



CROATIAN NATIONAL BANK

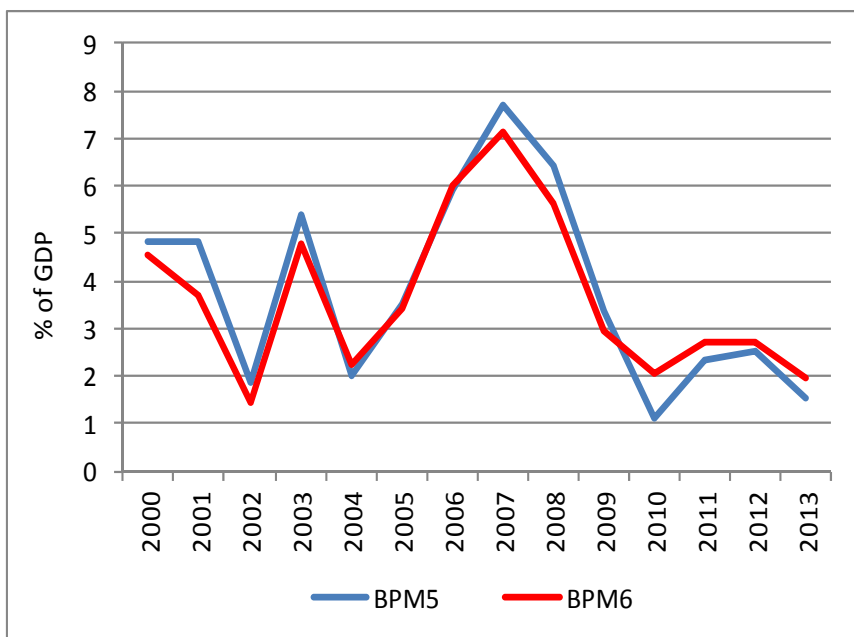
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# Foreign Direct Investments in Croatia: Trends, Structure and Effects

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September 2015

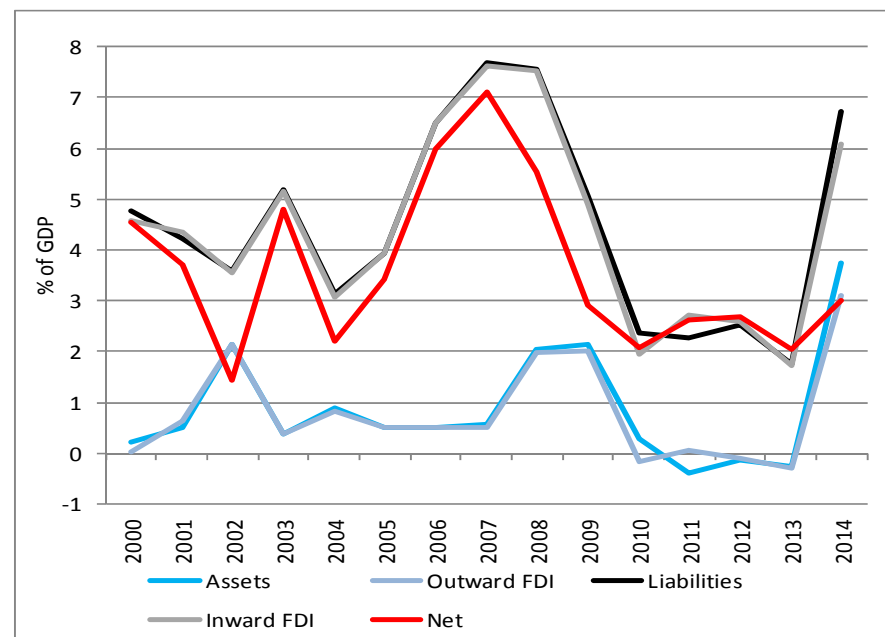
# Recent changes in FDI statistics

## Net FDI according to BPM5 and BPM6



Note: Net FDI according to both BPM5 and BPM6 is expressed as % of GDP according to ESA2010 methodology.  
Source: HNB

## Assets/liability vs. directional approach



Note: Net FDI is calculated as the difference between liabilities (inward FDI) and assets (outward FDI).  
Source: HNB

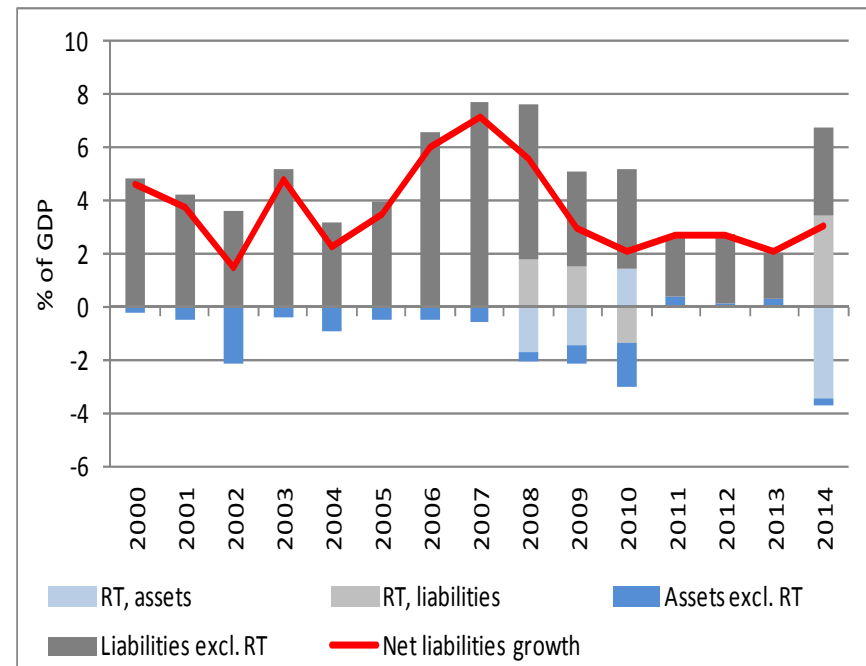
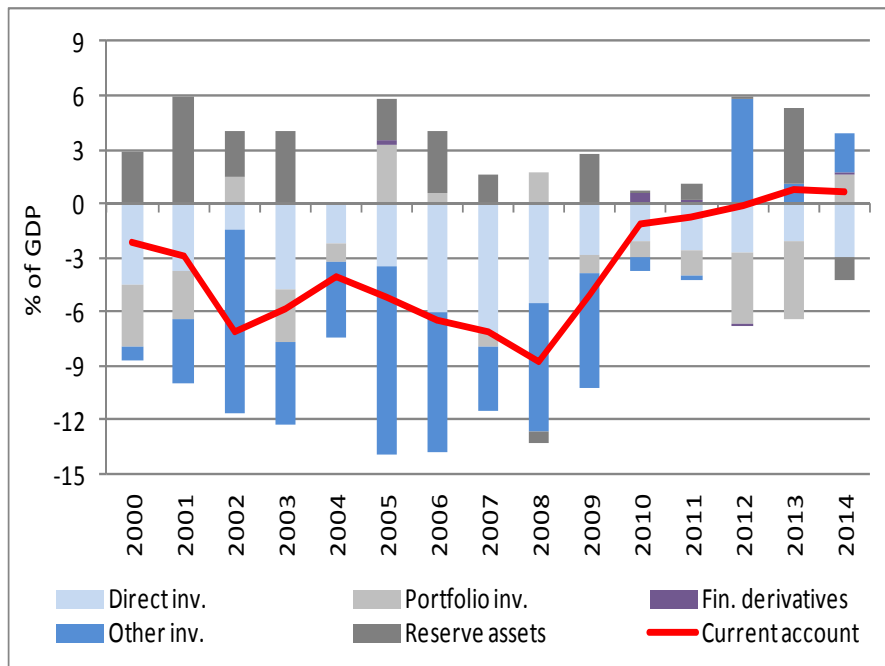
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# **1. Trends and structure of FDI in Croatia and international comparison**

# FDI dynamics in Croatia

In addition to foreign borrowing, FDIs were important source of financing CAD in the pre-crisis period...

... but net FDI inflow declined since the onset of the crisis, with strong impact of round-tripping in 2014



Note: Negative sign indicates net capital inflow.

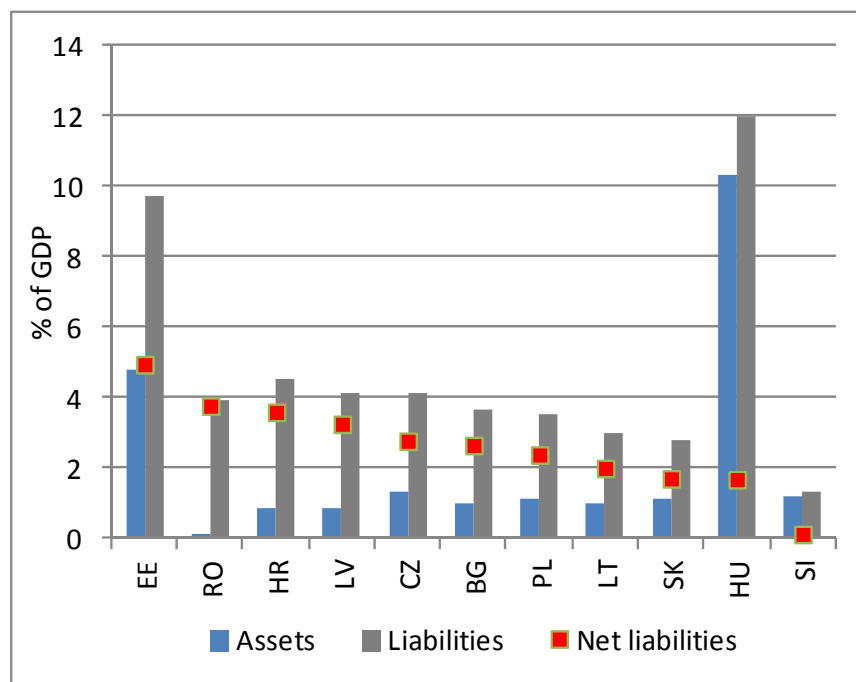
Source: HNB

Note: In BoP statistics, round-tripping (RT) was recorded in 2008 (0.8 EUR bn), 2009 (0.7 EUR bn), 2010 (-0.6 EUR bn) and 2014 (1.5 EUR bn). The signs follow analytical approach; acquisition of assets is presented with negative and incurrence of liabilities with positive sign.

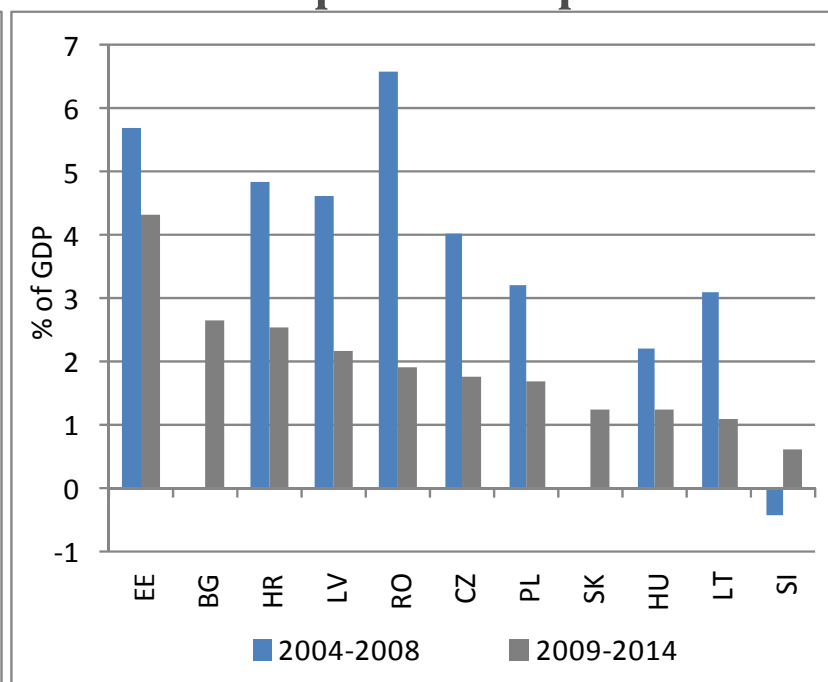
Source: HNB

# Relatively strong FDI inflow in Croatia compared to other CEE countries

## Average in 2004 – 2014 period



## Net FDI, average in the pre-crisis and post-crisis period



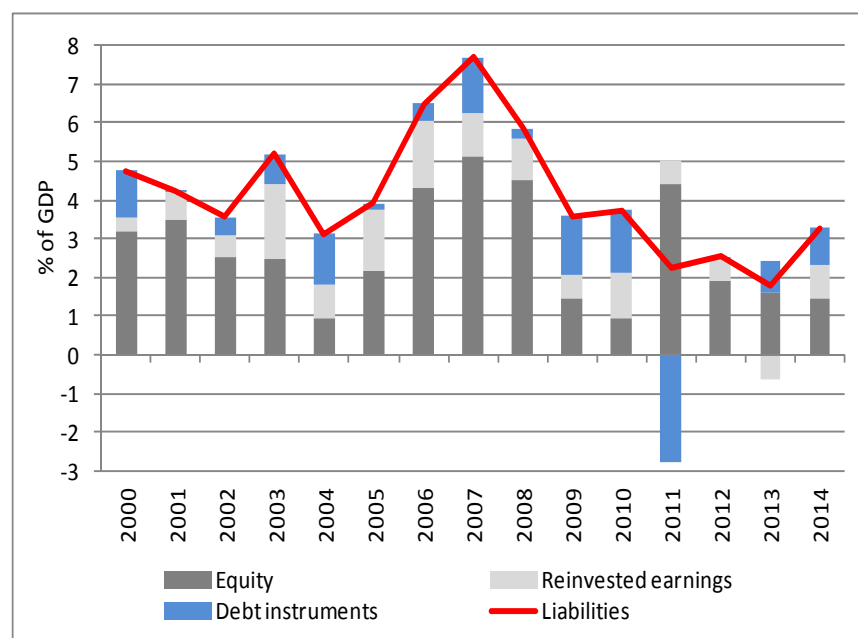
Note: Average values for Bulgaria are obtained using 2010-2014 data and for Slovakia using 2008-2014. Net liabilities are calculated as difference between liabilities and assets. Therefore, positive sign refers to net investment inflow.

Sources: Eurostat; HNB

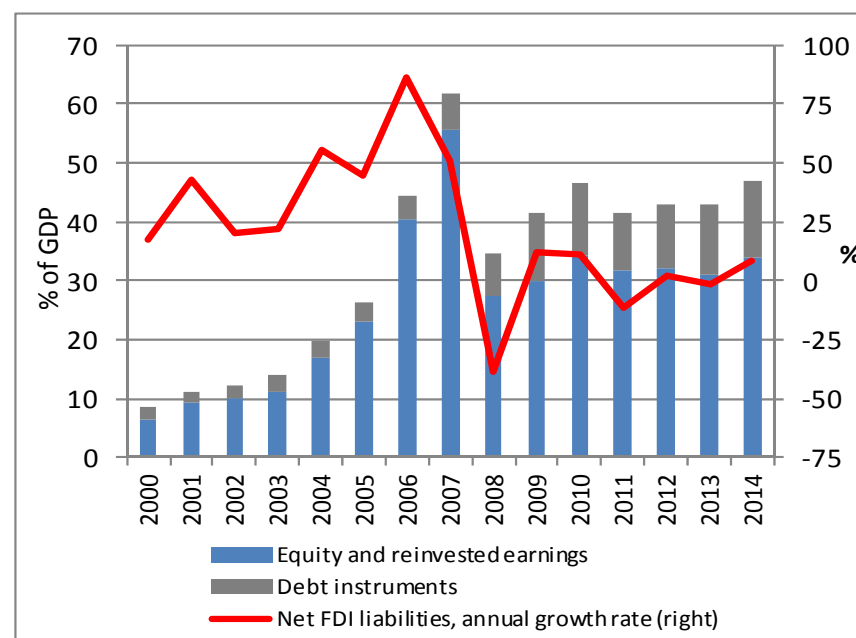
# Structure of FDI flows and stocks in Croatia

**FDI inflow dominated by equity investment, with strong growth of reinvested earnings in 2014**

BoP, net incurrence of liabilities



IIP, stock of net FDI liabilities



Note: Data doesn't include round-tripping

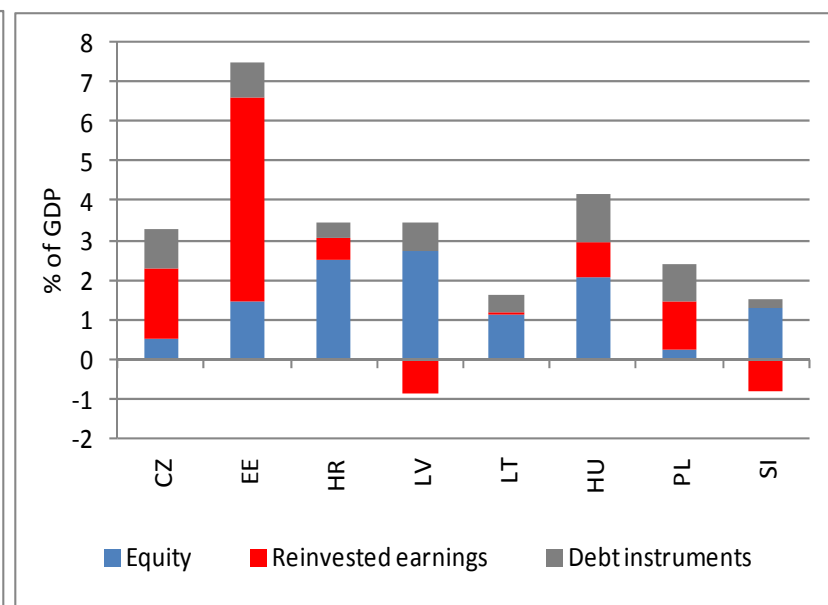
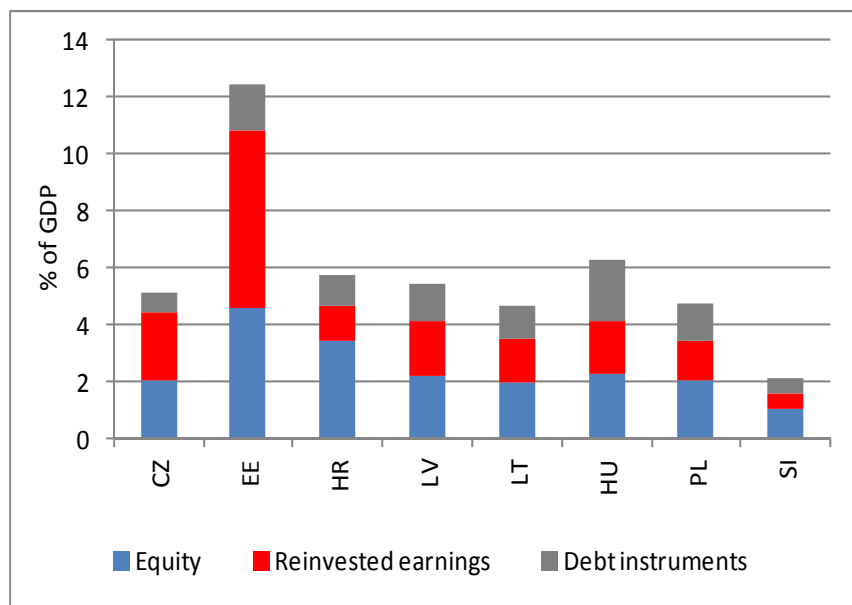
Source: HNB

Source: HNB

# Relatively strong equity investment in Croatia

2004 – 2008 average

2009 – 2014 average

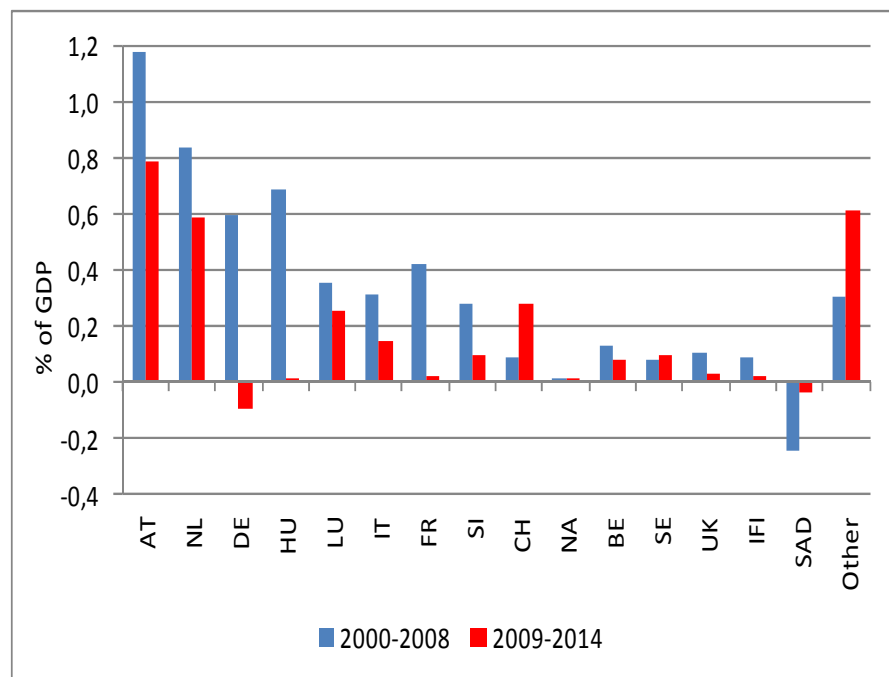


Note: Data includes round-tripping.

Sources: Eurostat; HNB

# Most of investment in Croatia...

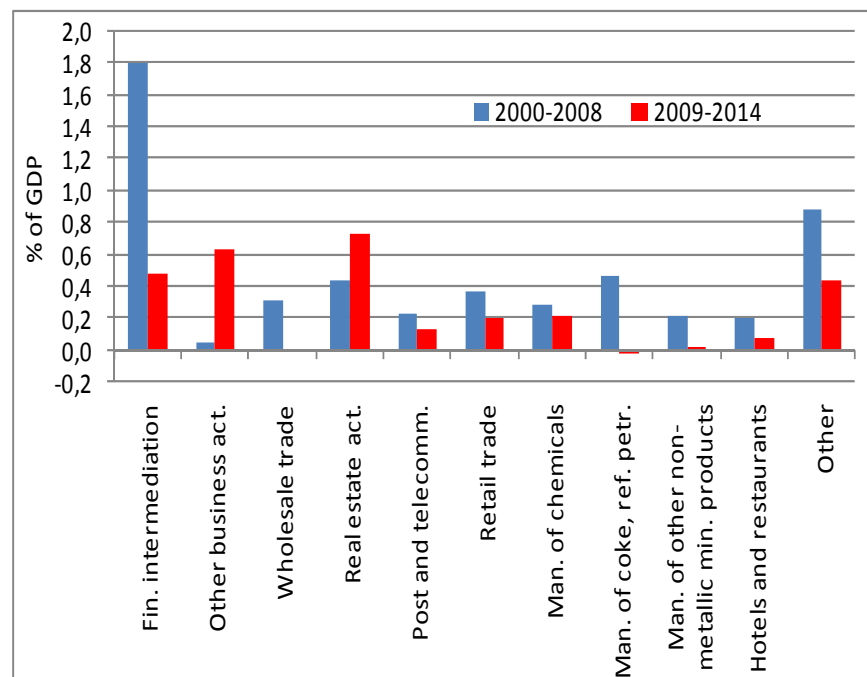
... from Austria, Netherlands, Germany, Hungary



Note: Data doesn't include round-tripping. IFI refers to international financial institutions.

Source: HNB

... in financial intermediation, trade, real estate, telecommunication



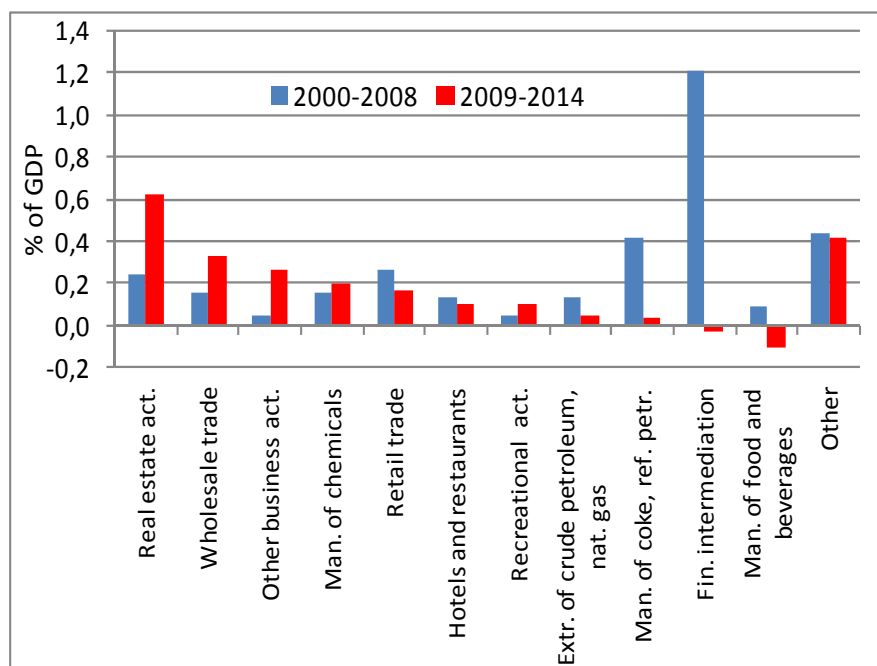
Note: Data doesn't include round-tripping.

Source: HNB

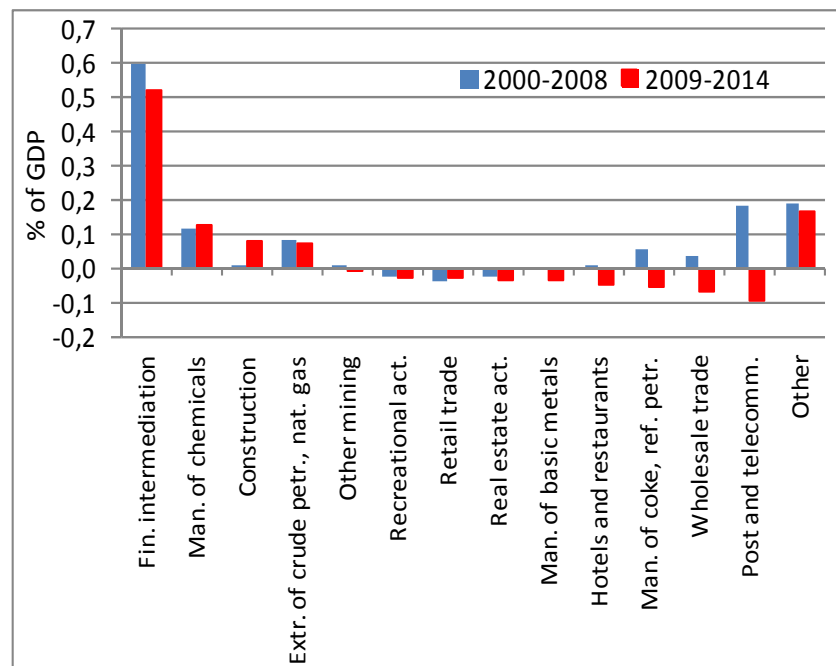


# Real estate and trade boost equity investments; financial intermediation dominates in reinvested earnings

## Equity investment



## Reinvested earnings

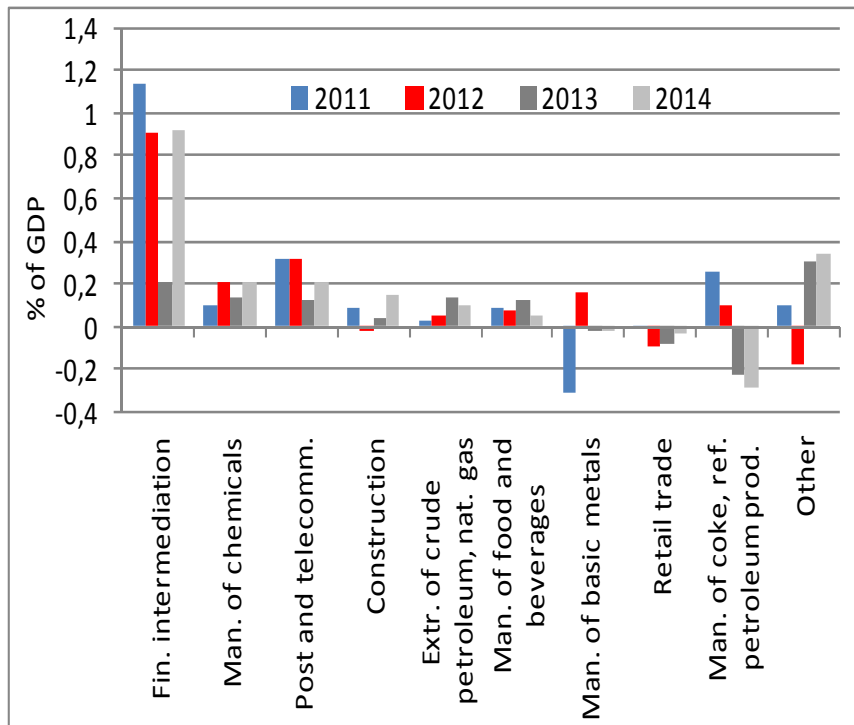


Note: Data doesn't include round-tripping.

Source: HNB

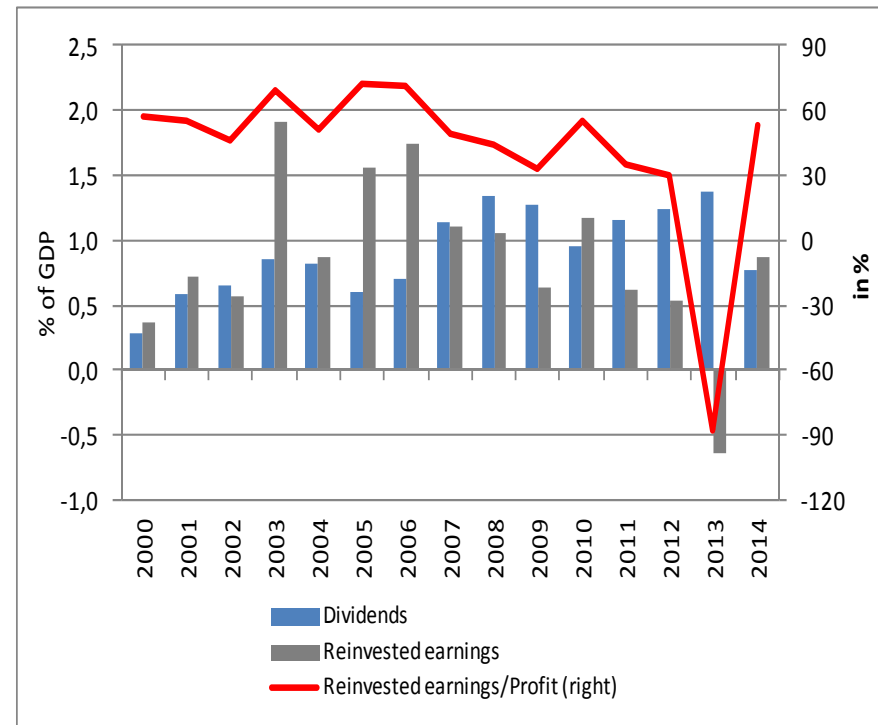
# Retained profits declined while dividends remain stable

## Profit of FDI firms



Source: HNB

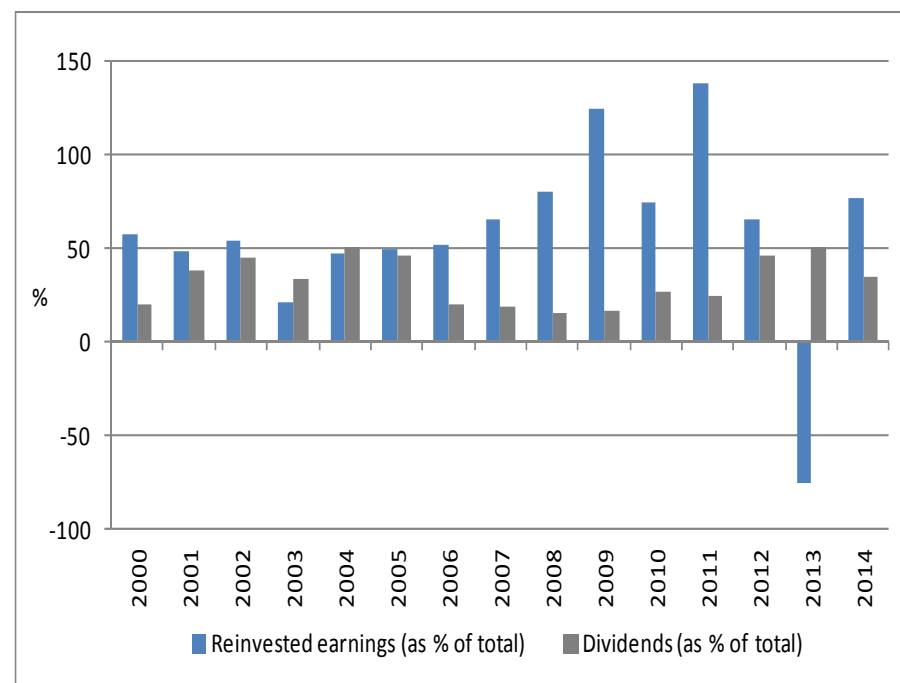
## Utilisation of profit earned



Source: HNB

# The importance of financial intermediation in the structure of reinvested earnings and dividends

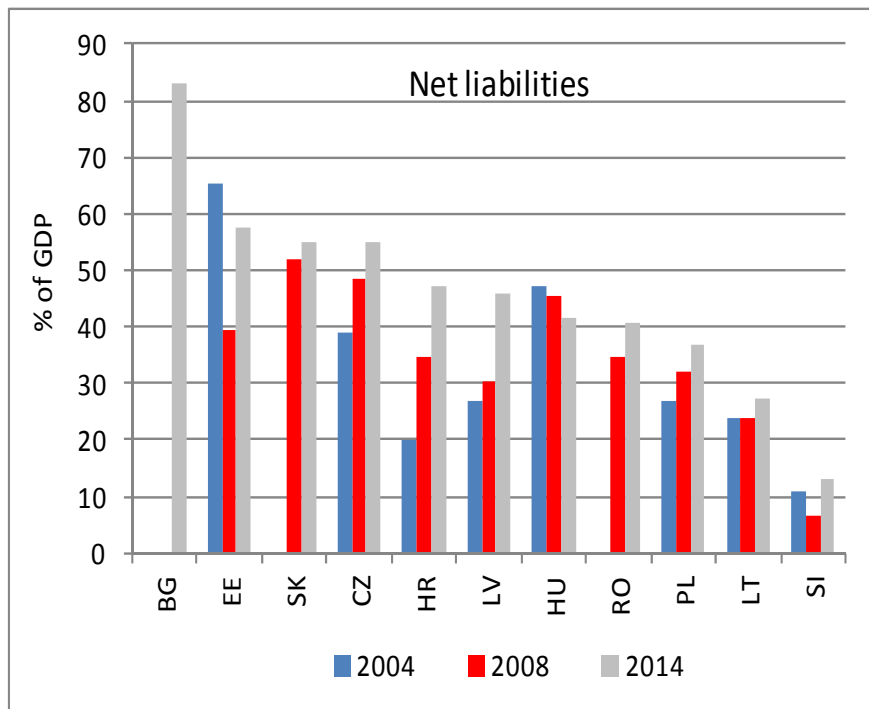
- *In the post-crisis period the share of financial intermediation in total realization of reinvested earnings increased*
- *Approximately 90% of total reinvested earnings were realized in financial intermediation in 2009-2014 period*



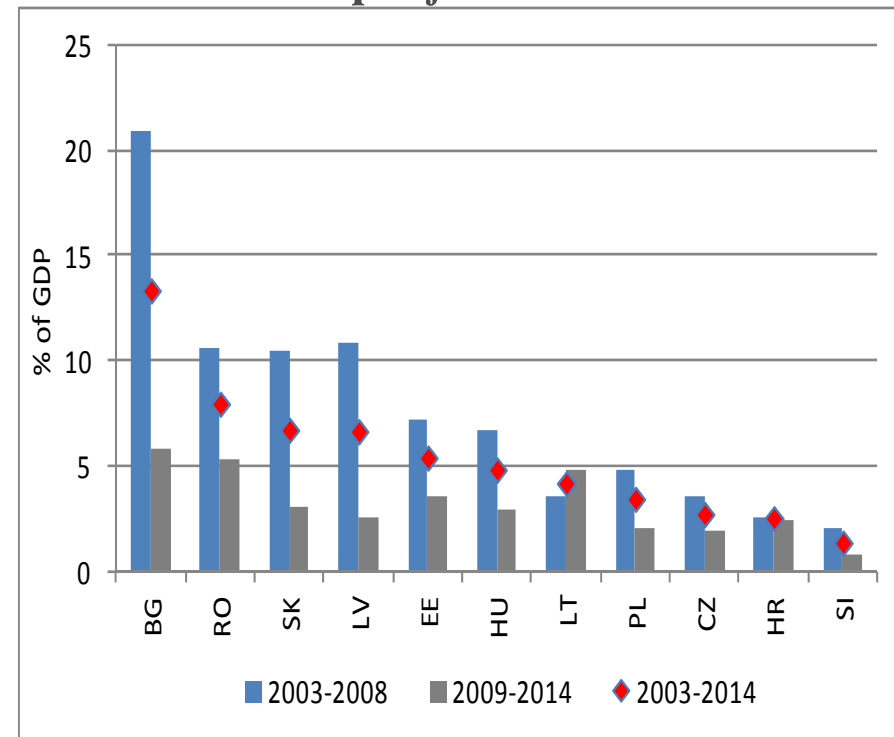
Source: HNB

# High net FDI liabilities, but modest *greenfield* investments in Croatia

## Stock of net FDI liabilities



## Value of greenfield investment projects



Sources: Eurostat; HNB

Note: Data for a specified period refers to an average annual value during this period. In case of Lithuania, calculated averages don't include 2003.

Source: UNCTAD, World Investment Report 2015

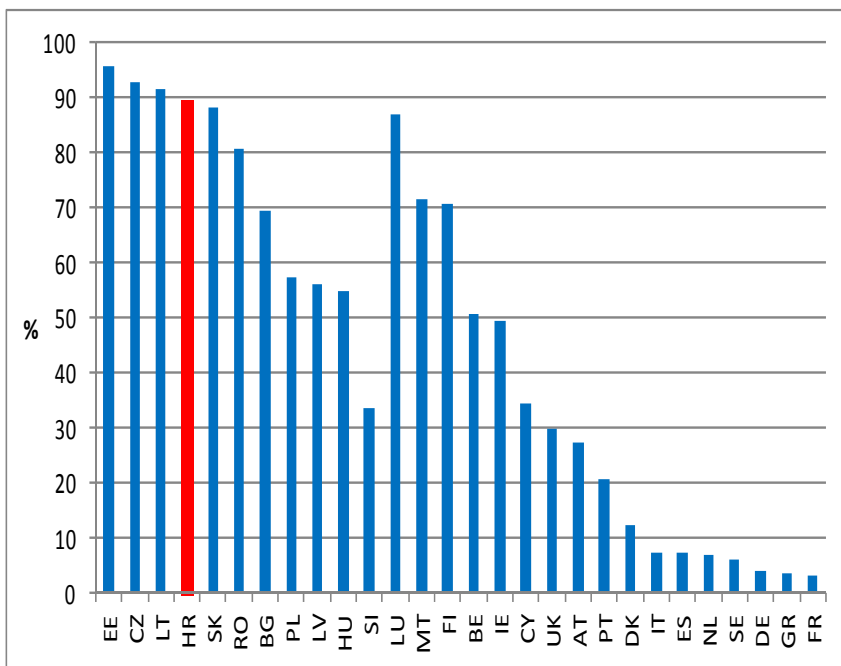
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## **2. Effects of FDI in Croatia**

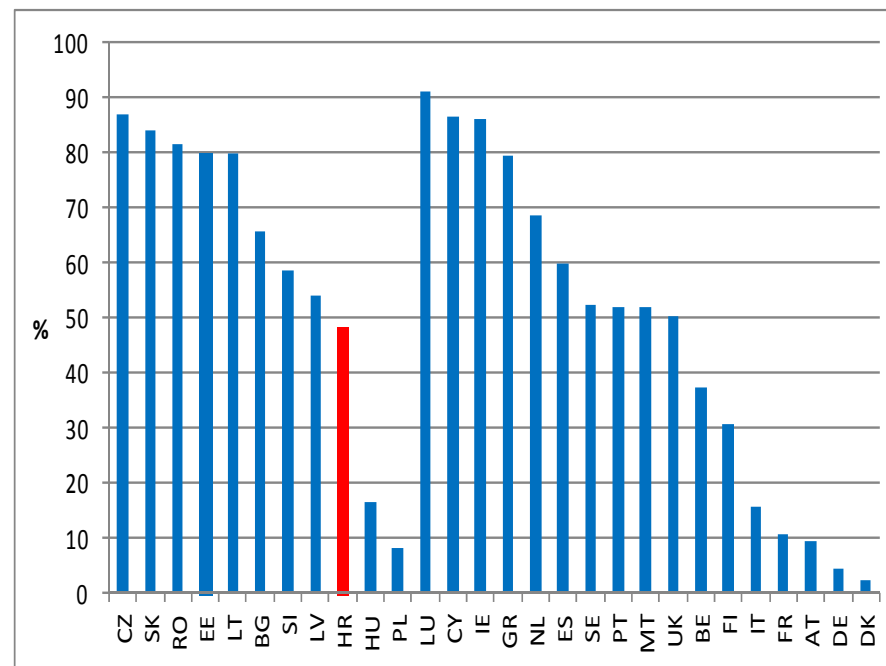
**banking & manufacturing**

# Croatian banking sector today predominantly foreign-owned ...

## Assets



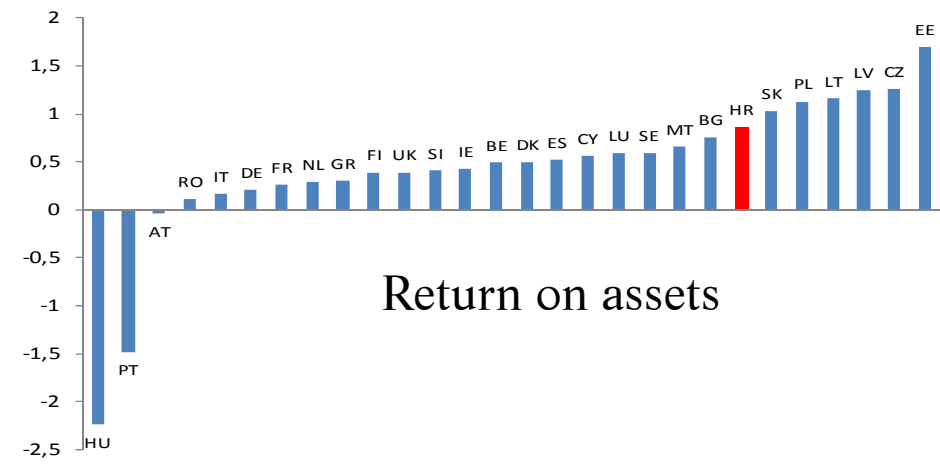
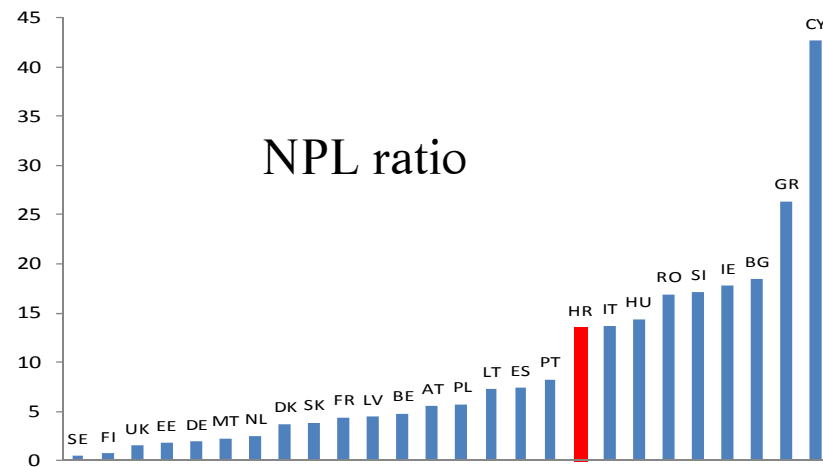
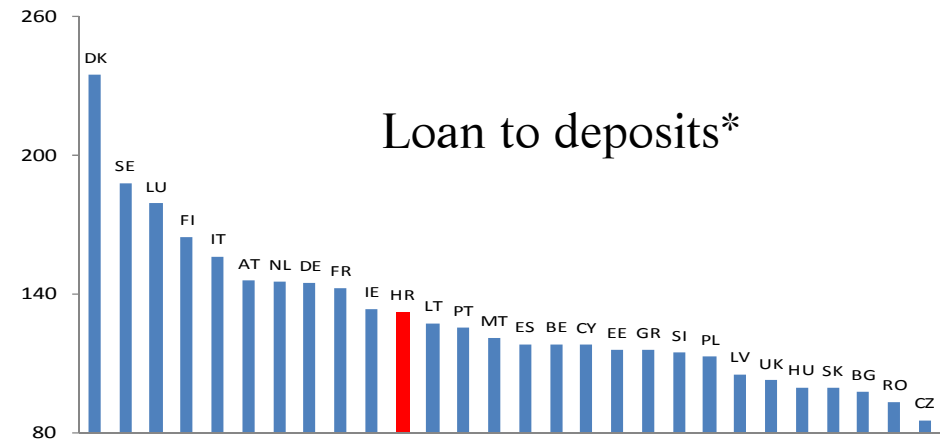
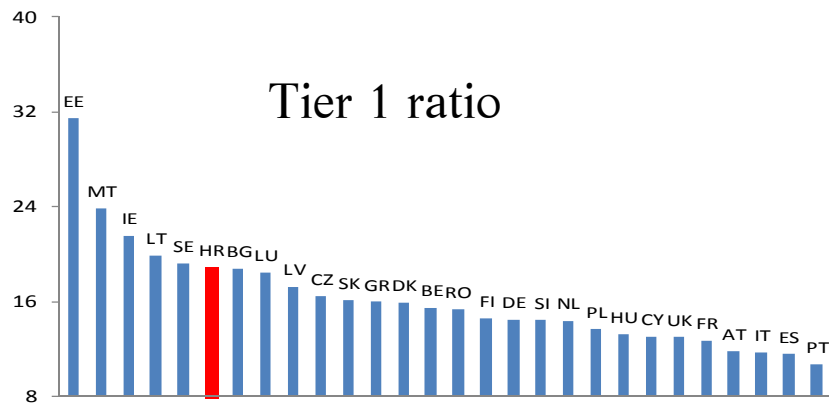
## No of banks



Note: Charts show the share of foreign-owned banks in total banking sector assets (left) and in total number of banks in a country (right).

Source: ECB (Consolidated banking data), June 2014

# ... and well-placed in European rank tables



\*Loan to deposit ratio is calculated as total loans and advances to non-financial institutions deposits.  
Source: ECB (Consolidated banking data), June 2014

# Foreign banks in Croatia - early evidence

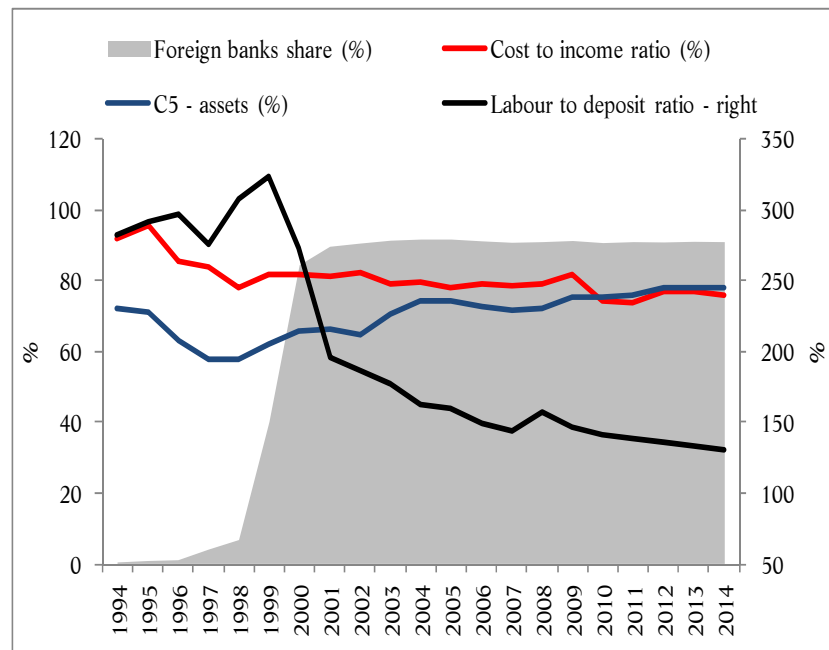
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- Early evidence supportive of positive impact of foreign banks:
  - *“foreign-owned banks are on average the most efficient”* (Jemrić&Vujčić, 2002)
  - *“de novo foreign banks are substantially the most cost efficient ... foreign banks as a group are more efficient than domestic private or state banks”* (Kraft et al, 2002)
  - *“arrival of foreign-owned banks has contributed to a higher level of competition, improved efficiency and better quality of products and services”; “foreign banks have been more profitable, had lower operating costs, and maintained better asset quality than domestic banks”* (Kraft, 2002)

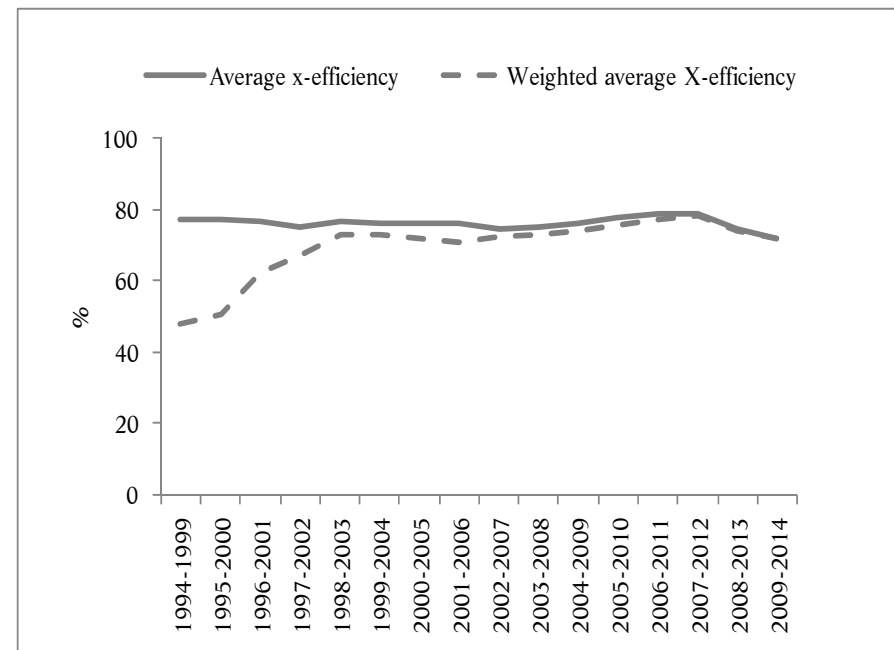


# Efficiency indicators

## Traditional indicators



## Bank x-efficiency



Note: X-efficiency can only be calculated for six-year periods because residuals from bank cost equation have to be averaged for longer periods to dismantle random factor from efficiency factor.

Source: HNB

# Evolution of bank efficiency in Croatia

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- ❑ Significant efficiency gains in the last 18 years.
- ❑ Mostly the result of market consolidation - traditional efficiency indicators are heavily influenced by the economies of scale, as average bank is becoming larger.
- ❑ X-efficiency (managerial efficiency not infected with economies of scales or risk management) scores of banks have stabilized (Turk-Arasis, 2002 and Huljak 2015).
- ❑ Foreign banks in Croatia - far larger and more challenging to run (more products, wide presence, potential agency problems, ...), but managerial efficiency scores are similar to domestic banks. However, operational efficiency is no guarantee for success.
- ❑ Early evidence (Kraft 2002) suggests that the transfer of skills and knowledge regarding risk management from foreign owners to newly acquired banks was an important channel of technology transfer.
- ❑ Foreign banks were more conservative in their risk management and provisioning policies (higher provisioning expenses, higher risk-based capital, and higher level of recoveries).

## FDIs in industry in the pre-crisis period

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- FDI manufacturing firms more successful than domestic in terms of faster growth in revenues, capital and productivity but positive effects on employment can not be confirmed (Škudar, 2002)
- Positive effects of FDIs on productivity (Marić, 2008):
  - Own-firm effects: FDI firms are on average by one-third more productive than domestic firms in the same sector
  - Spillover effects: FDIs had positive effect on other domestic firms in different sectors of the economy
  - Positive effects in the 1999-2002 period stronger compared to 2003-2005 period

## Impact of global crisis on performance of non-financial corporations

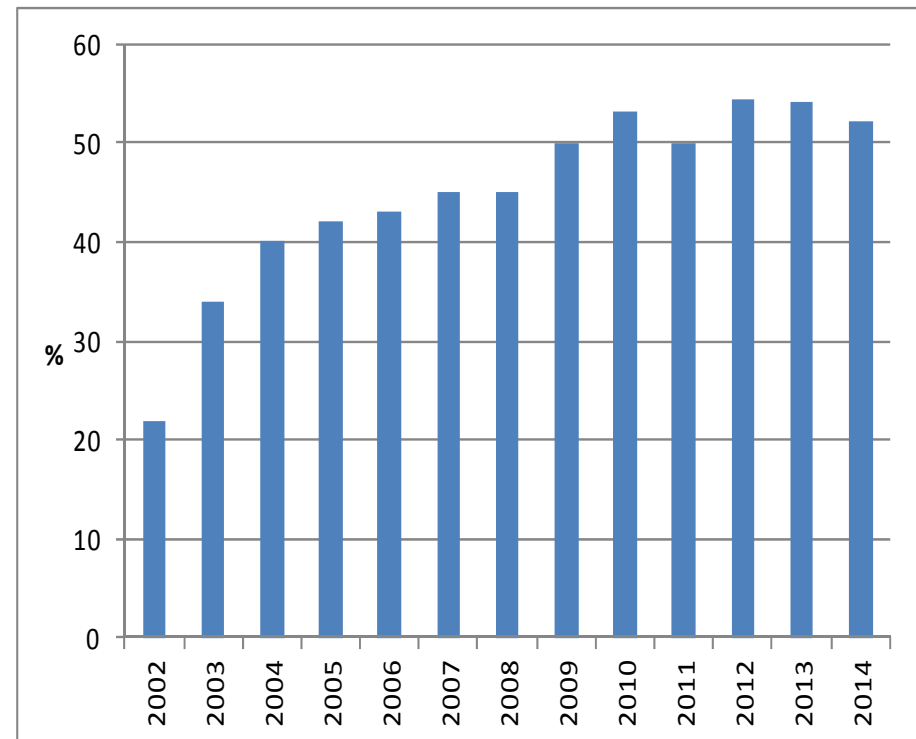
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- Global crisis had asymmetric impact on Croatian non-financial corporations (HNB, 2012):
  - State-owned and export-oriented firms were less affected
  - Evidence on whether FDI firms were affected less or more not clear
  - FDI firms made much sharper cuts in the workforce, as a way to cope with the crisis – they are more flexible and respond more promptly to the requirements of their owners

# FDIs and Croatian exports

- *FDIs had relatively mild positive impact on manufacturing exports (Vukšić, 2005)*
- *Foreign sector is more export-oriented than domestic but FDI penetration in manufacturing is relatively low (Hunya and Škudar, 2006)*
- *Increase in NFC's export intensity is closely related to the presence of foreign capital, favourable financing conditions and economic environment conducive to enterprise growth (HNB, 2013)*

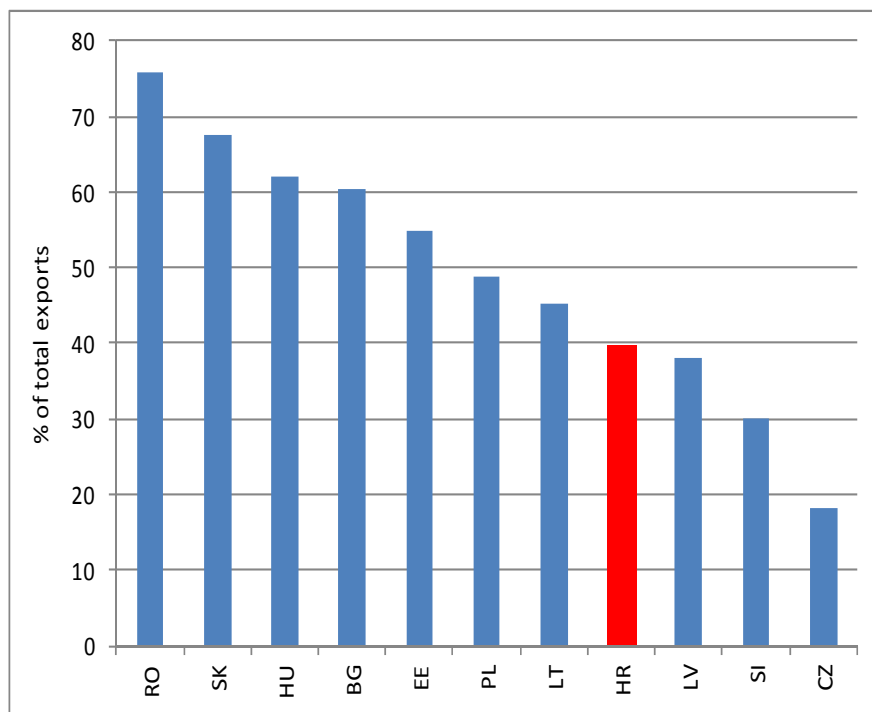
**Share of FDI firms in Croatian exports**



Sources: FINA for data until 2010, later CBS and HNB

# FDIs and exports

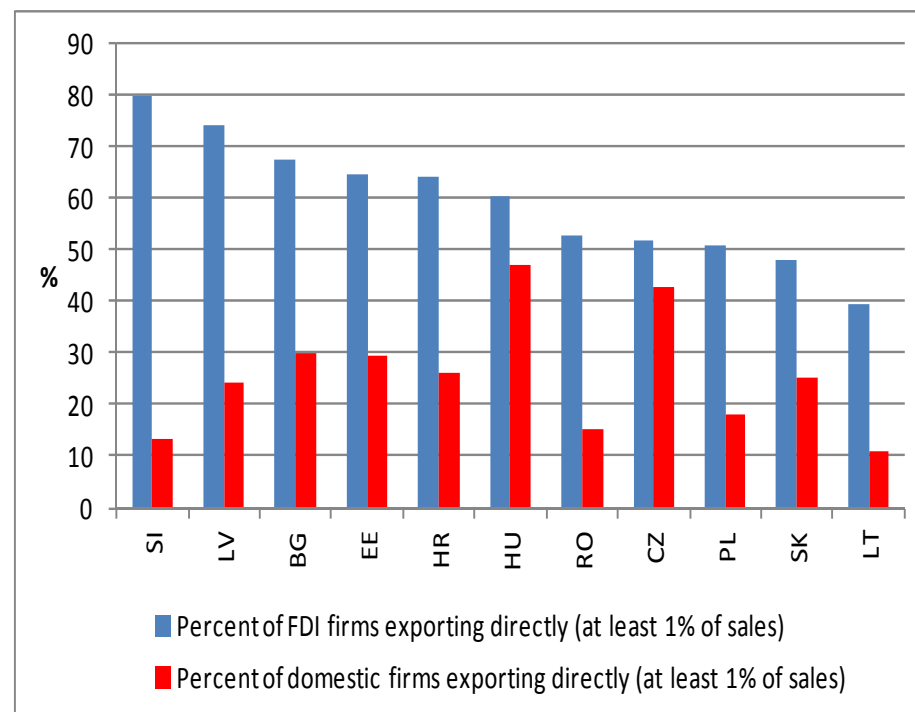
Share of foreign controlled enterprises in merchandise exports, 2011



Note: Foreign controlled enterprises refer to companies where share of foreign ownership exceeds 50%. Data for Slovenia refers to 2012.

Sources: Eurostat; HNB (for Croatia)

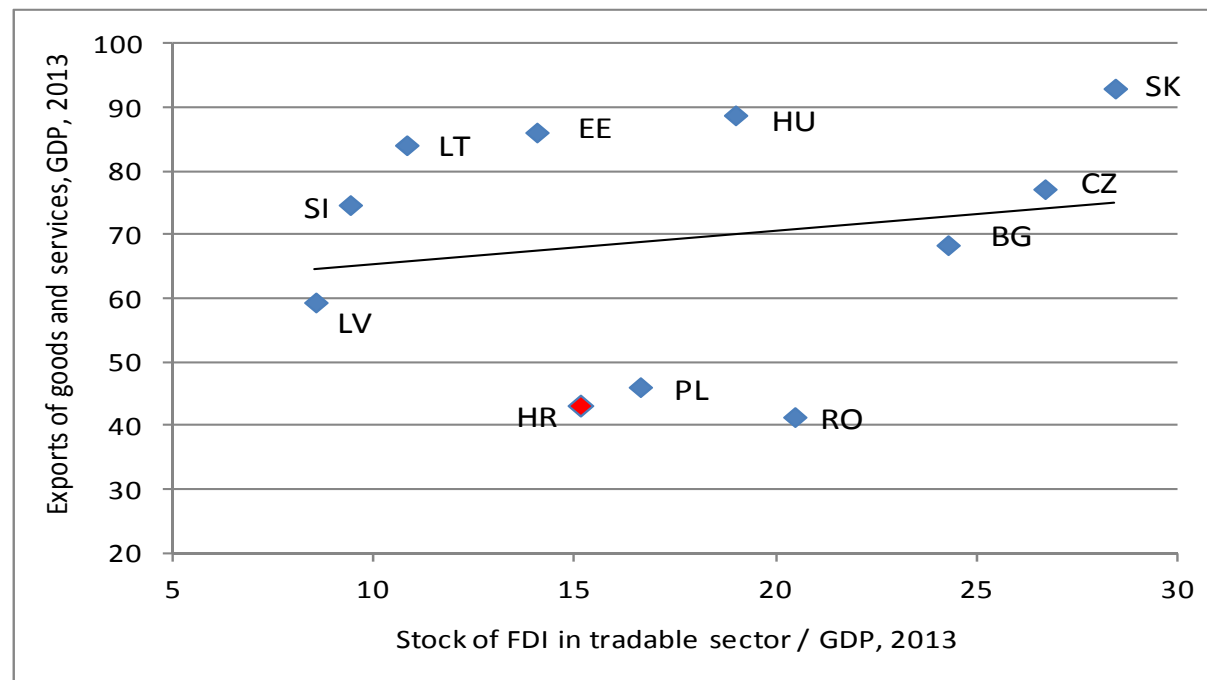
Share of FDI and domestic firms exporting at least 1% of their sale, 2013



Source: World Bank, *Business Environment and Enterprise Performance Surveys (BEEPS)*

# FDIs in tradable sector and exports

## Positive correlation between FDI in tradable sector and exports of goods and services



Notes: Tradable sector is defined as mining and quarrying, manufacturing, electricity, gas and water supply. Economic activities for Bulgaria and Croatia are based on NACE Rev.1 and for other countries on NACE Rev. 2 classification. Data for Czech R., Poland, Romania and Slovakia refer to 2012 and for other countries to 2013.

Sources: WiiW; HNB calculations

# Conclusion

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- ❑ Relatively strong FDI inflow, but its structure not “optimal”
- ❑ Effects of FDI are positive, but of lesser magnitude compared to peers – particularly on exports.
- ❑ Attracting new FDI into the tradable sector important
- ❑ Providing investment-friendly institutional environment key precondition for FDI growth
- ❑ Product and labour market reforms promoting higher labour force participation, education and innovation



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**Thank you!**