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Announcement of the continued application of the structural systemic risk buffer of 1.5%

Based on the analysis of structural vulnerabilities and systemic risks in the domestic economy during the regular biannual review of the structural systemic risk buffer, the Croatian National Bank has maintained this buffer rate at 1.5% of the total risk exposure.

The Croatian National Bank has prescribed the obligation to maintain a structural systemic risk buffer of 1.5% of the total risk exposure by December 2020 Decision on the application of the structural systemic risk buffer (Official Gazette 144/2020), pursuant to Article 129 of the Credit Institutions Act (Official Gazette 159/2013, 19/2015, 102/2015, 15/2018, 70/2019, 47/2020 and 146/2020; hereinafter referred to as: 'Act'). Credit institutions with a registered office in the Republic of Croatia are obligated to maintain this buffer on an individual and a consolidated basis, which obligation will be reviewed, pursuant to Article 131 of the Act at a minimum once every two years. In accordance with Article 132 of the Act, the Croatian National Bank may set a structural systemic risk buffer rate on any set or subset of exposures referred to in Article 131, paragraph (1) of the Act up to a combined buffer rate of 3%, and subject to a previous positive opinion or authorisation of the European Commission this rate may even be set up to 5% or above 5%.

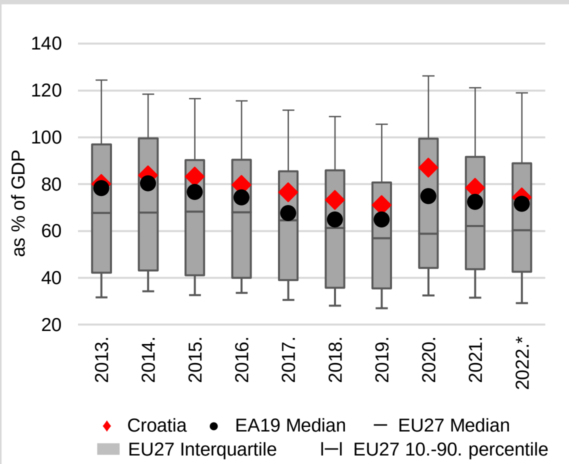
Structural imbalances and systemic risk exposures held steady at a moderately elevated level in the last two years. After economic activity recovered quickly from the disturbances caused by the COVID-19 pandemic, economic outlook deteriorated this year due to rising geopolitical insecurity, higher prices of energy and raw materials that have increased inflation and rising costs of borrowing. Of the structural vulnerabilities of the domestic economy, which, as a small and open economy is highly susceptible to the spillover of the effects from the international environment, particularly noteworthy are a relatively high public debt level, high exposure of the banking sector to the government and the persisting imbalances in the labour market seen in the very low rates of labour force participation and unfavourable demographic and migration trends that limit the potential for economic growth. Croatia's entry into the euro area at the beginning of 2023 will reduce structural vulnerabilities associated with the currency risk, however, these risks have never been taken into account in the calibration of this buffer rate anyway.

The level of public debt that rose steeply in the first year of the COVID-19 pandemic, has started falling gradually since 2021, but still remains slightly above the median value of euro area member states and the entire EU (Figure 1), which, together with a relatively high risk premium makes the Croatian economy highly sensitive to the likely further worsening of the global financing conditions. Fiscal support aimed at alleviating the effects of energy crisis and inflation might pose a further burden for the public debt. Banks' exposure to the government remains high, with exposures to the government currently comprising around one fifth of the total assets of the banking sector, one of the highest exposures of this type among euro area and European Union countries (Figure 2). As for the labour market, even though unemployment is down to a historical low, the population activity rate remains extremely low, ranking among the lowest of all euro area countries and the entire EU (Figures 3 and 4). In addition, demographic and migration trends continue to have an unfavourable impact on the labour market and growth potential of the Croatian economy.

The banking sector is well capitalised and liquid, however, credit institutions' resilience over the next period will largely depend on a further development of structural vulnerabilities of the economy that may exacerbate the impact of unexpected shocks on the economy and the financial system. Amid such circumstances, it is vital to keep the banking sector well capitalised so that in the event of systemic risks materialisation, credit institutions are able to withstand possible losses and continue to finance the domestic economy.

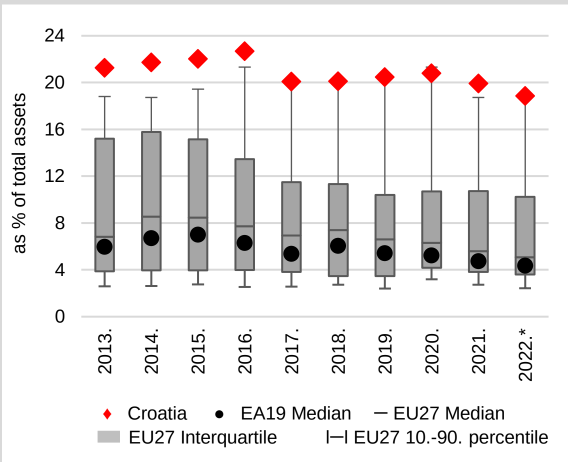
All this supports continued application of the structural systemic risk buffer of 1.5% of the total amount of risk exposure by all credit institutions, as defined in Article 3 of the Decision on the application of the structural systemic risk buffer ('Official Gazette 144/2020'). The Croatian National Bank will continue to regularly monitor developments in systemic risks of structural nature and will review the level of the structural systemic risk buffer as needed, and at a minimum once in every two years.

Figure 1 General government debt to GDP ratio is relatively high



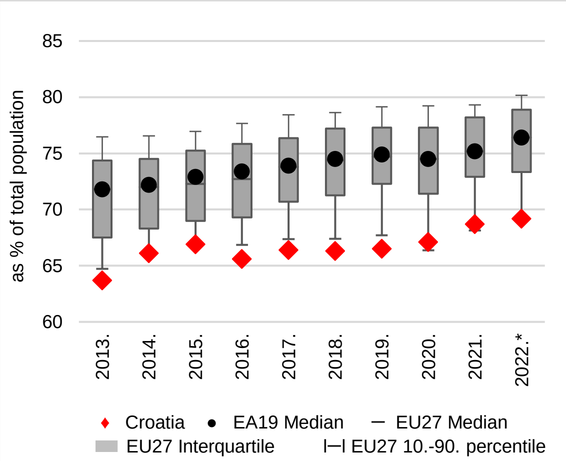
Source: Eurostat.
* Q2/2022

Figure 2 Banking sector exposure to the government is among the highest compared to other EU countries



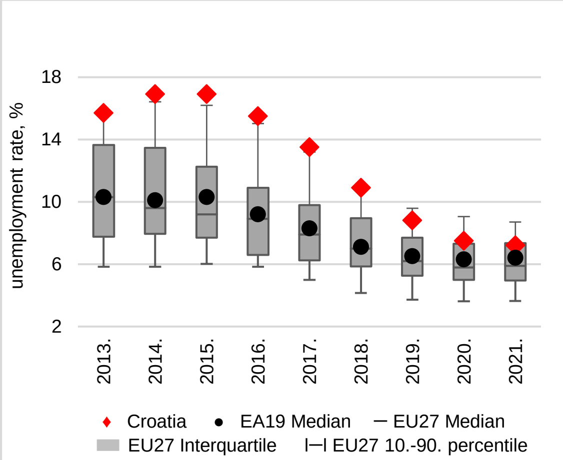
Source: Eurostat.
*Q3/2022

Figure 3 Population activity rate is among the lowest compared to other EU countries



Note: Active population is defined as the sum of employed and unemployed persons.
Source: Eurostat.
*Q2/2022

Figure 4 Unemployment rate, although reduced considerably, remains among the highest compared to other EU countries



Note: Unemployment rate is defined as a three-year backward moving average.
Source: Eurostat.