

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

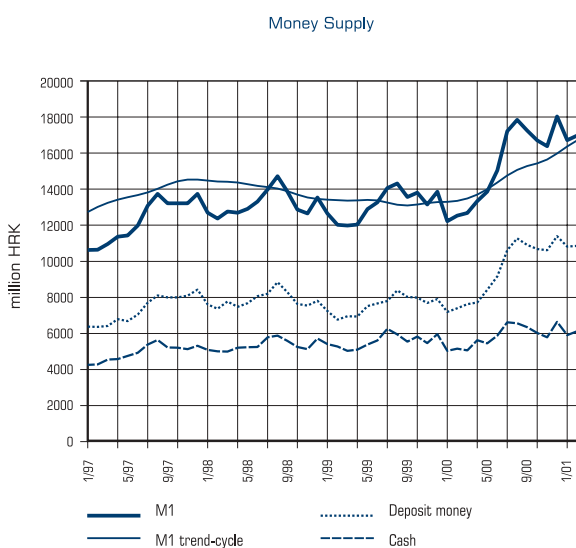
Money Supply

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.

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.

Figure 2.1



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 ex-

treme 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.

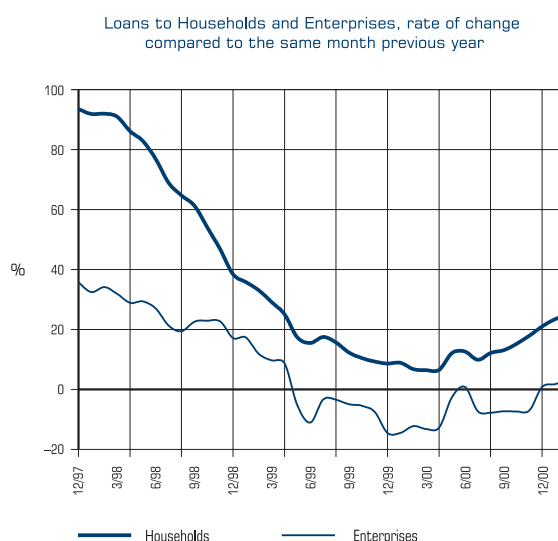
The 2000 growth in kuna savings and time deposits was satisfactory. They grew by 42.8% or HRK 2.5bn to HRK 8.4bn at the year-end. Their share in total liquid assets even slightly increased. Although the share of kuna savings in total savings has never been large, their growth indicates a (short-term)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



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 re-deposited 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

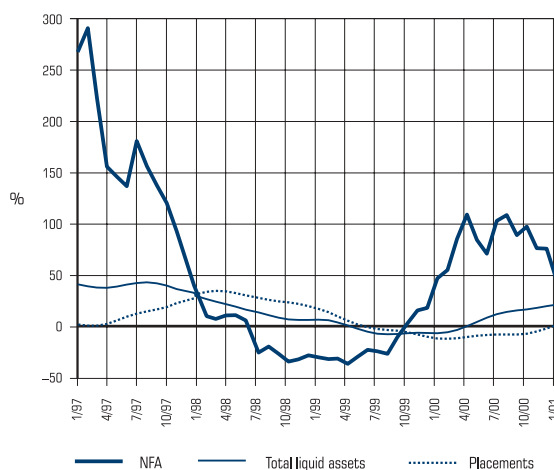
At the beginning of 2000, net foreign assets rose mostly due to an increase in commercial bank net foreign assets. Banks were not interested in placing their funds in domestic sectors and invested abroad. As the gap between increasing bank liquidity and stagnant placements grew wider, banks looked for 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 pre-season, 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

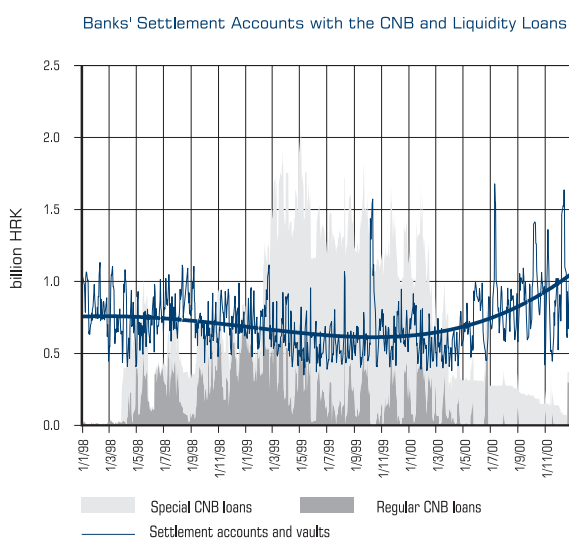
In 2000, banks and savings banks could use Lombard loans for the maximum of 15 working days in a month, in the amount up to 50% of the nominal value of purchased kuna CNB bills, Ministry of Finance bills and promissory notes, and up to 30% of the nominal value of purchased foreign currency CNB bills. 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



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.

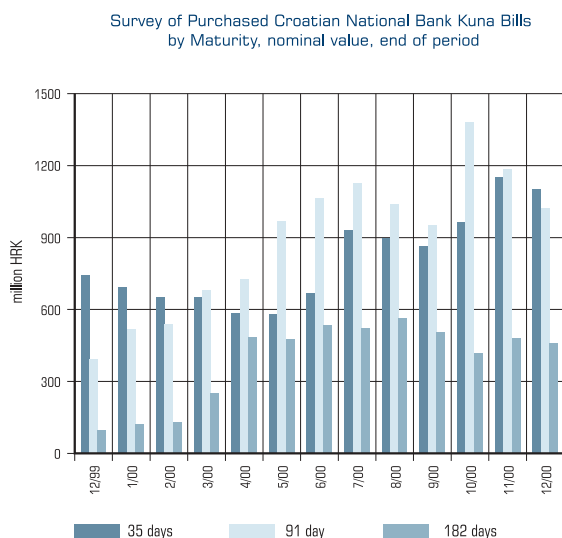
The Croatian National Bank auctioned kuna bills in nominal amounts of 100,000.00 kuna through the multiple-price method with discount. In addition to regular weekly auctions of bills with maturities of 35, 91 and 182 days, the central bank issued bills with adjusted maturities at three additional auctions. 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



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.

