFRY, there were continued efforts to collect and reconcile data related to the settlement of claims of the Republic of Croatia in the clearing accounts against the Russian Federation and the former Czechoslovakia.

With the aim of providing expert support to the Stabilization and Association Agreement between the European Union and the Republic of Croatia, and within the framework of the Stability Pact, representatives of the Croatian National Bank, in line with their responsibilities, actively participated in the work of several task forces which were set up for these purposes.

4

Banking System of the Republic of Croatia

4.1 Characteristics of the Banking System

At the end of 2000, the banking system of the Republic of Croatia comprised 43 banks and one branch of a foreign bank, as well as 26 savings banks, including four housing savings banks. The share of bank assets in the total assets of the banking sector, which amounted to HRK 114.3bn at the end of 2000, was 98.6%, whereas that of savings banks stood at 1.4%. Banks recorded profits of HRK 1,987.7m, while savings banks incurred losses amounting to HRK 45.3m. Thus, the total profit of banking system for the year was HRK 1,942.4m, compared to a profit of HRK 665.4m in 1999. Following a decline in bank assets in 1999, assets started growing again in 2000. In comparison with 1999, the assets of the system increased by 20.5%.

As shown in Table 4.1, 39 banks and one branch of a foreign bank had full authorization, which includes the performance of international credit transactions, as well as domestic and international payment transactions. Two banks had medium authorization, implying legally prescribed banking operations apart from those previously stated, whereas one bank had limited authorization, which comprises basic banking operations, as provided by Article 35 of the Banking Law. One bank did not meet the criteria for authorization, and at present, the CNB's proposal for initiating bankruptcy proceedings is being processed within the competent Commercial Court. All banks and savings banks (apart from the aforementioned bank without the operating license, which is a limited liability company) are structured, in compliance with the provisions of the Banking Law, as joint stock companies. Banks and savings banks (except housing savings banks) are of a universal type. Following the significant inflow of foreign capital into the Croatian banking sector over the last two years, the further development of the market and banking institutions can be expected, and this will be accompanied by an adequate regulatory framework.

Table 4.1 Number of Banking Institutions

Institution type	1998	1999	2000
1. Banks	60	53	44
1.1. With full authorization	53	47	39
1.2. With medium authorization	–	–	2
1.3. With limited authorization	6	5	1
1.4. Authorization not granted	–	–	1
1.5. Branches of foreign banks with full authorization	1	1	1
2. Savings banks	36	34	26
2.1. General	33	30	22
2.2. Housing savings banks	3	4	4
Total	96	87	70

Tables 4.1 and 4.2 show that the number of banks has constantly been decreasing since 1998. Out of 60 and 53 banks at the end of 1998 and 1999, respectively, there were only 44 banks remaining by the end of 2000, meaning that 9 fewer banks were in oper-

ation in 2000 compared to 1999. In contrast to 1999, when bank bankruptcies created quite a public stir, the fall in the number of banks in 2000 continued as a natural process of consolidation in the banking system. Accordingly, four banks merged with other banks during 2000[1], four bankruptcy proceedings[2] were initiated, and the license was revoked for Alpe Jadran banka d.d. In 2000, a branch of the foreign bank Societe Generale was taken over by a branch of the foreign bank Bayerische Hypo und Vereinsbank AG, München. Out of 34 savings banks that were operating at the end of 1999, only 26 banks continued operations in 2000, since operating licenses were revoked for 7 savings banks[3], and one savings bank (Adria štedionica) went bankrupt.

Table 4.2 Changes in the Number of Banking Institutions

Banks	1998	1999	2000
Number of banks at the beginning of the year	61	60	53
Banks undergoing bankruptcy proceedings	–1	–7	–4
Banks whose license was revoked	–	–	–1
Banks that merged with banks	–	–	–4
Number of banks at the end of the year	60	53	44

Savings banks	1998	1999	2000
Number of savings banks at the beginning of the year	33	35	34
Savings banks undergoing bankruptcy proceedings	–1	–1	–1
Savings banks whose license was revoked	–	–	–7
Savings banks that merged with banks	–	–1	–
New housing savings banks	+3	+1	–
Number of savings banks at the end of the year	35	34	26

In 2000, the CNB appointed a temporary administrator for two banks (Cibalae banka d.d. and Istarska banka d.d.). Cibalae banka went bankrupt in the same year, following a take over of a part of its assets by another bank, whereas the problem with Istarska banka d.d., which stirred up great public interest, was resolved by recapitalization, i.e. a majority lot of shares was purchased by a bank in majority foreign ownership.

In 2000, the Law on Bank Rehabilitation and Restructuring was repealed. In two banks[4], the rehabilitation process was completed and preparations for privatization began. The completion of the privatization of three banks[5] signaled the end of the privatization process in major banks, the rehabilitation of which was initiated in the mid 1990's. All four banks rehabilitated in this period were in majority foreign ownership at the end of 2000.

Table 4.3 shows that, over the past three years, significant changes regarding majority ownership structures occurred in banks in favor of foreign shareholders. In 1998, 10

1 Zagrebačka banka - Pomorska banka merged with Zagrebačka banka d.d.; Čakovečka banka d.d. and Trgovačka banka d.d. merged with Bjelovarska banka, now operating under a new name; Krapinsko-zagorska banka d.d. merged with Privredna banka Zagreb d.d.

2 Hrvatska gospodarska banka d.d., Agroobrtnička banka d.d., Cibalae banka d.d, Trgovačko turistička banka d.d. For Trgovačko turistička banka the proposal for initiating bankruptcy proceedings was submitted as early as mid 1999.

3 Štedionica za razvoj i obnovu; Gold štedionica; Štedionica Mediteran; Investicijsko-komercijalna štedionica; Štedionica Dugi pogled; Zagrebačka štedionica; Štedionica Grošbanak.

4 Dubrovačka banka d.d., Croatia banka d.d.

5 Privredna banka Zagreb d.d., Splitska banka d.d., Riječka banka d.d.

banks were foreign owned, and the share of their assets in total bank assets amounted to 6.7%. The number of banks in foreign ownership increased to 13 in 1999, and their share in total bank sector assets grew to 40.2%. At the end of 2000, 20 banks with assets amounting to 83.7% of total banking sector assets were in majority foreign ownership. At the end of 2000, 21 banks maintaining a 10.2% share in total banking sector assets were in the majority ownership of domestic private persons, whereas 3 banks accounting for 6.1% of total banking sector assets were in majority state ownership.

Table 4.3 Ownership Structure of Banks

Ownership structure	Number of banks			Share in total assets (%)		
	1998	1999	2000	1998	1999	2000
Banks in total or majority private ownership of domestic shareholders	42	32	21	56.4	12.7	10.2
Banks in total or majority state ownership	8	8	3	36.9	47.1	6.1
Banks in total or majority foreign ownership	10	13	20	6.7	40.2	83.7
Total	60	53	44	100.0	100.0	100.0

Table 4.4 shows banks classified by the size of their assets. The number of banks with assets larger than HRK 5bn increased over the past two years from 4 to 5 in 2000. Their share in total banking sector assets grew from 58.2% in 1999 to 65.9% in 2000, whereas the assets of these banks increased by 36% in comparison with the pervious year. Table 4.4 indicates that the number of banks with assets ranging from HRK 1bn to 5bn is on the decline (from 19 banks in 1998, i.e. 15 banks in 1999, to 13 banks in 2000). Similarly, the share of assets of this group of banks in total banking sector assets fell from 31.6% in 1999 to 25.8% in 2000 (as a result of one bank's movement into a higher group). The number of banks with assets ranging from HRK 0.5bn to 1bn varied over the past three years (9 banks in 1998, 5 banks in 1999, and 8 banks in 2000). The share of these banks' assets in total banking sector assets increased from 3.3% in 1999 to 4.6% in 2000. The number of banks with assets below HRK 0.5bn fell from 28% in 1998, i.e. 29% in 1999, to 18% in 2000. The share of assets of this bank group in total banking sector assets was reduced from 6.9% in 1999 to 3.7% in 2000.

Table 4.4 Banks by Assets Size, thousand HRK

Assets	1998	1999	2000
Assets exceeding 5,000,000	4	4	5
Assets from 1,000,000 to 5,000,000	19	15	13
Assets from 500,000 to 1,000,000	9	5	8
Assets below 500,000	28	29	18
Number of banks at the end of the year	60	53	44

4.2 The Balance Sheet Structure of the Banks

The balance sheet structure of the banks in 2000 showed an improvement in quality over that in the previous year. Following the 1998 banking crisis and the beginning of the recovery in 1999, the year 2000 saw significant strengthening in the deposit base and bank capital.

4.2.1 Bank Asset Structure

Total bank banking sector assets amounted to HRK 112.7bn at the end of 2000, which is a 20.5% increase over that at year-end 1999 when it stood at HRK 93.5bn. Loans to other clients (non-banking sector) accounted for the largest part of assets in 2000, as was the case in the previous year. These loans grew by 11.4% compared to 1999, amounting to HRK 50.5bn (in 1999, an 8.5% fall was recorded). Table 4.5 shows the downward trend of the share represented by loans in bank assets (51.2% in 1998, 48.5% in 1999, and 44.9% in 2000). Corporate loans accounted for 49%, whereas the share of household loans and all other loans accounted for 41% and 10%, respectively. Regarding the maturity structure, 45% of loans fell due within a year, whereas 55% were long-term loans. Deposits with banking institutions amounted to HRK 17.7bn, a 71.2% increase over the previous year. Their share in assets grew from 11.0% in 1999

Table 4.5 Bank Asset Structure, end of period, million HRK and %

	1998		1999			2000		
	Amount	Share	Amount	Share	Growth rate	Amount	Share	Growth rate
1. Money assets and deposits with the CNB	6,412.5	6.6	9,733.5	10.4	51.8	11,495.2	10.2	18.1
1.1. Money assets	815.2	0.8	1,245.9	1.3	52.8	1,507.5	1.3	21.0
1.2. Deposits	5,597.3	5.8	8,487.6	9.1	51.6	9,987.7	8.9	17.7
2. Deposits with banking institutions	11,459.9	11.8	10,312.5	11.0	–10.0	17,655.4	15.7	71.2
3. Treasury bills and CNB bills	1,070.8	1.1	3,139.5	3.4	193.2	6,060.2	5.4	93.0
4. Trading portfolio of securities	288.5	0.3	1,067.8	1.1	270.1	2,481.5	2.2	132.4
5. Loans to financial institutions	854.8	0.9	1,246.2	1.3	45.8	1,106.6	1.0	–11.2
6. Loans to other clients	49,591.8	51.2	45,391.5	48.5	–8.5	50,543.8	44.9	11.4
7. Investment portfolio of securities	17,747.1	18.3	15,477.1	16.5	–12.8	14,230.7	12.6	–8.1
8. Invest. in subsidiaries and related companies	2,788.5	2.9	1,768.6	1.9	–36.6	2,563.3	2.3	44.9
9. Foreclosed and repossessed assets	340.6	0.4	447.2	0.5	31.3	621.2	0.5	38.9
10. Tangible assets and software (less deprec.)	3,168.7	3.3	3,164.6	3.4	–0.1	3,324.1	2.9	5.0
11. Interests, fees and other assets	3,745.3	3.9	2,518.1	2.7	–32.8	3,308.9	2.9	31.4
12. Less: specific reserves for unidentified losses	691.3	0.7	743.6	0.8	7.6	697.2	0.6	–6.2
TOTAL ASSETS	96,777.0	100.0	93,522.9	100.0	–3.4	112,693.7	100.0	20.5

to 15.7% in 2000. Out of total deposits with banking institutions, 97.4% were deposited with foreign banks. The growth of deposits with foreign banks indicates a general unwillingness of banks to place money in loans. Both in nominal terms and in terms of the share in assets, the investment portfolio of securities displayed a downward trend (18.3% in 1998, 16.5% in 1999, and 12.6% in 2000). This decline resulted from the redemption of a part of the bonds of the Republic of Croatia, as well as a sale (accelerated by bank privatization) of previously acquired shares of banks in companies. Deposits with the Croatian National Bank (mainly reserve requirements) amounted to 8.9% of total assets, tangible assets accounted for 2.9%, whereas Ministry of Finance treasury bills and CNB bills grew, accounting for 5.4% of bank assets. According to currency structure, 30.7% of bank assets were in foreign currency.

4.2.2 Bank Liability Structure

As can be seen in Table 4.6, the share of deposits in total bank liabilities moved upward (60.5% in 1998, 60.9% in 1999, and 64.6% in 2000). In 2000, 72.8% of all deposits were denominated in foreign currency. Following a 1999 fall, deposits grew by 27.7% in 2000, amounting to HRK 72.8bn. Loans received (loans from financial institutions and other loans) moved lower, both in nominal terms and in terms of share in liabilities (22.5% in 1998, 21.6% in 1999, and 17.6% in 2000). Out of total loans received, 18% were granted by domestic financial institutions (The Croatian Bank for Reconstruction and Development, the CNB and other financial institutions), 12% by the Republic of

Table 4.6 Bank Liability Structure, end of period. million HRK and %

	1998		1999			2000		
	Amount	Share	Amount	Share	Growth rate	Amount	Share	Growth rate
1. Loans from financial institutions	4,761.3	4.9	5,282.3	5.6	10.9	4,098.9	3.6	–22.4
1.1. Short-term loans	2,142.7	2.2	2,088.7	2.2	–2.5	1,149.0	1.0	–45.0
1.2. Long-term loans	2,618.5	2.7	3,193.7	3.4	22.0	2,949.9	2.6	–7.6
2. Deposits	58,584.6	60.5	56,997.0	60.9	–2.7	72,764.5	64.6	27.7
2.1. Giro and current account deposits	9,117.0	9.4	9,216.9	9.9	1.1	12,624.9	11.2	37.0
2.2. Savings deposits	13,564.2	14.0	13,678.0	14.6	0.8	17,644.0	15.7	29.0
2.3. Time deposits	35,903.4	37.1	34,102.1	36.5	–5.0	42,495.6	37.7	24.6
3. Other loans	17,028.9	17.6	15,007.5	16.0	–11.9	15,749.6	14.0	4.9
3.1. Short-term loans	1,435.1	1.5	1,652.8	1.8	15.2	488.0	0.4	–70.5
3.2. Long-term loans	15,593.7	16.1	13,354.7	14.3	–14.4	15,261.6	13.6	14.3
4. Debt securities issued	1.1	0.0	0.0	0.0	–95.9	0.0	0.0	–100.0
4.1. Short-term debt securities issued	0.9	0.0	0.0	0.0	–94.8	0.0	0.0	–100.0
4.2. Long-term debt securities issued	0.2	0.0	0.0	0.0	–100.0	0.0	0.0	
5. Supplementary capital	492.8	0.5	343.1	0.4	–30.4	527.4	0.5	53.8
5.1. Subordinated instruments issued	–		105.5	0.1		290.0	0.3	174.8
5.2. Hybrid instruments issued	–		237.5	0.3		237.4	0.2	0.0
6. Interests, fees and other liabilities	6,553.3	6.8	4,849.2	5.2	–26.0	5,438.2	4.8	12.1
7. Profit/loss for the current year	–1,671.6	–1.7	466.4	0.5	–127.9	1,496.0	1.3	220.8
8. Capital	11,026.7	11.4	10,577.3	11.3	–4.1	12,619.1	11.2	19.3
TOTAL LIABILITIES	96,777.0	100.0	93,522.9	100.0	–3.4	112,693.7	100.0	20.5

Croatia, and 70% by foreign entities (mostly foreign financial institutions). 91.7% of the loans received had maturities longer than 1 year. Interests, fees and other liabilities accounted for 4.8% of bank liabilities.

Profit for the current year, following the loss incurred in 1998, had an upward trend. In 2000, profit for the current year accounted for 1.3% of liabilities.

4.3 Bank Capital

At the end of 2000, bank capital accounted for 11.2% of liabilities, amounting to HRK 12.6bn, which was a 19.3% increase compared to 1999 (in the same period, bank assets grew by 20.5%). In comparison with assets, capital showed a mild downward trend (11.4% in 1998, 11.3% in 1999, and 11.2% in 2000). As shown in Table 4.7, share capital amounted to HRK 8.6bn, a 4.7% increase compared to 1999. In capital structure, share capital fell, whereas retained earnings and legal reserves showed continual growth, both in nominal terms and in terms of their respective share in capital.

Table 4.7 Bank Capital Structure, end of period, million HRK and %

	1998		1999			2000		
	Amount	Share	Amount	Share	Growth rate	Amount	Share	Growth rate
1. Share capital	8,944.7	81.1	8,219.7	77.7	–8.1	8,604.7	68.2	4.7
2. Retained earnings/loss	16.7	0.2	73.7	0.7	341.0	798.4	6.3	983.7
3. Legal reserves	1,165.5	10.6	1,540.2	14.6	32.2	1,782.6	14.1	15.7
4. Reserves provided for by the articles of associations and other capital reserves	899.8	8.2	743.8	7.0	–17.3	1,433.4	11.4	92.7
TOTAL CAPITAL	11,026.7	100.0	10,577.3	100.0	–4.1	12,619.1	100.0	19.3

Risk-based capital is a calculation category to measure a bank's capability to cover possible losses. It is composed of core capital and supplementary capital which must not exceed the amount of core capital. At the end of 2000, risk-based capital in the banking system amounted to HRK 12.4bn, which is an 11% increase compared to 1999 when it amounted to HRK 11.1bn. Core capital dominated the risk-based capital structure. The capital adequacy ratio is a measure of bank solvency and stability. It is the ratio between risk-based capital and risk-weighted assets. According to the current regulations, this ratio must not be below 10%. At the banking system level, the capital adequacy ratio amounted to 21% at the end of 2000, the same as in end 1999. At the end of 2000, two banks had the minimum permitted capital adequacy ratio, 10%, whereas all other banks had a relatively high capital adequacy ratio.

Accordingly, the quality of bank capital improved compared to the previous years, especially after "the removal" of "problem" banks from the banking system. Nevertheless, the assets quality determining the amount of potential losses and a bank's capability to earn profit from the placed funds, must also be taken into account.

4.4 Bank Asset Quality

The asset quality analysis is one of the most significant elements in evaluating the operational stability of a bank. CNB decisions, issued pursuant to the Banking Law, regulate in detail the classification of a bank's placements by risk categories and the calculation of the required specific reserves for identified potential losses. Specific reserves for identified losses represent the bank's expenditure by which asset items are reduced. Therefore, specific reserves for identified losses have a significant effect on a bank's business performance. The assessment of assets quality is carried out for bank's placements (loans, placements to banks and the central bank, contingent liabilities, claims based on interest income and investment portfolio of debt securities).

Table 4.8 Classification of Bank Placements by Risk Categories, end of period, million HRK and %

Placement	1998		1999		2000	
	Amount	Share	Amount	Share	Amount	Share
A	97,227.9	85.1	92,061.5	85.5	109,284.9	87.9
B	6,377.8	5.6	4,507.0	4.2	3,561.5	2.9
C	5,574.8	4.9	3,749.9	3.5	3,111.6	2.5
D	2,718.1	2.4	3,393.6	3.2	3,904.9	3.1
E	2,359.6	2.1	3,903.3	3.6	4,507.3	3.6
Total	114,258.2	100.0	107,615.4	100.0	124,370.2	100.0

Placements that are subject to assessment are classified into the following risk categories: A, B, C, D, and E, according to the degree of risk. Risk category A includes placements that do not involve the risk of non-payment, and thus no specific reserves for identified losses are set aside for these placements, whereas for other risk categories, specific reserves for identified losses are calculated relative to the degree of risk (e.g. specific reserves for category E, involving the highest risk, amount to 100% of placements). Income includes interest from placements classified into risk categories A and B, whereas interests from placements classified into other risk categories are not included in income unless they are collected. Apart from specific reserves for identified losses, banks are also obliged to calculate specific reserves for unidentified losses to the amount of 1% of placements and off-balance sheet risky items classified into risk category A.

Table 4.9 Provision to Placement (A, B, C, D, E) Ratio of Banks, end of period, million HRK

	1998	1999	2000
1. Total provis. for ident. and unident. losses	7,645.6	9,486.2	10,055.4
1.1. Provisions for identified losses	6,951.6	8,694.7	9,126.0
1.2. Provisions for unidentified losses	694.0	791.5	929.4
2. Total gross placements (A,B,C,D,E)	114,258.2	107,615.4	124,370.2
3. Relative ratio of total provisions to total gross placements	6.7%	8.8%	8.1%

As shown in Table 4.8, risk assets classified into category A accounted for 87.9% of total risk assets at the end of 2000 (85.5% in 1999), whereas other categories together comprised 12.1% of total risk assets (14.5% in 1999). Performing categories (A and B) accounted for 90.8% of total risk assets (89.7% in 1999), and non-performing assets (grades C, D, and E) for 9.2% of total risk assets (10.3% in 1999). Specific reserves for identified and unidentified losses in 2000 amounted to HRK 10.0bn, i.e. 8.1% of total risk assets. Table 4.9 shows the provision to placement ratio over the past three years. A continuous growth in specific reserves is noticeable (particularly in 1999). The share of specific reserves in placements fluctuated (6.7% in 1998, 8.8% in 1999, 8.1% in 2000). A significant change occurred in 1999 when placements (as a result of a reduction in the number of banks) decreased in nominal terms, and reserves increased (due to the application of more strict criteria in assessing placements). Therefore, it can be asserted that the reduction in the share of reserves in placements in 2000 was a result of improved placement quality, which is confirmed by the increased share of categories A and B. It must be noted that the data for 2000 are based on non-audited reports.

4.4.1 Limitations Decreasing Risks

In accordance with the Banking Law, banks are obliged to report to the Croatian National Bank on the amount and type of their exposure, as well as to comply with the following ratios and levels of exposure regulated by the Banking Law:

- Bank exposure to a single borrower or group of related borrowers must not exceed 25% of its risk-based capital.
- Total sum of a bank's large exposures must not exceed 400% of its risk-based capital. A bank's large exposure is exposure to a single borrower or group of connected borrowers exceeding 10% of its risk-based capital.
- Bank exposure to a single shareholder with more than 3% of bank shares (and their related persons) must not exceed 5% of the bank's risk-based capital.
- A bank's investment in tangible assets (land, buildings, equipment and refurbishing of business premises) must not exceed 30% of its risk-based capital.
- A bank's investment in tangible assets together with equity participation in companies must not exceed 70% of its risk-based capital.

Banks are also obliged to report their exposure to persons with special relationships with the bank (shareholders with more than 5% of shares, members of the bank's management and supervisory board and its procurators, persons holding a contract to work under special conditions in the bank, the spouses and children of all those listed above, legal entities in which those listed hold more than 20% of the voting shares, legal entities in which a bank itself has more than 20% of the voting shares).

The purpose of the described reporting and limitations is to reduce credit risk concentration, restrict placements to shareholders, as well as to restrict bank investments in assets which are not the bank's primary activity. For banks breaching the limitations, the

Croatian National Bank may set a time limit for adjustment to the provisions on permissible limitations, as well as adjustment dynamics. Table 4.10 shows banks according to compliance with the prescribed limitations.

For 12 out of 14 banks that breached the permitted exposure to a single borrower, a deadline was established for adjusting their exposure to the prescribed limitations. The same deadline was set for 7 out of 10 banks that breached the permitted exposure to a single shareholder with more than 3% of shares. 9 banks violated the permitted total exposure to shareholders with more than 5% of bank shares, and for 6 of them, a time limit for adjustment was set. A total of 12 banks violated the provisions on the maximum amount of investment in tangible assets and 9 banks violated the provisions on the maximum amount of investment in tangible assets and equity participation. Out of these 12 (i.e. 9) banks, 5 (i.e. 4) banks were allowed temporary non-compliance.

Table 4.10 Banks according to Compliance with the Prescribed Limitations, balance as of December 31, 2000

Type of limitation	Compliant	Non-Compliant		Total number of banks
		Permitted time limit for adjusting to the prescribed limitations	Banks breaching the prescribed limitations	
Bank exposure to single borrower must not exceed 25% of risk-based capital	30	12	2	44
Total amount of large exposures must not exceed 400% of risk-based capital	43	–	1	44
Exposure to a single shareholder with more than 3% of bank shares must not exceed 5% of risk-based capital	34	7	3	44
Total exposure to shareholders with more than a 5% of bank shares must not exceed 25% of risk-based capital	35	6	9	44
Investment in tangible assets must not exceed 30% of risk-based capital	32	5	12	44
Investment in tangible assets and equity participation must not exceed 70% of risk-based capital	35	4	3	44

The number of banks that violated the limitations is smaller than in the previous year, partly as a result of adjustments in 2000, and partly because of the overall reduction in the number of banks operating. Some banks violated legally determined limitations due to their connection with certain regional industries and large companies, as well as a transfer of placements into assets and equity participation in companies over the previous years. For most of the banks, the Croatian National Bank established a time limit for adjustment. For banks breaching the limitations, but with no adjustment time limit established, the process of supervision by the CNB is under way. For one bank in violation of these limitations, bankruptcy proceedings were proposed in 2000, and the operating license was revoked for another bank in 2001.

4.5 Bank Earnings Quality

In 2000, banks reported a profit of HRK 1,987.7m. 38 out of 44 banks earned profit amounting to a total of HRK 2,134.9m, whereas 6 banks incurred a total of HRK 147.2m in losses. As shown in Table 4.11, interest income in the overall banking system amounted to HRK 8,337.3m, a 6.7% increase over 1999 levels. Interest expenses stood at HRK 4,044.3m, a 3.1% growth compared to the previous year. Net interest income in 2000 amounted to HRK 4,293.0m, representing a 10.3% increase over that in 1999. Interest income and expenses did not reach their 1998 levels, when significantly more banks were operating and interest rates were higher. Net non-interest income fell by 1.8% from the previous year, since both non-interest income and non-interest expenses were somewhat lower. Accordingly, banks did not significantly increase their non-interest income bearing activities following the drop in 1999.

Table 4.11 Bank Income Statement, million HRK and %

	1998	1999		2000	
	Amount	Amount	Change	Amount	Change
1. Net interest income	4,374.4	3,893.4	–11.0	4,293.0	10.3
1.1. Interest income	8,713.6	7,816.1	–10.3	8,337.3	6.7
1.2. Interest expenses	4,339.2	3,922.7	–9.6	4,044.3	3.1
2. Net non-interest income	1,629.7	2,035.5	24.9	1,999.7	–1.8
2.1. Non-interest income	4,507.1	2,962.4	–34.3	2,919.3	–1.5
2.2. Non-interest expenses	2,877.4	926.9	–67.8	919.6	–0.8
3. General administrative expenses and amortization	3,515.1	3,211.1	–8.6	3,519.4	9.6
4. Net operating income before provisions	2,489.0	2,717.9	9.2	2,773.3	2.0
5. Loan loss provision expenses	5,212.0	1,898.4	–63.6	762.6	–59.8
6. Pretax income/loss	–2,723.0	819.4	–130.1	2,010.7	145.4
7. Profit tax	179.8	104.8	–41.7	23.0	–78.1
8. After tax profit/loss	–2,902.9	714.6	–124.6	1,987.7	178.1

General administrative expenses and amortization amounted to HRK 3,519.4m, which was a 9.6% increase over that in the previous year. Net operating income before loan loss provisions stood at HRK 2,773.3m, up 2% over previous year levels, whereas a growth of 9.2% was recorded in 1999. Loan loss provisions fell significantly (HRK 5,212.0m in 1998; HRK 1,898.4m in 1999; HRK 762.6m in 2000). In 1998, a considerable increase in loan loss provision expenses was recorded, but following the exit of problem banks from the market in 1999, these expenses significantly decreased. This trend continued in 2000. Interest income accounted for 74.1% of the Croatian banks' income structure, an up from that in the previous year, whereas non-interest income accounted for 25.9%. Interest expenses accounted for 47.7% of the expenses structure (excluding loan loss provisions), non-interest expenses for 10.8%, and general administrative expenses for 41.3%, increasing their share in structure. As in the previous years, interest income was predominant in the income structure, whereas general administrative expenses dominated the expenses structure. Realized profit against average assets increased from 0.74% in 1999 to 1.9% in 2000. Increased profit resulted, only to some extent, from an increase in net income before provisions and was to a great extent the result of a reduction in loan loss provision expenses. The reported profit of HRK 1,987.7m was 2.7 times larger than in 1999, when it amounted to HRK 714.6m. Apart from the aforementioned reduction in loan loss provision expenses, the reported profit was also influenced by deferred tax payments related to the application of International Accounting Principle 12. It should be noted that preliminary data were used in reporting the results for 2000, and thus bank performance in 2000 may be somewhat different after the annual reports for all banks have been audited.

4.6 Bank Liquidity

Bank liquidity is, in the narrowest sense, its capability to provide the funds for settling its due liabilities. In managing liquidity, banks take into account, among other things, the variability of deposits, availability of assets that can easily be changed into cash, access to money markets, central bank lending, and asset and liability maturity structures match. In order to assure liquidity reserve, banks place part of their assets in securities bearing lower interest which, however, can easily be changed into liquid assets. Liquidity ratios that can be used are the credit to deposit ratio (about 70% is considered optimum), and the short term assets to short term liabilities ratio.

At the end of 2000, HRK 2,496.0m in CNB bills denominated in kuna were purchased (HRK 850.4m at the end of 1998, and HRK 1,348.7m at year-end 1999). HRK 1,692.7m in CNB bills denominated in foreign currency were also purchased (HRK 1,377.4m in 1998, and HRK 1,507.6m in 1999). At the end of 2000, CNB loans amounting to HRK 299.6m were utilized, compared to HRK 1,044.1m at the end of 1999. The credit to deposit ratio was 71% in end 2000 (86% in 1998; 82% in 1999). The short-term assets to short-term liabilities ratio stood at 92.3% in 2000 (88.8% – 1998; 90.1% – 1999). Thus, bank liquidity has been continually improving over the past three years.

4.7 Savings Banks Performance

At the end of 2000, 26 savings banks were in operation, of which 4 were housing savings banks. During 2000, licenses were revoked for 7 savings banks, and against one savings bank bankruptcy proceedings were initiated. Savings banks founded before the

Banking Law came into force, which were issued the operating license based on the previously valid Law on Banks and Savings Banks, must adjust their operation to the Banking Law by the end of 2001, by increasing the paid-in capital so that it amounts to a minimum of HRK 20m. All savings banks are 100% privately owned.

Total savings bank assets at the end of 2000 amounted to HRK 1,613.9m, a 25.5% increase compared to that at the end of 1999. This increase was influenced by 171.7% growth in the assets of housing savings banks; the assets of savings banks founded in accordance with the previously effective Law on Banks and Savings Banks fell however by 3.5%. The share of the assets of housing savings banks in total assets of savings banks increased from 16.5% at the end of 1999 to 35.8% at the end of 2000. Such developments were effected by a reduction in the number of savings banks as a result of the withdrawal of licenses on one hand, and the intensive growth in assets of housing savings banks on the other.

4.7.1 The Structure of Savings Banks Balance Sheet

Loans to other clients accounted for the greatest part of savings banks assets, amounting to HRK 653.3m at the end of 2000. This is a 1.4% fall compared to the previous year. Their share in total assets decreased from 51.5% in end 1999 to 40.5% in end 2000. Some items significantly increased (due to their growth in housing savings banks balance sheets), both in nominal terms and in terms of their share in savings banks assets. These items include Ministry of Finance treasury bills and CNB bills whose share in savings banks assets increased from 9.8% in 1999 to 14.8% in 2000, the trading portfolio of

Table 4.12 Asset Structure of Savings Banks, end of period, million HRK and %

	1999		2000		
	Amount	Share	Amount	Share	Change
1. Money assets and deposits with the CNB	89.8	7.0	93.2	5.7	3.9
1.1. Money assets	24.3	1.9	36.1	2.2	48.5
1.2. Deposits	65.5	5.1	57.1	3.5	–12.7
2. Deposits with banking institutions	93.1	7.2	100.3	6.2	7.7
3. Treasury bills and CNB bills	126.4	9.8	239.0	14.8	89.0
4. Trading portfolio of securities	3.1	0.2	143.9	8.9	4,590.7
5. Loans to financial institutions	50.5	3.9	11.1	0.7	–78.1
6. Loans to other clients	662.3	51.5	653.3	40.5	–1.4
7. Investment portfolio of securities	32.4	2.5	190.9	11.8	488.5
8. Investment in subsidiaries and related companies	1.4	0.1	1.4	0.1	3.7
9. Foreclosed and repossessed assets	25.8	2.0	17.7	1.1	–31.5
10. Tangible assets and software (less depreciation)	66.5	5.2	59.1	3.7	–11.0
11. Interests, fees and other assets	142.5	11.1	112.5	7.0	–21.1
12. Less: specific reserves for unidentified losses	7.6	0.6	8.5	0.5	12.7
TOTAL ASSETS	1,286.2	100.0	1,613.9	100.0	25.5

securities (increased from 0.2% in 1999 to 8.9% in 2000) and the investment portfolio of securities (up from 2.5% in 1999 to 11.8% in 2000). All other items decreased in their assets share compared to the previous year.

Deposits were dominant in the liability structure of savings banks, amounting to HRK 1,178.8m at the end of 2000. Their share in total liabilities grew from 64.2% in 1999 to 73% in 2000, whereas in nominal terms, deposits increased by 42.7%, mainly the result of deposit growth in housing savings banks. The share of all other liabilities, apart from supplementary capital, decreased compared to 1999. Supplementary capital increased from HRK 52m in 1999 to HRK 83.2m in 2000, and its share in liabilities grew from 4% at the end of 1999 to 5.2% in 2000.

Table 4.13 Liability Structure of Savings Banks, end of period million HRK and %

	1999		2000		
	Amount	Share	Amount	Share	Change
1. Loans from financial institutions	28.8	2.2	13.3	0.8	–54.0
1.1. Short-term loans	24.8	1.9	12.1	0.7	–51.4
1.2. Long-term loans	4.0	0.3	1.2	0.1	–69.9
2. Deposits	826.3	64.2	1,178.8	73.0	42.7
1.1. Giro and current account deposits	6.6	0.5	6.9	0.4	5.2
1.2. Savings deposits	38.6	3.0	46.9	2.9	21.4
1.3. Time deposits	781.1	60.7	1,125.0	69.7	44.0
3. Other loans	8.4	0.7	4.4	0.3	–48.0
1.1. Short-term loans	7.8	0.7	3.8	0.3	–51.2
1.2. Long-term loans	0.6	0.0	0.6	0.0	–5.5
4. Debt securities issued	0.0	0.0	0.0	0.0	0.0
1.1. Short-term debt securities issued	0.0	0.0	0.0	0.0	0.0
1.2. Long-term debt securities issued	0.0	0.0	0.0	0.0	0.0
5. Supplementary capital	52.0	4.0	83.2	5.2	60.1
1.1. Subordinated instruments issued	12.8	1.0	9.9	0.6	–22.4
1.2. Hybrid instruments issued	39.2	3.0	73.3	4.6	87.0
6. Interests, fees and other assets	53.0	4.1	56.4	3.5	6.4
7. Profit/loss for the current year	–41.4	–3.2	–43.4	–2.7	4.6
8. Capital	359.1	27.9	321.2	19.9	–10.6
TOTAL LIABILITIES	1,286.2	100.0	1,613.9	100.0	25.5

4.7.2 Savings Banks Capital

Savings banks capital decreased by 10.6% due to a loss incurred in 1999 and a reduction in the number of savings banks. The share of capital in total liabilities fell from 27.9% in 1999 to 19.9% in 2000. The loss incurred in 2000 will influence a further capital decrease.

At the end of 2000, the risk-based capital of savings banks amounted to HRK 310.3m, down from the HRK 336m as at December 31, 1999. Savings bank core capital decreased in 2000 due to operational losses. However, at the same time their supplementary capital (hybrid and subordinated instruments) increased and was added by savings banks to risk-based capital in accordance with the legislation.

Table 4.14 Savings Banks Capital Structure, end of period, million HRK and %

	1999		2000		
	Amount	Share	Amount	Share	Change
1. Share capital	369.4	102.8	353.5	110.1	–4.3
2. Retained earnings/loss	–46.1	–12.8	–50.4	–15.7	9.3
3. Legal reserves	13.6	3.8	3.9	1.2	–71.3
4. Reserves provided for by the articles of association and other capital reserves	22.2	6.2	14.2	4.4	–36.0
TOTAL CAPITAL	359.1	100.0	321.2	100.0	–10.6

Savings bank capital adequacy was 38% in end 1999, whereas it was 37% in end 2000. At the end of 2000, the capital adequacy in three savings banks was less than the permitted minimum of 10%.

4.7.3 Asset Quality of Savings Banks

Savings banks are obliged to perform assets quality analysis in the same manner as banks. At the end of 2000, banks classified into risk category A (for which specific reserves for unidentified losses are not calculated), a total of HRK 1,348.7m, accounted for 88.1% of gross placements of savings banks. At the end of 1999, 75.9% of savings bank gross placements were graded A. In end 2000, 11.9% of the total risk-based assets of savings banks were classified into risk categories B, C, D, and E, for which specific reserves are calculated and reported. This is a significant reduction in comparison with the 24.1% recorded in 1999. Such an improvement in asset quality was a consequence of the "removal" from the system of savings banks whose licenses were revoked, as well as the bankruptcy of one bank. For the same reason, the share of total provisions (for both identified and unidentified losses) in gross placements fell from 10.6% at the end of 1999 to 5.9% at the end of 2000.

Table 4.15 Classification of Savings Banks Placements by Risk Categories, end of period, million HRK and %

Placement	1999		2000	
	Amount	Share	Amount	Share
A	925.4	75.9	1,348.7	88.1
B	92.7	7.6	57.7	3.8
C	110.2	9.0	51.5	3.4
D	46.0	3.8	31.4	2.0
E	44.6	3.7	41.7	2.7
Total	1,218.9	100.0	1,531.0	100.0

Table 4.16 Provision to Placement (A, B, C, D, E) Ratio of Savings Banks, end of period, million HRK

	1999	2000
1. Total provisions for identified and unidentified losses	129.2	90.5
1.1. Provisions for identified losses	121.6	82.3
1.2. Provisions for unidentified losses	7.6	8.2
2. Total gross placements (A,B,C,D,E)	1,218.9	1,531.0
3. Relative ratio of total provisions to total gross placements	10.6	5.9

4.7.4 Limitations Decreasing Risks

Savings banks, identical to banks, are obliged to comply with the regulations determining ratios and levels of exposure.

As shown in Table 4.17, for savings banks violating the legal limitations, time limits were set for adjusting to the prescribed limitations, excluding one bank where the process of supervision was under way.

Table 4.17 Savings Banks according to Compliance with the Prescribed Limitations, balance as of December 31, 2000

Type of limitation	Compliant	Non-Compliant		Total number of savings banks
		Permitted time limit for adjusting to the prescribed limitations	Savings banks breaching the prescribed limitations	
Savings bank exposure to single borrower must not exceed 25% of risk-based capital	23	3	–	26
Total amount of large exposures must not exceed 400% of risk-based capital	23	3	–	26
Exposure to s single shareholder with more than 3% of shares in the savings bank must not exceed 5% of risk-based capital	21	4	1	26
Total exposure to shareholders with more than 5% shares in the savings bank must not exceed 25% of risk-based capital	23	3	–	26
Investment in tangible assets must not exceed 30% of risk-based capital	24	2	–	26
Investment in tangible assets and equity participation must not exceed 70% of risk-based capital	24	2	–	26

4.7.5 Savings Bank Earnings Quality

In 2000, savings banks incurred operational losses amounting to HRK 45.3m, implying a further deterioration in savings bank operations, following a HRK 2.3m loss in 1998 and HRK 49.2m loss in 1999. Losses totaling HRK 76m were reported by 9 savings banks, whereas 17 savings banks reported HRK 30.7m in profits.

The operational losses of housing savings banks, amounting to HRK 23m, also significantly contributed to the amount of the reported losses. These losses resulted from the fact that housing savings banks were established in 1998 and 1999 and were in their initial operational stages. Net interest income amounted to HRK 79.8m, which was a 29.9% fall compared to the previous year. General expenses and amortization increased by 4.6%. Net operating losses before loan loss provisions stood at HRK 37.2m. Loan loss provision expenses of HRK 66m in 1999 (which was an increase from 1998), were followed by a drastic fall in 2000, when they amounted to HRK 6.7m. Such a fall can to a certain extent be accounted for by license withdrawals from "problem" savings banks and their removal from the savings banks balance sheet, and a consequential growth in placements involving lower risk in the savings bank placement structure in 2000.

Table 4.18 Savings Bank Income Statement, million HRK and %

	1999	2000	Change
1. Net interest income	114.0	79.8	–29.9
1.1. Interest income	231.4	197.1	–14.8
1.2. Interest expenses	117.4	117.3	–0.1
2. Net non-interest income	26.8	11.5	–57.2
2.1. Non-interest income	60.4	62.3	3.1
2.2. Non-interest expenses	33.6	50.8	51.3
3. General administrative expenses and amortization	122.8	128.5	4.6
4. Net operating income before provisions	18.0	–37.2	–306.1
5. Loan loss provision expenses	66.0	6.7	–89.8
6. Pretax income/loss	–48.0	–43.9	–8.6
7. Profit tax	1.2	1.4	17.6
8. After tax profit (loss)	–49.2	–45.3	–8.0

4.8 The Supervision of Banks and Savings Banks

The Bank Supervision Area consists of the On-Site Supervision Department, Off-Site Supervision Department, and Department for Improving Bank Supervision. The Foreign Trade Transactions Control Department is also within the organizational structure of the Bank Supervision Area.

Following its establishment in 1993, the Bank Supervision Area within the Croatian National Bank has been gradually developed and enhanced with respect to organization and human resources. In 1999, the Area was reorganized (the Department for the Inspection of Compliance with Monetary and Foreign Exchange Policy Measures was merged with the On-Site Bank Supervision Department) and 24 new employees were recruited.

At the end of 2000, the Bank Supervision Area consisted of a total of 73 employees[6].

In 2000, as in the previous years, efforts were made regarding the ongoing training of employees, by continuing cooperation with USAID technical assistance, and providing

[6] Total number of employees does not include those employed with the Foreign Trade Transactions Control Department.

occasional internal training within the Area, as well as joint training with other areas of the Croatian National Bank. The employees participated in various seminars and training courses in Croatia and abroad and were enrolled in post-graduate studies.

In 2000, the Bank Supervision Area conducted a total of 45 examinations of banking operations (24 banks and 21 savings banks), 4 examinations of the implementation of measures for eliminating illegal and irregular activities (2 banks and 2 savings banks), as well as 6 examinations of exchange operations. The On-Site Supervision Department issued 34 examination findings based on the data on the implementation of monetary and foreign exchange policy measures. The Off-Site Supervision Department prepared 24 examination findings on the examination of a part of operations (16 for banks and 8 for savings banks). 43 orders for the improvement of conditions and the elimination of illegal and irregular activities were issued within the Bank Supervision Area (13 related to additions to, the prolongation and revocation of orders), as well as 1 order for determining illiquidity.

Over 2000, a total of 42 citations were processed (26 minor offence citations, 14 citations for economic infractions and 2 citations for infringement of currency regulations). In several banks and savings banks, the intervention of criminal and financial police was requested. In 2000, the Foreign Trade Transactions Control Department filed a total of 3,201 requests for initiating misdemeanor court proceedings for the infringement of currency regulations.

In 2000, several amendments to the regulations were adopted based on the Banking Law, which shall be applicable from 2001. The amendments were adopted for the purpose of eliminating certain misinterpretations that were observed when applying the decisions in practice.

Further strengthening of bank supervision quality is one of the strategic goals of the Croatian National Bank. Accordingly, special efforts have continued to be made to improve the compliance with the BIS Core Principles that lay down the minimum requirements for effective banking supervision, as well as to enhance the CAMEL method application, i.e. to introduce the CAMELS method into bank supervision, and to follow other European and world guidelines and standards, which themselves have constantly been improving.

5

Currency Department Operations

In line with its objectives and tasks, the Currency Department of the Croatian National Bank received printed cash from the manufacturer, supplied cash to branches of the Institute for Payment Transactions, processed and destroyed worn out banknotes withdrawn from circulation, issued commemorative coins and provided expert evaluation of suspicious kuna banknotes.

5.1 Movements in Cash

At the end of 2000, the currency in circulation amounted to HRK 6.6bn. Of this amount, 66.1m units went to kuna banknotes amounting to HRK 6.3bn and 691.8m units went to coins, both kuna and lipa, worth HRK 0.337bn.

In comparison with 1999, the quantity of banknotes outside the treasury of the Croatian National Bank and the Institute for Payment Transactions at the end of 2000, was 1.0% lower while their value increased by 9.5%.

The amount of coins outside the treasury of the Croatian National Bank and the Institute for Payment Transactions at the end of 2000 increased by 11.4% and their value increased by 24.1%, compared with that in 1999.

During 2000, the amount of banknotes and coins outside the treasury amounted to an average of 15 banknotes and 153 coins per person.

According to the data for 2000, the renewal index (destroyed banknotes/circulation x 100) was 37 compared with 35 in 1999.

5.2 Commemorative Coins

In 2000, the Croatian National Bank released a commemorative HRK 25 coin, marking the jubilee of the year 2000.

Within the gold and silver coins program, a HRK 500 gold coin was issued in 2000 to commemorate the 10th anniversary of the formation of the Croatian Parliament, May 30, 1990 – May 30, 2000, and the third edition of a HRK 200 silver coin was also issued in 2000, as part of the series entitled “FAMOUS CROATIAN WOMEN”, dedicated to artist Slava Raškaj.

During 2000, the value of identified counterfeit banknotes was HRK149,700.00. In comparison with 1999, the value of identified counterfeits increased by 34.9%, and this mostly via counterfeit HRK 100 and HRK 200 banknotes. An analysis of the counterfeit notes showed that they were mainly produced by means of computers and printed on color printers.

6

Payment Operations

The main activities in the area of payment operations in 2000 were focused on the further implementation of payment system reform in the country, on the improvement of the existing payment system in the country and on the supervision of institutions authorized to perform payment transactions.

At its 58th session held on January 4, 1995, the Council of the Croatian National Bank set down the basic foundations for the country's new payment system and defined changes which had to be introduced relating to:

- the development of the new payment system infrastructure;
- the transfer of bank and savings bank accounts from the Institute for Payment Transactions to the Croatian National Bank; and
- the transfer of business entity and natural person accounts from the Institute for Payment Transactions to the banks.

These changes are aimed at minimizing system risk in payment operations, achieving the better liquidity management of banks and their customers as well as the better liquidity management of the entire banking and financial system, breaking up the monopoly on payment operations, establishing a modern system of payment operations, based on recommendations on payment operations given by the EMU and compatible with the systems found in more developed countries.

The reform was to be implemented gradually to enable the safe functioning of the payment system, but also because the present Payment System Law (official gazette *Narodne novine,* No. 27/1993 and 97/2000) allows only certain changes. So far several changes have been implemented.

6.1 New Payment System Infrastructure

6.1.1 Croatian Large Value Payment System (CLVPS)

The Croatian Large Value Payment System became operative on April 6, 1999. This was the first basic step in the implementation of the payment system reform. The CLVPS is a system that allows interbank payment transactions through the accounts of banks and savings banks at the Croatian National Bank in real time and on the gross settlement principle.

Participants in the CLVPS are the Croatian National Bank, banks, and savings banks. For the time being CLVPS is used for payment transactions between banks/savings banks, between the Croatian National Bank and banks and savings banks and for a small number of payment transactions between participants in the payment system whose accounts are held in banks and savings banks. Payments through the CLVPS are expected to increase significantly once the transfer of business entity accounts to the banks is completed, since payment transactions between business entities will make up part of the system.

The CLVPS fully annuls the system risk in the execution of payments. Payment is executed only if the payer bank has sufficient funds for its execution in its account.

6.1.2 National Clearing System (NCS)

In an effort to continue its payment system reform, the Council of the Croatian National Bank reached a decision in December 2000 to launch the National Clearing System, as a final step in providing the infrastructure needed to reach the reform's ultimate goal, which is to transfer payment system transactions and the accounts of business entities from the Institute for Payment Transactions to the banks. The NCS became operative on February 5, 2001. It is an interbank, small payment system, or a system for the settlement of all interbanks payment transactions which are not conducted through the CLVPS.

The basic characteristics of this system include:

- Participants in settlements through the NCS are the Croatian National Bank, banks and savings banks. Banks/savings banks post their payment transactions or the payment transactions of customers whose accounts are maintained by a bank/ a savings bank against their clearing accounts in the NCS for settlement. Payment transactions may also be submitted to the NCS for settlement in a bank's/savings bank's clearing account by the Institute for Payment Transactions, an institution which provides payment transaction services in the name and for the account of a bank/savings bank, as well as by a participant in the payment system on the basis of a special authorization issued by its depository institution.
- Settlements are performed on a net multilateral principle. Net positions for each bank/savings bank are calculated in relation to the others, i.e. in relation to the system as a whole. Thus calculated, the clearing account's net position is transferred at the end of the day from the clearing account of a bank/savings bank with the NCS to its settlement account with the Croatian National Bank for final settlement.
- Settlement is made up to a defined limit. Since the limit is guaranteed, for all payments through the NCS there is no system risk involved in the settlement in a bank's/savings bank's account.
- As a system of interbank payments, payment transactions are not conducted in real time, but in cycles during the day.

Ever since the NCS was put into operation, it has been used for the interbank payments of all banks and savings banks and of their customers whose accounts are kept in banks/savings banks and in the Institute for Payment Transactions.

6.1.3 Unified Register of the Accounts of Business Entities

The Unified Register of the Accounts of Business Entities is the essential infrastructure for the transfer of business entity accounts to the banks. The Register keeps records of the accounts of all business entities in the country. By means of the identification number assigned to each business entity by the Central Bureau of Statistics, it is possible to locate every account opened by the entity with institutions authorized to perform payment operations. The Unified Register of the Accounts of Business Entities is located within the Croatian National Bank.

6.2 Transfer of Bank and Savings Bank Accounts from the Institute for Payment Transactions to the Croatian National Bank

The accounts of all banks and savings banks have been transferred from the Institute for Payment Transactions to the Croatian National Bank. For banks this means more efficient liquidity management and for the Croatian National Bank this means more efficient liquidity management of the entire banking system.

Since other changes in the payment system were not made (the transaction accounts of business entities and some natural persons continue to be maintained by the Institute for Payment Transactions), banks and savings banks keep a daily transit account with the Institute for Payment Transactions which is used for the supply of banks/savings banks with cash, for registering payments in and out across the accounts of banks/savings banks with the Institute for Payment Transactions and in the Croatian Post and for the settlement of cash payment transactions across accounts of depositors with the Institute for Payment Transactions.

6.3 The Transfer of Payment Operations related to Business Entity Accounts to the Banks

All the preparations have been made for the transfer of payment operations related to business entity accounts to the banks, in line with the existing legal framework. For this purpose, the relevant by-laws have been adopted regulating the manner of keeping accounts and keeping a register of accounts in banks and the functioning of the Unified Register of the Accounts of Business Entities.

With the required infrastructure also being established, all preconditions, both legal and operative, have been fulfilled for the transfer of payment operations related to business entity accounts to the banks in line with the National Payment System Law.

All the previously mentioned changes were made within the framework of the current National Payment System Law, which does not allow further changes. For a full reform to be carried out, a new Law has to be adopted. The current legislation does not allow government accounts for payment operations to be transferred to the Croatian National Bank, nor does it allow the accounts of business entities in state or majority-state ownership to be transferred to the banks. These operations, under the current legislation, fall within the exclusive jurisdiction of the Institute for Payment Transactions.

During 2000, efforts were also made to improve the existing payment system in the country. For this purpose, amendments to the National Payment System Law were adopted, a number of regulations governing payment operations enacted and some technological solutions found to improve the execution of payments.

Some of the changes include:

- The legal requirement for payment notification was cancelled. An authorized institution executes payment orders on the day it receives them, provided these orders are issued in line with the regulations and if there are sufficient funds to cover the payments.

- An institution of “double cover” has been prescribed. This is a requirement which has to be met for the execution of a payment consisting of sufficient cover in the account of the payer and in the account of his depository institution. Supervision of the cover in the payer’s accounts is carried out by an authorized institution for payment transactions, which manages the payer’s account. Supervision of the cover in the accounts of the depository institution is secured through the system of interbank payment settlements.

Control over the payment operations of authorized institutions was conducted by means of on-site controls and by means of constant contact and cooperation with the authorized institutions.

On-site supervision of payment operations was carried out in 12 branches of the Institute for Payment Transactions and in 11 branches of the Croatian Post.

7

CNB Statistics

7.1 Statistics

In 2000, in addition to its regular data collection and processing operations, the Croatian National Bank continued to upgrade its statistics, as follows:

1. The reporting system, methodology and software for recording external debt were installed, while the reporting system was improved.

2. In cooperation with other CNB departments and on the basis of the IMF Reserves Template, the report on the international reserves of the CNB was designed, together with the data preparation system.

3. The methodology was devised and software developed for compiling the International Investment Position (IIP).

4. The CNB continued improving and modifying the compilation of the balance of payments.

5. The monetary statistics were enhanced and the exploitability of its data was improved, while the central government categories have been adjusted for further reporting.

6. Actions were taken to improve the quality and transparency of data intended to inform domestic experts as well as the general public in the country and abroad.

8

Organization, Management and Human Resources

8.1 Council of the Croatian National Bank

According to article 65 of the Law on the Croatian National Bank (official gazette *Narodne novine*, No. 35/1995 – amended version), the Council of the Croatian National Bank and the Governor of the Croatian National Bank comprise the governing bodies of the Croatian National Bank.

The Council of the Croatian National Bank consists of the Governor of the Croatian National Bank, Deputy Governor and Vicegovernors, who are members of the Council by virtue of their office, and no more than eight independent experts.

The Council of the Croatian National Bank and each of its members are responsible to the Croatian Parliament for performing the functions and tasks of the Croatian National Bank prescribed by the Law on the Croatian National Bank and other legislation.

Pursuant to the decision of the House of Representatives of the Croatian Parliament, the composition of the Council of the Croatian National Bank changed in July 2000.

Newly appointed members are: Željko Rohatinski, PhD, the Governor of the CNB and the Chairman of the CNB Council, Boris Vujčić, PhD, Deputy Governor, Tomislav Presečan, MSc, Vicegovernor, Relja Martić, Vicegovernor and Čedo Maletić, Vicegovernor. The independent experts sitting on the Council are: Branko Vukmir, PhD, Silvije Orsag, PhD, Sandra Švaljek, PhD, Alen Belullo, PhD, Branimir Lokin, PhD, Mate Babić, PhD, Božidar Jelčić, PhD and Damir Novotny, MSc.

The first meeting of the newly composed CNB Council, chaired by the Governor, Željko Rohatinski, was held on 19 July 2000.

The Council decides on the management of CNB operations by a two-thirds majority vote of its members. In the event that the required agreement is not reached, the Governor, having assessed that it is otherwise not possible to perform the tasks of the Croatian National Bank, enacts a temporary decision and notifies the Croatian Parliament, which makes the final decision.

In accordance with the Law on the Croatian National Bank, the central bank is responsible for the stability of the national currency. The CNB independently establishes the targets of monetary and foreign exchange policy and, within the framework of its rights and obligations, the measures to meet these targets.

The field of activity of the Council is prescribed by article 67 of the Law on the Croatian National Bank. The Council of the Croatian National Bank makes decisions at its meetings, while the Governor of the Croatian National Bank is responsible for their implementation.

In managing Croatian National Bank operations, the Council of the Croatian National Bank establishes monetary and foreign exchange policy and sets the measures for their implementation.

The Council of the Croatian National Bank makes the annual and quarterly forecasts for monetary policy. Once a month, the members of the Council discuss economic and monetary developments, information on the condition of the banking system and the report on the management of international reserves.

Pursuant to the authorization granted to the Croatian National Bank by the Banking Law, the Council makes decisions on regulations regarding its implementation. Some of these decisions are published in the official gazette *Narodne novine*, while some are of an internal nature. They are related to the prudential control of banks, granting and withdrawing approval for the establishment of banks, approving the appointment of chairmen or members of banks or savings banks' management boards and the acquisition of more than 10% of voting shares at banks' general meetings.

The Council also gives its judgement on granting operating licenses to savings and loan co-operatives and decides on other issues within the competence of the Croatian National Bank, including the regulation of the payment system, the supervision of the operations of the Institute for Payment Transactions and the issuing of circulation and commemorative coins.

In the year 2000, the Council held 18 meetings in order to make decisions on the matters within its competence.

8.2 Internal Audit

The Croatian National Bank founded the Internal Audit in 1995 as an independent organizational unit, reporting directly to the Governor of the Croatian National Bank.

The Internal Audit independently and objectively performs its three basic tasks:

1. supervision and counseling;
2. improving business operation quality;
3. providing advice on risk management and other elements of corporate management.

In its work, the Internal Audit conforms to the internationally accepted professional standards of the internal audit, the Charter of the Rights and Obligations of the Internal Audit and the Law on the Croatian National Bank. The reports of the Internal Audit are first submitted to the Governor and then to the relevant management body. The head of the Internal Audit is in charge of cooperating with external auditors and coordinating their respective operations.

The audit plan of the Internal Audit is illustrative of its risk-based approach as most of its activities are focused on the highest-risk areas. In assessing risk management, special emphasis is placed on the functioning of the system of internal controls and compliance with internal procedures, methodologies and rulebooks. In 2000, Internal Audit conducted 52 audits, pursuant to its own work plan and the Governor's instructions. The audits have shown that no irregularities were found in the functioning of CNB areas and departments and that laws and internal procedures and rulebooks have been complied with.

In 2000, as in previous years, the Internal Audit mostly dealt with the management of international reserves and the foreign currency liquidity of the CNB. Consequently, 31% of all internal audit reports were related to this area. Regular monthly and occasional targeted audits were carried out, covering the investment of international reserves, interventions in the foreign exchange market and the sale of foreign currency. These audits also involved monitoring the performance of the CNB portfolio and its benchmarks. The first independent control unit started functioning within the Foreign Exchange Asset Management Department in 2000. This improved the quality of the control function within the Bank and laid the groundwork for the reliance of the Internal Audit on the findings of autonomous control units. The Internal Audit also conducted additional audits, in accordance with the Governor's instructions, focused on the functioning of the Currency Department, assessed and rationalized expenses and controlled the auctions of CNB bills and the extending of loans to banks.

In 2000, there were 4 members of the Internal Audit, who accounted for 0.6% of all CNB employees. Further training of the Internal Audit members was continued through their attending specialized courses in Croatia and abroad and taking examinations for certified internal auditors specializing in banks and financial institutions. With the support of the CNB management and the provision of funds and personnel, the Internal Audit plans on the further improvement of audit techniques.

8.3 Organization and Computerization

The following changes were introduced into the organizational structure of the Croatian National Bank:

- ❑ the Executive Directors' Board was replaced by the Governor's Advisory Board;
- ❑ three on-site divisions were set up within the On-Site Supervision Department;

- the Accounting, Treasury and Payment Operations Area was divided into two areas: the Planning, Analysis and Accounting Area and the Payment Operations Area;
- the Planning and Analysis Department was established. Its function and operations conform to the planning methodology set forth by the System of Business Operation.

The proposal for the Rulebook on the Planning of the Operations of the Croatian National Bank was drawn up, as well as for eight instructions on the preparation of individual plans, to be applied in formulating the Operating Plan of the CNB for 2002.

4 employees are engaged in organizing business operations.

This number of employees has resulted from applying internationally accepted standards, in cooperation with relevant areas, to the methodology of business functions, rather than setting up specialist divisions within the Department, in charge of specific operational areas.

Prerequisites for the continued functioning of this Department are the implementation of the System of Business Operation and the hiring of the required personnel.

The upgrading of the CNB's information system, its software, network and hardware, continued in 2000. The applications for international credit transactions subsystem (loans taken and loans granted), bank supervision and monetary statistics were completed and modified. The projects for the storing and analytical monitoring of accounting data and recording securities were devised for the accounting subsystem. At the same time, bank supervision and monetary statistics applications were substantially modified and upgraded to meet user needs. The modifications of the project supporting the monitoring of foreign exchange transactions related to the export and import of goods and services involved the introduction of the Common Customs Declaration (CCD) and the amendments to the Instruction for the Implementation of the Decision on the Method for Executing External Payments and Supplying Data on External Payments.

In 2000, new applications supporting the monitoring of reserve requirements, foreign currency CNB bill auctions and the Unified Register of Business Entities Accounts were designed, together with the new application for the material accounting of fixed assets and small inventory. The application for the monitoring of the Unified Register of Business Entities Accounts was the first Internet application made in the CNB, utilizing modern data protection methods and a digital authorization certificate.

The design of the application for monitoring banks' limits in the National Clearing System was begun and the new application for the Croatian Large Value Payment System introduced.

8.4 Human Resources

8.4.1 CNB Employees

Having climbed over several years, the number of employees of the Croatian National Bank dropped by 0.34% at the end of 2000 in comparison with 1999. The other features of human resources development remained the same: extensive education and training and raising employee qualifications.

In 2000, the number of employees fell from 580 to 578. This was owing to the fact that the number of departures from the CNB (27) exceeded the number of new employees (23). Most departures were due to retirement. Mandatory requirements for retirement were assessed individually late in 2000, resulting in a larger number of retirees than expected in view of their age. 9 employment contracts were terminated on account of the termination of employment by consent, mostly initiated by employees. The number of unilateral terminations of employment increased, in comparison with 1999, when there was only one such case, which slowed down the usual mobility of employees.

Among the newly employed, there were a few employees who renewed their employment with the CNB, based on an agreement or the suspension of entitlements. The others were new employees, hired following announcements for open positions, subsequent interviews and the final choice of applicants. Most of them were experienced, as opposed to 1999 when trainees accounted for 38% of newly hired employees.

The average age of employees is close to 41. 116 employees below the age of 30 account for 20% of all employees, while almost the same share is accounted for by 119 employees above the age of 50. The average total work experience within the Bank is 18 years, while the average work experience is almost 13 years.

The CNB employee skills pattern at the end of December 2000 is presented in the following table:

	PhD	Msc	BA	2 yr.	Sec.	Qualified	Unqualified	TOTAL	WOMEN
Number	5	37	280	47	154	17	38	578	396
Share	0.87	6.40	48.44	8.13	26.64	2.94	6.57	100	68.51

55.71% of CNB employees hold a university degree, including Master's and Doctoral degrees, which is a 0.34% increase in comparison with the previous year. The rise in the employee qualification was brought about by an increase in the number of employees holding a Master's degree (7) and a doctorate (1).

8.4.2 Education and Training of Employees

The number of employees and various forms of advanced employee training at the Croatian National Bank have created the prerequisites for the further development and improvement of the majority of areas and departments.

The personnel basis has been created through hiring trainees, as well as experienced renowned experts, by granting scholarships to students and providing many employees with intensive advanced training.

The CNB's active educational policy, pursued in recent years, has resulted in the establishment of a team of highly skilled professionals in the area of the supervision and auditing of banks and savings banks. With regard to the significance of this function of the central bank and the current condition of the banking and financial system in Croatia, special attention was paid in 2000 to the further training of the employees in this area and improving the methodology for the prudential control of banks. In addition, the functioning of other CNB areas was continually improved and their employees provided with further education.

Title-content of program	Number	Participants
Seminars in Croatia	82	222
Seminars abroad	109	154
Foreign language courses	34	98
Computer training	13	67
Occupational and fire safety	5	139
Post-graduate studies (two-year)	12	12
Post-graduate studies (one-year)	9	9
Doctorate in science	1	1
Total	252	702

In comparison with 1999, the number of programs and participants increased by a considerable 71% especially regarding seminars held abroad. Almost 70% of all programs dealt with four vital functions of the Croatian National Bank: research, central banking operations, international relations and bank supervision. In addition to seminars organized outside the CNB, there were also in-house seminars held on a regular basis.

In 2000, the CNB used services and educational programs organized within the technical assistance of the Bank for International Settlements, the International Monetary Fund in Washington and Vienna, and the central banks of Great Britain, France, Netherlands, Austria, Switzerland (Studienzentrum Gerzensee) and others.

8.4.3 Salaries

Employee salaries were in line with the wage policy in Croatia, the Financial Plan of the CNB and the decisions of the Council of the Croatian National Bank. Individual promotions and salary increases were granted consistently in keeping with available funds and according to established criteria. They were aimed at improving CNB employee motivation and efficiency.

8.4.4 New Scholarship Holders

In 2000, the CNB again invited applications for scholarships, chose the best candidates and awarded 5 scholarships to third-year and 5 scholarships to fourth-year economics students.

9

Financial Report: Annual Financial Statement of the CNB for 2000

Pursuant to the provisions of the Law on Accounting (official gazette *Narodne novine*, No. 90/1992) and a partial application of International Accounting Standard 30, the Croatian National Bank compiles basic financial statements which include a balance sheet, income statement and notes.

In its operations, the Croatian National Bank earns income, incurs expenditures and establishes a surplus of income over expenditures. Income and expenditures are forecast by a financial plan, which is adopted by the Council of the Croatian National Bank and approved by the Croatian Parliament.

Articles 76 and 77 of the Law on the Croatian National Bank (official gazette *Narodne novine*, No. 35/95 – amended version) stipulate the earning of income and the settlement of expenditures related to the activities of the Croatian National Bank.

The surplus of income over expenditures created by the Croatian National Bank in its operations is government revenue. If expenditures are greater than income, the shortfall is covered from a special reserve fund. In case this is not sufficient, the shortfall is covered from government funds.

According to its annual financial statement for 2000, the Croatian National Bank had positive financial results.

Table 9.1 Income Statement, million HRK

ITEM	Plan 2000	Outturn 2000	Index 3/2
1	2	3	4
I. INCOME			
1. Interest receivable	1,296.1	1,391.6	107.4
2. Other income	100.0	102.2	102.2
TOTAL INCOME	1,396.1	1,493.8	107.0
II. EXPENDITURES			
1. Interest payable	945.7	898.9	95.0
2. Expenses	256.6	238.8	93.1
TOTAL EXPENDITURES	1,202.3	1,137.6	94.6
SURPLUS OF INCOME OVER EXPENDITURES	193.8	356.2	183.8

9.1 Income

The total income of the Croatian National Bank in 2000 was HRK 1,493.8m, which was 7% over plan. The most important item in total income was income derived from interest on funds deposited abroad, which accounted for 88.8% of the total and exceeded the planned level by HRK 100.3m.

Table 9.2 Income of the Croatian National Bank in 2000, million HRK and %

ITEM	Plan 2000	Outturn in 2000	% share	Index 3/2
1	2	3	4	5
1. Interest receivable				
1.1. Interest on loans and other placements from the primary issue	69.60	64.80	4.3	93.1
1.2. Interest and other income on funds deposited abroad	1,226.50	1,326.84	88.8	108.2
2. Other income	100.00	102.19	6.9	102.2
TOTAL INCOME	1,396.10	1,493.84	100.0	107.0

9.1.1 Interest Receivable

Interest and other Income from Funds Deposited Abroad

Interest earned on foreign exchange deposits abroad is accounted as income of the Croatian National Bank in kuna equivalent. In 2000 this income was HRK 1,326.8m, or 8.2% over planned.

Income from the investment of international reserves rose in 2000 due to the growth of these efficiently managed reserves, an increase in interest rates compared to the previous year and the growth of bonds' prices.

The rate of yield on the Croatian National Bank euro portfolio in 2000 stood at 4.38% compared with 2.81% in 1999. The yield on the Croatian National Bank US dollar portfolio was 6.56% in 2000, in comparison with 5.02% in 1999.

In 2000, positive exchange rate differences amounted to HRK 7,478.1m, while negative were HRK 7,126.9m, which resulted in the net positive exchange rate difference of HRK 351.2m.

Table 9.3 Structure of Income from Interest on Loans from the Primary Issue in 2000, million HRK and %

ITEM	Plan 2000	Outturn in 2000	% share	Index 3/2
1	2	3	4	5
1. Income from interest on lombard loans	7.8	7.0	11.6	89.8
2. Income from interest on repo loans (repo auctions of CNB bills)	2.3	2.1	3.5	91.4
3. Income from interest on intervention loans	3.4	2.9	4.8	85.5
4. Income from interest on liquidity loans	49.1	45.5	75.6	92.7
5. Income from default interest on overdue interest on loans	2.4	2.7	4.5	112.9
TOTAL	65.0	60.2	100.0	92.7
6. Income from interest on loans to the government	4.6	4.6	–	99.5
TOTAL	69.6	64.8	–	93.1

Interest on Loans and other Placements from the Primary Issue

Income earned by the Croatian National Bank in 2000 from interest on loans and other placements from the primary issue amounted to HRK 64.8m, or 93.1% of the planned amount. This was the result of decreased demand for central bank loans by banks and savings banks due to the considerably improved liquidity of the banking system, as well as reductions in interest rates (Decision on the Interest Rates of the Croatian National Bank, official gazette *Narodne novine*, No. 39/2000).

Table 9.4 Structure of Income from Interest on International Reserves by Investment Instruments in 2000, million HRK and %

ITEM	Plan 2000	Outturn 2000	% share	Index 3/2
1	2	3	4	5
1. Income from interest on investment in foreign securities	227.9	250.9	18.9	110.1
2. Income from interest on time foreign currency deposits	701.8	690.8	52.1	98.4
3. Income from interest on reverse-repo transactions	150.3	223.8	16.9	148.9
4. Income from interest on FIXBIS I FRIBIS	43.0	62.8	4.7	146.1
5. Interest income on the basis of the investment management	43.2	37.1	2.8	85.8
6. Income from interest on SDRs of the IMF	60.3	61.5	4.6	102.0
TOTAL	1,226.5	1,326.8	100.0	108.2

Income from interest on loans granted to banks and savings banks was HRK 60.2m in 2000, or 92.7% of the planned amount.

Income from interest on liquidity loans accounted for the largest share in this income, amounting to HRK 45.5m, or 75.6% of the planned amount. The rate of interest charged on liquidity loans was the rate charged on Lombard loans increased by 0.5 percentage points for loans used up to three months and the same rate increased by 1 percentage point for loans with longer periods of use.

The rate of interest charged on Lombard loans was reduced from 13% to 12% annually in April 2000. In 2000 income earned from interest on Lombard loans stood at HRK 7m, or 11.6% of total interest income derived from loans granted to banks.

Interest rates achieved at repo auctions over 2000 followed this downward trend. The average weighted interest rate, standing at 12.5% at first four auctions, fell to 6.1% at the last auction held in December. In 2000, this rate was 10.6% for the year compared with 12.3% in 1999. This income, amounting to HRK 2.1 m, accounted for as little as 3.5% of total income earned from interest on loans granted to banks. This was due to the fact that only seven repo auctions were held and that these auctions mainly involved agreements and deposits with short maturities.

Interest paid by banks and savings banks on intervention loans was 19% annually until April and 18% annually from April on. This income amounted to HRK 2.9m or 4.8% of total income derived from interest on loans to banks.

Income from default interest on overdue interest on loans was HRK 2.7m, or 12.9% higher than planned. Income from default interest on overdue interest on loans accounted for 4.5% of total income from interest on loans granted to banks.

Of the total income earned from interest on loans from the primary issue in 2000, the remaining HRK 4.6m, or 7.1%, was income from interest charged on loans granted to the government at the 5.9% annual discount rate. This rate was 7.9% until April 2000.

9.1.2 Other Income

Other income in 2000 stood at HRK 102.2m, or 2.2% higher than planned, and accounted for 6.9% of total income.

The largest item, in the amount of HRK 76.9m or 75.2%, was income from provisions for doubtful loans and interest (ordinary or default) charged on loans and unallocated or inaccurately calculated reserve requirements.

HRK 12.5m, or 12.3%, was income from interest charged to banks and savings banks by the Croatian National Bank at the rate of 18% annually (19% until April 2000), together with income from default interest charged to banks and savings banks which did not adequately calculate their reserve requirements, failed to maintain the legally prescribed average amount or calculated and allocated a lower than prescribed amount for reserve requirements.

The remaining HRK 12.8m, or 12.5% of other income, derives from the sale of securities (tax stamps), income from in-house restaurants and the sale of numismatics, as well as other extraordinary income.

9.2 Expenditures

According to the annual financial statement for 2000, the expenditures of the Croatian National Bank were HRK 1,137.6m or 5.4% lower than planned. Interest payable accounted for the largest share in expenditures, 79%, while expenses accounted for the remaining 21%.

9.2.1 Interest Payable

Interest on Reserve Requirements

In 2000, the Croatian National Bank paid HRK 533.8m of interest on allocated reserve requirements of banks and savings banks, which was 2.1% less than planned.

Table 9.5 Level and Structure of Expenditures compared with the Planned Expenditures for 2000, million HRK and %

ITEM	Plan 2000	Outturn in 2000	% share	Index 3/2
1	2	3	4	5
1. Interest payable				
1.1. Interest on reserve requirements of banks	545.1	533.9	46.9	97.9
1.2. Interest on securities	325.5	288.5	25.4	88.6
1.3. Interest on IMF arrangements	75.1	76.5	6.7	101.9
2. Expenses				
2.1. Material and other expenses	65.0	50.0	4.4	76.9
2.2. Depreciation	16.5	15.9	1.4	96.2
2.3. Employee expenses	113.1	111.6	9.8	98.7
2.4. Expenses of trading in securities denominated in foreign exchange	50.0	53.8	4.7	107.5
2.5. Provisions for doubtful loans and interest	12.0	7.5	0.7	62.5
TOTAL EXPENDITURES	1,202.3	1,137.6	100.0	94.6

In the period from January to November 2000, the Croatian National Bank paid interest to banks and savings banks at the 5.9% remuneration rate, both on kuna reserve requirements allocated in reserve requirement accounts and settlement accounts. Beginning from November 2000 and in keeping with changes made to reserve requirements, interest has been paid only on kuna reserve requirements allocated in reserve requirement accounts, at the reduced remuneration rate of 4.5%.

Table 9.6 Structure of Interest Paid on Reserve Requirements in 2000, million HRK and %

ITEM	Plan 2000	Outturn 2000	% share	Index 3/2
1	2	3	4	5
1. Interest on kuna reserve requirements	250.0	236.3	44.3	94.5
2. Interest on foreign currency reserve requirements	295.1	297.6	55.7	100.8
TOTAL	545.1	533.9	100.0	97.9

In 2000, interest paid on banks' kuna reserve requirements held with the Croatian National Bank was HRK 236.2m.

In 2000, the central bank calculated interest on foreign exchange reserve requirements allocated in foreign exchange accounts with the Croatian National Bank at the rate equal to the one set on placements abroad. The average rate of interest paid to banks and savings banks by the Croatian National Bank in 2000 was 5.72% on reserve requirements allocated in US dollars and 4.13% on reserve requirements in euro. Since December 2000, foreign exchange reserve requirements have been set aside in euro.

In 2000, interest paid by the Croatian National Bank to banks and savings banks on allocated reserve requirements amounted to HRK 297.6m.

Interest on Securities

Over 2000, the Croatian National Bank paid HRK 288.5 m, or 88.6% of planned, in interest payable to banks and savings banks which purchased kuna and foreign currency CNB bills (in US dollars and/or euro). This amount accounted for 25.4% of total expenditures. The structure of interest is shown in Table 9.7.

Table 9.7 Structure of Interest Payable Paid on Securities in 2000, million HRK and %

ITEM	Plan 2000	Outturn 2000	% share	Index 3/2
1	2	3	4	5
1. Interest on kuna CNB bills	220.0	181.1	62.8	82.3
2. Interest on foreign currency CNB bills	80.5	80.8	28.0	100.4
3. Interest on foreign currency repo transactions	25.0	26.5	9.2	106.0
TOTAL	325.5	288.5	100.0	88.6

Following interest rate developments in the market, the Croatian National Bank gradually lowered interest rates at the auctions of CNB bills. From January to December, interest rates on kuna CNB bills fell by 3.9 percentage points for 35-day bills, 4.6 percentage points for 91-day bills and 4.8 percentage points for 182-day bills. In the last two months of 2000, interest rates stood at 6.65% for 35-day bills, 7% for 91-day bills, and 7.7% for 182-day bills. As for foreign currency CNB bills, average interest rates set on 63-day bills, the most common maturity of foreign currency bills, were 4.86% on euro CNB bills and 6.58% on CNB bills in US dollars.

Interest paid on purchased kuna CNB bills in 2000 amounted to HRK 181.1m. HRK 80.8m was paid on foreign currency CNB bills, while interest on foreign currency repo deposits was HRK 26.5m.

Interest on IMF Arrangements

This item comprises interest on two financial arrangements concluded between the International Monetary Fund and the Republic of Croatia: the STF[1] arrangement, approved on 14 October 1994, in the amount of 130.8m special drawing rights, and the EFF[2] arrangement, approved on 12 March 1997, amounting to 353.2m special drawing rights. These interest payments are being made to the IMF when they fall due from Croatian National Bank income, pursuant to the provisions of the Agreement on the Method of Settling Liabilities Arising from Financial Arrangements Concluded Between the International Monetary Fund and the Republic of Croatia, concluded on 1 June 2000 between the Ministry of Finance of the Republic of Croatia and the Croatian National Bank.

Interest calculated and paid by the Croatian National Bank in 2000 on the basis of STF and EFF arrangements totaled HRK 76.5m (6.9m special drawing rights). This exceeded the planned amount by 1.9% and accounted for 6.7% of total expenditures.

1 STF-Systemic Transformation Facility.
2 EFF-Extended Fund Facility.

The variable rate of interest on these arrangements rose considerably over 2000. Standing at 4.81% in the first half, it reached 5.58% in the second half of the year.

9.2.2 Expenses

Material and Other Expenses

In 2000 material and other expenses stood at HRK 50.0m, 23.1% lower than planned and HRK 5.3m down from levels in 1999.

Expenses were lower than planned in all categories, except for transportation and communication expenses, which showed a slight increase of approximately 4%.

With a share of 28.7%, other services provided by outside sources comprised the largest item in these expenses, amounting to HRK 14.4m. This included security services (protection of business premises and employees), tangible assets insurance services, municipal services, occupancy services, cash transportation services, services provided on the basis of work contracts, student services and other outside services.

Repair and maintenance expenses amounted to HRK 10.4m and accounted for a 20.7% share in total material and other expenses. These expenses included regular and investment maintenance of premises, office equipment and computers, plants, vehicles and other tangible assets.

These expenses accounted for 49.4% of material and other expenses, while the remaining 50.6% was accounted for by all other expenses.

Table 9.8 Structure of Material and other Expenses in 2000, million HRK and %

ITEM	Plan 2000	Outturn 2000	% share	Index 3/2
1	2	3	4	5
1. Banks' charges	2.0	1.7	3.5	87.1
2. Other expenses related to employees	0.5	0.5	0.9	100.0
3. Stationery and office supplies	1.9	1.9	3.8	100.0
4. Communications	3.1	3.2	6.4	103.8
5. Training, seminars, conferences, education studies and research	1.7	1.3	2.7	78.9
6. Professional fees	6.9	5.0	10.0	72.2
7. Other services provided by outside sources	16.1	14.4	28.7	89.1
8. Transport	1.4	1.5	2.9	104.4
9. Publications and subscriptions expenses	2.6	2.6	5.1	100.0
10. Other administrative expenses	7.6	6.5	13.1	85.3
11. Repairs and maintenance	11.0	10.4	20.7	94.3
12. Expenses from write-off and sale of fixed asstes	0.2	0.1	0.3	69.3
13. Other extraordinary expenses	10.0	1.0	1.9	10.0
TOTAL	65.0	50.0	100.0	76.9

Depreciation

The basic guidelines on fixed asset depreciation are given in Item 4 of International Accounting Standard 4 and relate to the following assets:

- assets expected to be used during more than one accounting period;
- assets with limited useful life; and
- assets held for administrative purposes.

The depreciation expenses of the Croatian National Bank in 2000 amounted to HRK 15.9m, or 96.2% of the planned amount.

Depreciation is calculated by means of the linear method and at the rates leveling the annual depreciation rates published in the Rulebook on Depreciation (official gazette *Narodne novine*, Nos. 91/1994 through 142/1997). Accordingly, the fixed asset depreciation expenses of the Croatian National Bank in 2000 were HRK 11.7m.

This item's remaining amount of HRK 4.2m was transferred to the depreciation of intangible assets. Under the new accounting system of the Croatian National Bank, introduced in 1999, the Chart of Accounts provides for accounting the expenses of printing notes and minting coins in the Croatian National Bank Balance Sheet. On the income statement, total expenses are not debited annually but depreciated, expenses for minting coins over five years and for printing banknotes over two years, and transferred to expenditures in monthly statements. In accordance with the Rulebook on Classifying Fixed and Intangible Assets, Liabilities and Claims, Calculating Depreciation and Writing-Off Small Inventory, the annual rates of coins and banknotes' depreciation are 20 and 50% respectively.

Depreciation expenses account for 1.4% of the total expenditures of the Croatian National Bank.

Employee Expenses

In 2000, expenses for employees amounted to HRK 111.6m or 98.7% of the planned amount. This included gross salaries, gross compensations and contributions on salaries.

Table 9.9 Salaries, Compensations and Contributions for Employees in 2000, million HRK and %

ITEM	Plan 2000	Outturn 2000	% share	Index 3/2
1	2	3	4	5
1. Employee gross salaries	78.5	77.0	69.0	98.1
1.1. Employees	77.0	75.6	–	98.1
1.2. Officials	1.5	1.5	–	100.0
2. Gross compensations to employees	18.0	18.1	16.3	100.6
3. Contributions on salaries	16.6	16.4	14.7	98.8
TOTAL	113.1	111.6	100.0	98.7

Salaries in the Croatian National Bank in 2000 were paid in accordance with the Statute of the Croatian National Bank and the Rulebook on Salaries and other Employee Income. The Rulebook provides for the level of salaries and adjustments in salaries to be determined by the Council of the Croatian National Bank.

In 2000 gross salaries in the Croatian National Bank totaled HRK 77.0m, 1.9% lower than planned.

Of the total HRK 77.0m paid in gross salaries, HRK 1.5m was paid as salaries for CNB officials (Governor, Deputy Governor and Vicegovernors) and HRK 75.5m for other CNB employee salaries. Officials' salaries were paid out in accordance with the Law on the Obligations and Rights of Government Officials (official gazette *Narodne novine*, Nos. 101/1998 through 25/2000).

The level of total salaries was also affected by a one-off holiday cash bonus, salaries paid to new employees, incentive payments to employees, an increase in the salaries of employees promoted during 2000, as well as the pattern of skills of CNB employees, of whom over 50% hold a university degree.

In 2000, HRK 18.1m was paid in gross compensations, which exceeded the planned amount by 0.9%, while HRK 16.4m was paid in contributions on salaries.

Employee expenses amounted to HRK 111.6m and accounted for 9.8% of total expenditures.

Expenses of Trading in Securities Denominated in Foreign Currencies

In accordance with International Accounting Standard 18, Item 34, which shows income and expenditures according to the gross principle, the expenses of trading in securities denominated in foreign currencies are planned within expenditures. Income planned on that basis within income from funds deposited abroad considerably exceeds expenditures, which produces a positive net effect. However, whether the CNB will incur expenses in addition to earning income depends on the relationship between the coupon and market interest rates, as well as on the timing of the sale of securities.

In 2000, the expenses of trading in securities denominated in foreign currencies were HRK 53.8m, which exceeded the planned amount by 7.5% and accounted for 4.7% of total expenditures.

Provisions for Doubtful Loans and Interest

When a bank is faced with financial difficulties that can negatively affect timely interest payments and principal repayments of loans extended by the Croatian National Bank which are not covered by the first-class instruments of collateral, the Croatian National Bank must evaluate the loan risk and make adequate provisions. This is pursuant to the Decision on the Provisioning Policy of the Croatian National Bank for Loans Extended to Banks, issued by the Governor of the CNB on 30 June 1999.

All Croatian National Bank claims (due and outstanding) on a certain bank are classified into the risk group containing the longest individual overdue claim on that bank, as follows:

- for loan obligations and/or interest overdue 61 to 90 days, provisions are made in the amount of 25% of the loan balance due, or 25% of overdue interest;
- for loan obligations and/or interest overdue 91 to 180 days, provisions are made in the amount of 50% of the loan balance due and 100% of overdue interest;
- for loan obligations and/or interest overdue over 180 days or in case a bankruptcy procedure has been initiated over a bank, provisions equal 100% of the loan balance due, or 100% of overdue interest.

Provisions are not required for loans covered by the first-class instruments of collateral, which include promissory notes of the Croatian National Bank or the Ministry of Finance of the Republic of Croatia.

Provisions made for doubtful loans and interest in 2000 totaled HRK 7.5m, or 62.5% of the planned amount, accounting for 0.7% of total expenditures. In 1999 these provision reached a significant HRK 407.5m, or 34.3% of total expenditures.

9.3 Surplus of Income over Expenditures

In accordance with article 80 of the Law on the Croatian National Bank (official gazette *Narodne novine*, No. 35/95 – amended version), the surplus of income over expenditures, after the settlement of expenditures, is government revenue.

Total income in 2000 was HRK 1,493.8m, or 7% over the planned amount, while expenditures were HRK 1,137.6m, 5.4% lower than planned. The surplus of income over expenditures was thus HRK 356.2m, or 83.8% more than planned. This surplus level was determined primarily by income from interest on funds deposited abroad, which amounted to HRK 1,326.8m and accounted for 88.8% of total income.

The surplus of income over expenditures of the Croatian National Bank is government revenue. Pursuant to the Governor's Decision of 19 February 1999, it is transferred to the Ministry of Finance of the Republic of Croatia according to the following schedule: an advance is paid by 20 July of the current year, based on the semi-annual financial statement of the Croatian National Bank, while the remaining amount is transferred after the annual financial statement has been adopted by the Council of the Croatian National Bank.

Table 9.10 Balance Sheet of the Croatian National Bank, in HRK

Account No.	Item	Balance on December 31, 1999	Balance on December 31, 2000
	ASSETS		
10	Domestic cash	43,496.4	33,218.0
11	Gold and precious metals in vaults	1,269,619.6	1,269,619.6
12	Foreign currency cash and correspondent banks' accounts	18,879,937,599.8	21,078,255,762.6
13	Foreign currency investments and claims	8,176,379,869.5	11,630,496,681.1
14	Assets in non-convertible currencies	1,282,775.3	1,282,775.3
15	Loans to the government	10,508,229.6	0.0
17	Loans to financial institutions	1,545,017,040.9	686,317,921.5
19	Provisions	–400,944,697.8	–331,544,233.7
20	Fixed assets	64,635,831.2	291,822,701.7
21	Intangible assets	12,043,621.3	28,614,705.6
22	Equity participation	8,054,296.8	8,054,296.8
23	Numismatics and other collections	14,368,965.2	14,680,419.0
24	Inventories	652,971.7	933,987.9
28	Miscellaneous loans	1,184,212.3	190,279.9
29	Other assets	6,863,388,117.0	7,967,695,885.1
	TOTAL ASSETS	35,177,821,948.7	41,378,104,020.3
	LIABILITIES		
30	Currency issues	6,341,015,235.8	7,168,994,943.3
31	CNB bills in circulation (discounted value)	1,255,387,189.0	2,543,390,420.0
32	Foreign currency liabilities	4,814,447,956.1	5,836,639,900.7
34	CNB bills in circulation denominated in foreign currency (discounted value)	1,634,708,039.9	1,812,737,401.3
35	Domestic currency liabilities to non-residents	5,342,357,031.7	5,185,699,073.0
36	Domestic currency government deposits	279,567,862.3	845,956,189.7
37	Domestic currency deposits from financial institutions	4,316,690,836.0	4,890,412,893.1
38	Domestic currency deposits from other institutions	166,198,349.0	149,998,482.5
39	Miscellaneous accounts payable	14,384,098.2	246,187,445.6
48	Adjustment, settlement and transit accounts	6,881,637,454.1	8,046,242,273.0
52	Reserves	4,131,427,896.6	4,651,844,998.3
	TOTAL LIABILITIES	35,177,821,948.7	41,378,104,020.3

The surplus of income over expenditures in the amount of HRK 123.0m was advanced to the Ministry of Finance of the Republic of Croatia in July 2000, on the basis of the semi-annual financial statement of the Croatian National Bank for 2000.

Table 9.11 Balance Sheet of the Croatian National Bank, Off-Balance Sheet Statment, in HRK

Account No.	Item	Balance on December 31, 1999	Balance on December 31, 2000
	ASSETS		
94	Commitments on operations on securities	132,125,028.9	5,265,323,064.7
97	Collaterals (pledged assets)	295,361,469.4	0.0
98	Collaterals denominated in foreign exchange	251,237,400.7	83,097,100.0
99	Other commitments	1,743,980,612.2	958,774,409.8
	TOTAL OFF-BALANCE SHEET ACCOUNTS	2,422,704,511.2	6,307,194,574.5
	LIABILITIES		
84	Contra-accounts of commitments on operations on securities	132,125,028.9	5,265,323,064.7
87	Contra-accounts of collaterals	295,361,469.4	0.0
88	Contra-accounts of collaterals denominated in foreign exchange	251,237,400.7	83,097,100.0
89	Contra-accounts for other commitments	1,743,980,612.2	958,774,409.8
	TOTAL OFF-BALANCE SHEET CONTRA-ACCOUNTS	2,422,704,511.2	6,307,194,574.5

Table 9.12 Balance Sheet of the Croatian National Bank, Treasury Inventory System, in HRK

Account No.	Item	Balance on December 31, 1999	Balance on December 31, 2000
	ASSETS		
1	Cash (HRK and HRD)	85,345,639,637.5	83,554,178,412.5
2	Custody accounts	432,187,233.7	403,032,442.1
3	Accounts for foreign operations (former YU)	581,085,280.5	587,168,868.9
4	Written-off receivables	482,026,353.2	583,327,402.3
9	Other	113,729,582.1	118,096,363.0
	TOTAL ASSETS	86,954,668,086.8	85,245,803,488.8
	LIABILITIES		
1	Cash (HRK and HRD)	85,345,639,637.5	83,554,178,412.5
2	Custody accounts	432,187,233.7	403,032,442.1
3	Accounts for foreign operations (former YU)	581,085,280.5	587,168,868.9
4	Written-off receivables	482,026,353.2	583,327,402.3
9	Other	113,729,582.1	118,096,363.0
	TOTAL LIABILITIES	86,954,668,086.8	85,245,803,488.8

Management and Internal Organization of the Croatian National Bank

Management of the Croatian National Bank

MEMBERS OF THE COUNCIL OF THE CROATIAN NATIONAL BANK

Chairman of the Council
Željko Rohatinski

Boris Vujčić
Relja Martić
Tomislav Presečan
Čedo Maletić

Branko Vukmir
Silvije Orsag
Mate Babić
Sandra Švaljek
Alen Belullo
Branimir Lokin
Damir Novotny
Božidar Jelčić

MANAGEMENT OF THE CROATIAN NATIONAL BANK

Željko Rohatinski, Governor
Boris Vujčić, Deputy Governor
Relja Martić, Vicegovernor
Tomislav Presečan, Vicegovernor
Čedo Maletić, Vicegovernor

EXECUTIVE DIRECTORS

Research and Statistics Area – **Ljubinko Jankov**
Central Banking Operations Area – **Adolf Matejka**
International Affairs and External Relations Area – **Jadranka Granić**
Bank Supervision Area – **Marija Mijatović**
Planning, Analysis and Accounting Area – **Đurđica Haramija**
Payment Operations Area – **Gordana Grabovac**
Organization Planning and Information Technology Area – **Petar Ćurković**
Legal, Personnel and General Services Area –

COUNCIL OF THE CROATIAN NATIONAL BANK

- **Governor**
  - Deputy Governor
  - Vicegovernors
  - Internal Audit
  - Office of the Governor
  - Advisory Board
    - Research and Statistics Area
      - Research Department
        - Monetary Analysis Division
        - Balance of Payments and Exchange Rate Analysis Division
        - Real Sector and Budget Analysis Division
        - Library and Documentation Center
        - Financial Markets and Institutions Analysis Division
      - Statistics Department
        - Monetary Statistics Division
        - Balance of Payments Statistics Division
        - General Statistical Records and Register of Foreign Loans Division
      - Public Relations and Publishing Department
        - Public Relations Division
        - Publishing Division
        - Translating and Language-Editing Division
    - Central Banking Operations Area
      - Monetary Policy Department
        - Monetary Policy Instruments Analysis and Review Division
        - Open Market Operations Division
        - Credit Management Division
      - Foreign Exchange Policy Department
        - Foreign Exchange Policy Instruments Analysis and Review Division
        - Foreign Exchange Measures Implementation Division
      - Foreign Exchange Asset Management Division
        - Foreign Exchange Trading Division
        - Foreign Exchange Settlement Division
        - Investment Research and Performance Evaluation Division
    - International Affairs and External Relations Area
      - International Financial Institutions Department
      - International Banking Department
        - Correspondent Banking Division
        - International Payments Division
        - International Loans and Credit Agreements Division
    - Bank Supervision Area
      - On-Site Supervision Department
        - On-Site Division I
        - On-Site Division II
        - On-Site Division III
      - Off-Site Supervision Department
      - Department for Improving Bank Supervision
      - Foreign Trade Transactions Control Department
        - Exports Control Division
        - Imports Control Division
        - Special Exports and Imports Control Division
        - Branch Offices: Dubrovnik, Osijek, Rijeka, Split and Umag
    - Payment Operations Area
      - Cashless Payment Operations Department
        - Domestic Payment System Policy, Development and Review Division
        - Domestic Payment Operations Division
        - Domestic Payment System Surveillance Divsion
      - Currency Department
        - Issue and Handling Operations Division
        - Custody Services Division
    - Planning, Analysis and Accounting Area
      - Planning and Analysis Department
      - Accounting Department
        - Central Accounting Division
        - Domestic Currency Analytical Bookkeeping Division
        - Foreign Exchange Analytical Bookkeeping Division
        - Finance and Internal Accounting Division
    - Organization Planning and Information Technology Area
      - Organization Planning Department
      - Information Technology Department
        - Division for Planning and Evaluation of Application Systems
        - System and Database Administration Division
        - Application Systems Development Division
        - Data Processing Division
    - Legal, Personnel and General Services Area
      - Legal Department
      - Personnel Department
      - General Services Department
        - Administrative Support Services Division
        - Building and Purchasing Services Division
        - Restaurant

List of Banking Institutions

December 31, 2000

LICENSED BANKS

BANK AUSTRIA CREDITANSTALT CROATIA d.d. [a]
Jurišićeva 2
10000 Zagreb

Phone: + 385 1/4800-777
Fax: + 385 1/4800-890
SWIFT: BACX HR 22

BNP – DRESDNER BANK (CROATIA) d.d. [a]
Andrije Žaje 61
10000 Zagreb

Phone: + 385 1/3652-777
Fax: + 385 1/352-779
Tlx: 21144 bndb hr
SWIFT: BNDB HR 2X

BRODSKO-POSAVSKA BANKA d.d.[a]
Trg pobjede 29
35000 Slavonski Brod

Phone: + 385 35/445-700, 445-800,
Fax: + 385 35/445-900
SWIFT : BROD HR 22

CASSA DI RISPARMIO DI TRIESTE – BANCA d.d.[a]
Smičiklasova 23
10000 Zagreb

Phone: + 385 1/4614-346, 4614-423
Fax: + 385 1/4614-347, 4614-428,
SWIFT: TSBZ HR 22

CENTAR BANKA d.d.[a]
Jurišićeva 3
10000 Zagreb

Phone: + 385 1 /4803-444
Fax: + 385 1/4803-441
Tlx: 21707
SWIFT: CBZG HR 2X

CONVEST BANKA d.d.[a]
Gajeva 33
10000 Zagreb

Phone: + 385 1/4922-333
Fax: + 385 1/4819-153
SWIFT: CNVT HR 22

CREDO BANKA d.d.[a]
Z. Frankopanska 58
21000 Split

Phone: + 385 21/380-655
Fax: + 385 21/380-660
SWIFT: CDBS HR 22

CROATIA BANKA d.d.[a]
Kvaternikov trg 9
10000 Zagreb

Phone: + 385 1/2338-139
Fax: + 385 1/2338-141
SWIFT: CROA HR 2X

DALMATINSKA BANKA d.d.[a]
Marka Oreškovića 3
23000 Zadar

Phone: + 385 23/201-500
Fax: + 385 23/201-774
Tlx: 27224 dbk zd rh
SWIFT: DBZD HR 2X
Reuters: DBZH

DUBROVAČKA BANKA d.d. [a]
Put Republike 5
20000 Dobrovnik

Phone: + 385 20/356-333
Fax: + 385 20/356-778
Tlx: 27540 hrvdubank
27592 hrvdubank
SWIFT: DUBA HR 2X

ERSTE & STEIERMÄRKISCHE BANK d.d.[a]
Varšavska 3-5
10000 Zagreb

Phone: + 385 1/4561-999
Fax: + 385 1/4561-900
SWIFT: CAKB HR 22

GOSPODARSKO KREDITNA BANKA d.d. [a]
Draškovićeva 58
10000 Zagreb

Phone: + 385 1/4802-666
Fax: + 385 1/4802-571
Tlx: 22404 ccb zg hr
SWIFT: CCBZ HR 2X

HRVATSKA POŠTANSKA BANKA d.d.[a]
Jurišićeva 4
10000 Zagreb

Phone: + 385 1/4804-513
Fax: + 385 1/4810-791
SWIFT: HPBZ HR 2X

HYPO ALPE-ADRIA-BANK d.d.[a]
Koturaška 47
10000 Zagreb

Phone: + 385 1/6103-666
Fax: + 385 1/6103-555
SWIFT: KLHB HR 22

HYPOBANKA d.d.[b]
Vodovodna 20a
10000 Zagreb

Phone: + 385 1/3643-710
Fax: + 385 1/3643-687
Tlx: 21621 hipzg rh
SWIFT: HYZG HR 22 BIC

IMEX BANKA d.d.[a]
Tolstojeva 6
21000 Split

Phone: + 385 21/357-015
Fax: + 385 21/583-849
Tlx: 26191
SWIFT: IMXX HR 22

ISTARSKA BANKA d.d.[a]
Dalmatinova 4
52100 Pula

Phone: + 385 52/527-101, 527-309
Fax: + 385 52/527-400, 527-444
Tlx: 24746, 24716 ibpu rh
SWIFT: IBPU HR 2X

ISTARSKA KREDITNA BANKA UMAG d.d.[a]
Ernesta Miloša 1
52470 Umag

Phone: + 385 52/741-622, 741-536
Fax: + 385 52/741-275, 741-396
Tlx: 24745 ikb rh
SWIFT: ISKB HR 2X

JADRANSKA BANKA d.d.[a]
Ante Starčevića 4
22000 Šibenik

Phone:+ 385 22/242-101
Fax: + 385 22/335-881
Tlx: 27435, 27 346 jbs rh
SWIFT: JADR HR 2X

KAPTOL BANKA d.d.[b]
Maksimirska 120
10000 Zagreb

Phone: + 385 1/2359-700
Fax: + 385 1/2339-575
SWIFT: KPZG HR 22

KARLOVAČKA BANKA d.d.[a]
I.G. Kovačića 1
47000 Karlovac

Phone: + 385 47/611-540
Fax: + 385 47/614-206
Tlx: 23742 kb ka rh
SWIFT: KALC HR 2X

KREDITNA ZAGREB d.d.[a]
Ul. grada Vukovara 74
10000 Zagreb

Phone: + 385 1/6167-333
Fax: + 385 1/6116-466
Tlx: 21197 krez zg rh
SWIFT: KREZ HR 2X

KVARNER BANKA d.d. [a]
Jadranski trg 4/I
51000 Rijeka

Phone: + 385 51/353-555
Fax: + 385 51/353-566
Tlx: 24564 kbri hr
SWIFT: KVRB HR 22

MEĐIMURSKA BANKA d.d. [a]
Valenta Morandinija 37
40000 Čakovec

Phone: + 385 40/370-500, 370-600
Fax: + 385 40/315-065
Tlx: 23251 banka rh
SWIFT: MBCK HR 2X

NAVA BANKA d.d.[b]
Tratinska 27
10000 Zagreb

Phone: + 385 1/3656-777
Fax: + 385 1/3656-700
SWIFT: NAVB HR 22

PARTNER BANKA d.d.[a]
Vončinina 2
10000 Zagreb

Phone: + 385 1/4602-222
Fax: + 385 1/4602-289
Tlx: 21212 parbaz rh
SWIFT: PAZG HR 2X

PODRAVSKA BANKA d.d.[a]
Opatička 1a
48300 Koprivnica

Phone: + 385 48/65-50
Fax: + 385 48/622-542
Tlx: 23368 pod kc rh
SWIFT: PDKC HR 2X

POŽEŠKA BANKA d.d.[a]
Republike Hrvatske 1b
34 000 Požega

Phone: + 385 34/254-200
Fax: + 385 34/254-258
Tlx: 28550 kb slp rh
SWIFT: POBK HR 2X

PRIVREDNA BANKA ZAGREB D.D.[a]
Račkoga 6/P.O.Box 1032
10000 Zagreb

Phone: + 385 1 /4723-344
Fax: + 385 1/4723-131
Tlx: 21120 pbz rh
SWIFT: PBZG HR 2X
Reuters: PBZH

RAIFFEISENBANK AUSTRIA d.d.[a]
Petrinjska 59
10000 Zagreb

Phone: + 385 1/4566-466
Fax: + 385 1/4811-624
Tlx: 21137 rba zg rh
SWIFT: RZBH HR 2X

RAZVOJNA BANKA "DALMACIJA" d.o.o.[d]
Poljička cesta 39
21000 Split

Phone: + 385 21/370-400
Fax: + 385 21/371-000

RIADRIA BANKA d.d.[a]
Đure Šporera 3
51000 Rijeka

Phone: + 385 51/339-111
Fax: + 385 51/211-093
Tlx: 24 161
SWIFT: ADRI HR 2X

RIJEČKA BANKA d.d.[a]
Jadranski trg 3a
51000 Rijeka

Phone: + 385 51/208-211
Fax: + 385 51/330-525, 331-880
Tlx: 24 143 bankom rh
SWIFT: RBRI HR 2X
Reuters: RBRH

SAMOBORSKA BANKA d.d.[c]
Trg kralja Tomislava 8
10430 Samobor

Phone: + 385 1/3362-530
Fax: + 385 1/3361-523
Tlx: 21811 samba rh
SWIFT: SMBR HR 22

SISAČKA BANKA d.d. [a]
Trg LJ. Posavskog 1
44000 Sisak

Phone: + 385 44/549-100
Fax: + 385 44/549-101
Tlx: 23645 sbdd sk rh
SWIFT: SSKB HR 2X

SLATINSKA BANKA d.d.[a]
Vladimira Nazora 2
33520 Slatina

Phone: + 385 33/551-354
Fax: + 358 33/551-566
Tlx: 28277 slatb rh
SWIFT: SBSL HR 2X

SLAVONSKA BANKA d.d.[a]
Kapucinska 29
31000 OSIJEK

Phone: + 385 31/231-231
Fax: + 385 31/201-039
Tlx: 28235, 28090 banka rh
SWIFT: SLBO HR 2X

SPLITSKA BANKA d.d.[a]
Ruđera Boškovića 16
21000 Split

Phone: + 385 21/370-500
Fax:+ 385 21/370-541
Tlx: 26252 st bank rh
SWIFT: SPLI HR 2X

ŠTEDBANKA d.d.[a]
Slavonska avenija 3
10000 Zagreb

Phone: 385 1/6306-666
Fax: 385 1/6187-015
SWIFT: STED HR 22

VARAŽDINSKA BANKA d.d.[a]
P.Preradovića 17
42000 Varaždin

Phone: + 385 42/400-000
Fax: + 385 42/400-112
Tlx: 23224 banka rh
SWIFT: VBDD HR 2X
Reuters: VBVH

VOLKSBANK d.d. [a]
Varšavska 9
10000 Zagreb

Phone: + 385 1/4801-300
Fax: + 385 1/4801-365
SWIFT: VBCR HR 22

ZAGREBAČKA BANKA d.d. [a]
Paromlinska 2
10000 Zagreb

Phone: + 385 1/6104-000, 6110-500
Fax: + 385 1/6110-555
Tlx: 21462 zaba rh
SWIFT: ZABA HR 2X
Reuters: ZBZH

PRIVREDNA BANKA – LAGUNA BANKA d.d.[a]
Prvomajska 4a
52440 Poreč

Phone: + 385 52/ 416-777
Fax: +385 52/ 416-770

BRANCHES OF FOREIGN BANKS

BAYERISCHE HYPO–UND VEREINSBANK AG
Glavna podružnica Zagreb [a]
Ul. Alexandera von Humboldta 4
10000 Zagreb

Phone: +385 1/6159-206, 6159-198
Fax: + 385 1/6159-197

REPRESENTATIVE OFFICES OF FOREIGN BANKS

LHB INTERNATIONALE HANDELSBANK AG, Zagreb

KREDITNA BANKA d.d. TUZLA, Zagreb

DEUTSCHE BANK AG, Zagreb

CASSA DI RISPARMIO DI UDINE E PORDENONE SPA, Zagreb

BANK FÜR KÄRNTEN UND STEIERMARK AG, Zagreb

COMMERZBANK AKTIENGESELLSCHAFT, Zagreb

[a] Licensed banks in accordance with Article 37 of the Banking Law (full authorization).
[b] Licensed banks in accordance with Article 36 of the Banking Law (medium authorization).
[c] Licensed banks in accordance with Article 35 of the Banking Law (limited authorization).
[d] Banks not yet licensed in accordance with Articles 35, 36 and 37 of the Banking Law.

LICENSED SAVINGS BANKS

BANICA CREDO ŠTEDIONICA d.d.[a]
Matice hrvatske 1
21 000 Split

Phone: + 385 21/314-488
Fax: + 385 21/314-488

GOSPODARSKA ŠTEDIONICA d.d.[a]
Stjepana Radića 2
10 216 Vrbovec

Phone: + 385 1/2792-888
Fax: + 385 1/72792-855

HIBIS ŠTEDIONICA d.d.
Vlaška 62
10 000 Zagreb

Phone: +385 1/4550-210
Fax: + 385 1/620-562

KRAPINSKA ŠTEDIONICA d.d.
Gajeva 2
49 230 Krapina

Phone: + 385 49/370-627
Fax: + 385 49/370-545

KRIŽEVAČKA ŠTEDIONICA d.d.
Preradovićeva 14
48260 Križevci

Phone: +385 48/681-018
Fax: + 385 48/681-018

MARVIL ŠTEDIONICA d.d.
Ivana Šibla 9
10 000 Zagreb

Phone: + 385 1/6601– 668
Fax: + 385 1/672-315

MEĐIMURSKA ŠTEDIONICA d.d.[a]
Kralja Tomislava 31
40 300 Čakovec

Phone: + 385 40/384-377
Fax: + 385 40/715-151

PRIMORSKA ŠTEDIONICA d.d.[a]
Riva 6
51 000 Rijeka

Phone: + 385 51/215-222
Fax: + 385 51/7214-022

PRVA OBRTNIČKA ŠTEDIONICA d.d. [a]
Tkalčićeva 11
10 000 Zagreb

Phone: + 385 1/4800-111
Fax: + 385 1/4800-144

SLAVONSKA ŠTEDIONICA d.d.
Medvedgradska 47
10 000 Zagreb

Phone: + 385 1/4666-877, 4666-728
Fax: + 385 1/4666-877

ŠTEDIONICA BROD d.d. [a]
I. pl. Zajca 21
35 000 Slavonski Brod

Phone: + 385 35/443-333
Fax: + 385 35/447-142

ŠTEDIONICA DORA d.d.[a]
Nova cesta 89
10 000 Zagreb

Phone: + 385 1/3821-344
Fax: + 385 1/3821-354

ŠTEDIONICA KOVANICA d.d.[a]
Zagrebačka 10
42 000 Varaždin

Phone: + 385 42/212-729
Fax: + 385 42/212-148

ŠTEDIONICA MORE d.d. [a]
Vlaška 67
10 000 Zagreb

Phone: + 385 1/4611-133
Fax: + 385 1/4550-113

ŠTEDIONICA SA-GA d.d.[a]
Ljubljanska avenija 100
10 090 Zagreb

Phone: + 385 1/3880-599
Fax: + 385 1/3880-545

ŠTEDIONICA SONIC d.d. [a]
Savska cesta 131
10 000 Zagreb

Phone: + 385 1/6345-666
Fax: + 385 1/6190-615

ŠTEDIONICA SPLITSKO-DALMATINSKA d.d.[a]
Boktuljin put bb
21 000 Split

Phone: + 385 21/352-444, 352-555
Fax: + 385 21/352-500

ŠTEDIONICA ZAGIŠTED d.d.
Hribarov prilaz 6a
10 000 Zagreb

Phone: + 385 1/672-101, 681-552
Fax: + 385 1/6602-711

ŠTEDIONICA ZLATICA d.d. [a]
Gajeva 28
10 000 Zagreb

Phone: + 385 1/4818-282
Fax: + 385 1/4558-588

ŠTEDIONICA ZLATNI VRUTAK d.d.
Maksimirska 39
10 000 Zagreb

Phone: + 385 1/2301-949, 2301-951
Fax: + 385 1/2301-950

TRGOVAČKA ŠTEDIONICA d.o.o.
Utješinovićeva 7
10 000 Zagreb

Phone: + 385 1/2339-610, 2339-611
Fax: + 385 1/2339-716

V i D ŠTEDIONICA d.d.[a]
Ulica grada Vukovara 52b
10 000 Zagreb

Phone: + 385 1/6111-330
Fax: + 385 1/6111-477

LICENSED HOUSING SAVINGS BANKS

PRVA STAMBENA ŠTEDIONICA d.d.
Jurišićeva 22
10 000 Zagreb

Phone: + 385 1/4801-514
Fax: + 385 1/4801-571

WÜSTENROT STAMBENA ŠTEDIONICA d.d.
Ilica 14
10 000 Zagreb

Phone: + 385 1/4803-788
Fax: + 385 1/4803-798

HRVATSKA STAMBENA ŠTEDIONICA d.d.
Zagrebačka 38
42 000 Varaždin

Phone: + 385 42/290-555
Fax: + 385 42/290-533

RAIFFEISEN STAMBENA ŠTEDIONICA d.d.
Ul. grada Vukovara 37b
10000 Zagreb

Phone: + 385 1/632-4100
Fax: +385 1/617-1099

[a] Operating license includes the collection of household foreign exchange savings and exchange operations.