

CROATIAN NATIONAL BANK

2001

ANNUAL REPORT

5

International Relations

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

Co-operation with the International Monetary Fund concerning information exchange and IMF support for the Republic of Croatia's economic and financial policy continued during 2001. Within the framework of this co-operation, numerous contacts were made with experts from the International Monetary Fund, both through this institution's representation office and through repeated IMF visits to Croatia.

In addition to the regular annual consultation related to Article IV of the Articles of Agreement of the IMF held in March 2001, there were especially intensive contacts with the IMF related to preparations for and implementation of a new Stand-By Arrangement, which was approved on 19 March 2001.

In 2001, in contrast to previous years, representatives of the Croatian National Bank (Governor and Deputy Governor), acting in the name of the Republic of Croatia, directly participated in the work of IMF management bodies, mostly through voting without meeting. The regular Annual Meeting of the Board of Governors of the International Monetary Fund and the World Bank, which was to be held in Washington at end-September 2001, was first postponed and then cancelled owing to the security situation related to terrorist attacks on the USA on 11 September 2001. The need to formulate a joint economic policy and respond to circumstances arising from the September events in the USA led to the decision to hold the meeting of the International Monetary Fund and the Development Committee of the World Bank in Ottawa on 17 November 2001. Representatives of the Croatian National Bank did not participate in the meeting because its topics and the number of participants were limited. Following existing practices, executive directors of the IMF Dutch Constituency and the World Bank represented the interests of the Republic of Croatia at the meeting.

In addition to direct voting, the interests of the Republic of Croatia in the IMF continued to be represented through the IMF Constituency which, together with Croatia, includes 11 countries and is headed by Mr. J. de Beaufort Wijnholds, the Dutch representative, as the Executive Director. In mid-2001, pursuant to the Constituency's operating rules, the Croatian National Bank appointed its representative, Mr. Michael Faulend, to the position of Assistant to the Executive Director of the IMF Dutch Constituency for a two-year period.

5.1.1 Stand-By Arrangement

The Executive Board of the IMF approved a 14-month arrangement in the amount of SDR 200m on 19 March 2001, which expires on 18 May 2002. In view of Croatia's relatively high level of international reserves, favorable balance of payments outlook and good standing in the international capital markets, this arrangement was concluded as

“precautionary”, i.e. the funds approved are not purchased but may be used if the need arises.

Under the arrangement, the Republic of Croatia committed itself to cut the budget deficit, while maintaining price stability based on the stable exchange rate of the domestic currency. The economic program for 2001 included, among others, a reduction in the consolidated central government deficit and structural reforms aimed at economic liberalization, restructuring and privatization.

In November 2001, the Executive Board of the IMF stated that, despite certain difficulties, Croatia’s economic indicators were generally favorable and approved the content of the documents submitted to the IMF, thus confirming the completion of the first review under the arrangement.

Negotiations on the second review under the arrangement began at end-November 2001. At that time, a letter of intent was written that describes the economic policies the Croatian authorities intend to pursue during the remaining period of the arrangement. The letter emphasized that the program objectives for 2001 relating to economic growth, inflation and international reserves had been exceeded.

At its session held on 29 March 2002, the Executive Board of the IMF adopted the content of the documents submitted to the IMF, thus confirming the completion of the second, and final, review under the arrangement.

It should be noted that this was the first arrangement with the IMF that was completed successfully and within the programmed period.

All documents relating to the stand-by arrangement have been regularly published on the web sites of the CNB and IMF, in line with the IMF projects aimed at increasing the transparency of its activities and the activities of its member countries.

5.1.2 Financial Sector Assessment Program

In their joint effort 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, to enable the early detection of weaknesses in their financial systems, to ensure co-ordinated and efficacious dialogue with the national governments and to identify the development and technical assistance needs of member countries. The Republic of Croatia applied to join the project in November 2000. The preliminary FSAP mission visited Croatia in April 2001, followed by the main mission in September 2001. The mission emphasized the successful maintenance of macroeconomic and banking sector stability but also the need to further improve the supervision of all parts of the financial sector and to implement appropriate structural reforms. The mission’s final report is expected to be released in 2002.

5.1.3 Contribution of the Republic of Croatia to Financing the Initiative to Reduce Poverty

Within the IMF and World Bank activities, the CNB joined the initiative of these two institutions aimed at reducing poverty – the HIPC initiative (Heavily Indebted Poor Countries) and the Poverty Reduction and Growth Facility (PRGS). The IMF and the World Bank conduct operations aimed at poverty reduction and growth increase in 77 of the poorest countries in the world. The basic condition for receiving the PRGF is low income per capita and the suitability for receiving International Development Association (IDA) facilities under very favorable conditions, which means a per capita income under USD 885 in 1999. The basic conditions for the HIPC status are: a) suitability for receiving IDA and PRGF facilities; b) unsustainable public debt even after the activation of traditional debt reduction mechanisms; and c) implementation of strategies aimed at poverty reduction and sustainable economic growth.

At the IMF's request, and in accordance with the Resolutions of the Government of the Republic of Croatia of 28 June 1996 and 7 October 1999, the Croatian contribution consists of an interest-free loan of SDR 519,161, the amount allocated to the SCA-2 Account. The funds in this account, opened by the IMF for the purpose of financing the HIPC Initiative, are collected from the member countries that paid increased charges and fees on the IMF financial facilities or that received reduced interest on their deposits with the IMF. The agreement on an interest-free loan maturing in 18 years was signed by the IMF and the CNB, which is authorized to conduct all operations and transactions in the name of the Republic of Croatia under the IMF Articles of Association. It came into force on 9 April 2001.

5.1.4 Technical Assistance of the International Monetary Fund

In 2001, several meetings with IMF representatives were held at the Croatian National Bank in connection with technical assistance in the areas of accounting, monetary and financial statistics, Special Data Dissemination Standard and monetary policy instruments.

In addition, as in the previous years, the IMF provided technical assistance to other institutions in the Republic of Croatia.

5.1.5 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 has concluded with the IMF: the Systemic Transformation Facil-

ity (STF), SDR 130.80m, approved in 1994 simultaneously with the stand-by arrangement, and the Extended Fund Facility (EFF), SDR 353.16m, approved in 1997. During 2001, SDR 5.35m in interest was paid on these arrangements: the principal payments on the STF and EFF arrangements were SDR 21.80m and SDR 2.39m respectively, with an additional SDR 0.5m paid in charges on the stand-by arrangement. As a member of the Special Drawing Rights Department (of the IMF), Croatia has regularly repaid its obligations based on the inherited obligations related to the allocation of the special drawing rights. During 2001, SDR 1.70m 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.

Balance on 31 December 2001		
GENERAL RESOURCES ACCOUNT	SDR (million)	% Quota
Quota	365.10	100.00
IMF holdings	462.17	126.59
SDR DEPARTMENT	SDR (million)	% net cum. al.
Net cumulative allocation	44.21	100.00
Holdings of Croatia	85.49	193.40
LIABILITIES PAID IN 2001	SDR (million)	–
Repayment of principal – STF arrangement	21.80	–
Repayment of principal – EFF arrangement	2.39	–
Interest payments on all arrangements	5.35	–
Charges on the stand-by arrangement	0.50	–
SDR Department membership fee	0.01	–
Net cumulative allocation costs	1.70	–

Note: The value of special drawing rights (SDRs) is the weighted average of the basket of leading world currencies, which is revised every five years. As of 1 January 2001, the currency basket is composed of the American dollar (45%), the euro (29%), the Japanese yen (15%) and the pound sterling (11%).

5.2 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) The following laws regulate the Republic of Croatia's membership in the World Bank Group, European Bank for Reconstruction and Development and Inter-American Development Bank: 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). Under these laws, the Ministry of Finance of the Republic of Croatia is the competent authority for co-operation with the World Bank Group, the European Bank for Reconstruction and Development and the Inter-American Development Bank, and is authorized to perform all operations and transactions in the name of the Republic of Croatia that are permissible under these institutions' articles of association. 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 2001, 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.

Payments Executed in 2001 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	369,000.00	EUR	738,000.00
IDB	a) HRK	1,440,443.67	USD	253,333.00
			(Ordinary capital)	
	b) EUR	205,886.50	DEM ^a	1,583,219.00
			(Fund for special operations – FSO notes)	
IBRD			HRK	89,622,398.73
IDA			HRK	437,666.65
MIGA			USD	202,334.00

^a Notes are cashed in euro.

b) The use and repayment of the funds pursuant to the Agreement signed on 4 June 1997 between the Republic of Croatia (Ministry of Finance) 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. The loan was used in entirety on 18 December 2001 when the second loan tranche of EUR 40,903,350.49 (DEM 80m) was disbursed.

c) An Agreement between the Republic of Croatia (Ministry of Finance) and the International Bank for Reconstruction and Development on the Structural Adjustment Loan (SAL) (official gazette *Narodne novine*, No. 2, 6 February 2002, "International Agreements") was signed on 5 December 2001. Under the Agreement, the International Bank for Reconstruction and Development approved a USD 202m loan to the Republic of Croatia to support the implementation of economic reforms in Croatia. The repayment term of the loan is 10 years, and the use – withdrawal of funds – is executed through a special account at the CNB. The first tranche of USD 102m was withdrawn on 13 February 2002, and the second tranche depends on the fulfillment of the terms stipulated in the Agreement.

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

5.3.1 Membership of the Croatian National Bank in the Bank for International Settlements

Following a series of unsuccessful negotiations on the distribution of the former SFRY's assets held at the BIS, due to lack of co-operation on the Yugoslav side, the Croatian National Bank and the central banks of Bosnia and Herzegovina, Slovenia and Macedonia gained full membership in the BIS in mid-1997 in accordance with a separate decision of the BIS. The decision stipulated that membership was to be based on the subscription of 10 "symbolic" shares, for which USD 122,940.00 was paid. It was agreed that the BIS would repurchase these symbolic shares after the resolution of the succession process. The process of accepting membership in the BIS was regulated by the Decision of the CNB Council made in May 1997 (official gazette *Narodne novine*, No. 54, 27 May 1997).

The issue of the distribution of assets (foreign exchange reserves, gold and shares) which the BIS kept in the name of the former National Bank of Yugoslavia again became topical after the political changes in the Federal Republic of Yugoslavia at end-2000. In this regard, delegations of the five successor states held several meetings at the end of 2000 and the beginning of 2001. The Agreement between the five successor states was ini-

tialled at a meeting in Brussels on 10 April 2001. It was later annexed to the Agreement on Succession Issues, which was initialed in May 2001 and signed on 29 June 2001 in Vienna. Under the Agreement, Croatia was entitled to 28.49% of the former SFRY's assets held at the BIS.

On the basis of the above-stated and related comments sent to the BIS by relevant institutions/central banks of the successor states, a resolution was reached at the Extraordinary General Meeting of the BIS on 11 June 2001 which cancelled 8,000 shares of the former National Bank of Yugoslavia (NBY) in the BIS capital. At the same time, a corresponding number of new shares were issued to the central banks of Croatia, Bosnia and Herzegovina, Slovenia, Macedonia and Yugoslavia. The resolution also called for the cancellation of ten symbolic shares previously issued to the central banks of Croatia, Bosnia and Herzegovina, Slovenia and Macedonia.

At its meeting on 4 July 2001, the CNB Council reached the Decision on the Croatian National Bank Membership in the Bank for International Settlements (BIS), Basle. In accordance with the resolution of the Extraordinary General Meeting of the BIS, the decision regulated the continuance of the CNB membership in the BIS by taking over a 28.49% stake (or 2,280 shares) in the total shares of the former NBY in the BIS capital. As previously agreed, the ten symbolic shares were returned to the BIS, which returned to the Croatian National Bank the amount it paid in 1997.

The Republic of Croatia also became entitled to a 28.49% stake in the other assets of the former NBY kept at the BIS, comprising gold and foreign exchange. Pursuant to the Croatian government's Decision on the acceptance of the distribution of the former NBY's assets held at the BIS, which was reached in 1996, these assets (13.127 tons of bullion and USD 8.32m of foreign exchange deposits) were included in the international reserves of the Republic of Croatia on 13 June 2001.

5.3.2 Regular Activities of the Croatian National Bank within the Co-operation with the Bank for International Settlements

In addition to the regular Annual General Meeting and the extraordinary General Meeting on 11 June 2001, an Extraordinary General Meeting of the BIS was held on 8 January 2001 at which a decision was reached that all BIS shares held by private shareholders be repurchased against payment of compensation of CHF 16,000 for each share.

The Governor and other members of the CNB management participated in the work of these meetings and the regular meetings of central bank governors from the BIS member countries, where a number of topical issues in the area of international banking and finance were discussed.

The Croatian National Bank participated in the activities of the Bank for International Settlements aimed at co-ordinating 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.

Furthermore, CNB representatives participated in the work of regional groups of the Basle Committee on Banking Supervision and the Committee on Payment and Settlement Systems.

A separate and important form of co-operation between the CNB and BIS has been established in the area of international reserves management.

5.4 Co-operation between the Croatian National Bank and Other International Institutions

The Croatian National Bank co-operated with other international financial institutions as well. For instance, representatives of the Japan Center for International Finance (JCIF) and the Institute for International Finance (IIF) visited Croatia again this year in July and November 2001 respectively.

The aim of these visits was to acquire information on Croatia's economic and political situation and to prepare the corresponding reports. These visits and reports are important for Croatia because of the high reputation these institutions and their reports have among the leading Japanese and world banks and funds.

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

After the negotiations on the Stabilisation and Association Agreement formally opened in November 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. Of the nine technical task forces (I – General political and technical-legal issues; II – Regional co-operation; III – Free movement of goods; IV – Free movement of workers, services and capital; V – Legal harmonization; VI – Co-operation in justice and home affairs; VII – Co-operation policies; VIII – Financial co-operation; IX – Agriculture and fisheries), CNB representatives contributed to the work of task forces IV, VII and VIII. The Ministry for European

Integration was appointed co-ordinator for relations with the European Union at the level of the Republic of Croatia.

The Stabilisation and Association Agreement between the Republic of Croatia and the European Union was initialed in Brussels on 14 May 2001 and signed by the Croatian government in Luxembourg on 29 October 2001. The Agreement will enter into force following its ratification by the Croatian Parliament, the European Parliament and the parliaments of all EU member countries. The Agreement was ratified by the Croatian Parliament and European Parliament on 5 December and 12 December 2001 respectively. Austria, which ratified the Agreement on 21 February 2002, was the first EU member country to do so.

Under the Agreement, one of the main tasks of Croatia is to approximate its legislation to the EU regulations. Even before the Agreement was signed, the CNB strove to incorporate relevant EU regulations concerning its field of competence and always requested the opinion of European Commission experts when preparing draft legislation. Such an opinion was also requested at the beginning of 2001 when the new Law on the Croatian National Bank was enacted.

Representatives of the Bilateral Relations Division of the European Central Bank visited the Croatian National Bank at end-April 2001. They held an economic workshop on the organization and functioning of the European Central Bank as the head institution of the European System of Central Banks.

5.6 International Payment Operations

The scope and dynamics of international payment operations continued growing in 2001. Orders for payments abroad and receivables from 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.

International payment operations for the purposes of the Croatian National Bank included a continuous monitoring of international standards related to banking (International Chamber of Commerce – ICC, Incoterms, ISO, etc.).

Related to the changes in SWIFT standards, SWIFT message MT 100 – *Customer Transfer* – has been replaced under the new standards by message MT 103 – *Single Customer Credit Transfer*. The Croatian National Bank started using this message for international payments in May 2001 and was the first bank in Croatia to do so.

5.7 Correspondent Relations with Foreign Banks and Other Financial Institutions

The Croatian National bank monitors economic, financial and political developments in certain countries and regions of special interest for both the Croatian banking system and the economy as a whole.

In 2001, special attention was paid to the candidate countries for EU membership in the first round and to their banking systems. The monitoring of developments in these countries was considered significant for comparison of their economic indicators with those of the Republic of Croatia and for comparing the status of Croatia with the status of these countries as potential EU members. In addition, certain banking groups operating in the Republic of Croatia operate also in other Central European countries, which gives added importance to the analysis of corresponding banking systems.

The collection and monitoring of data, which is divided into four groups, is implemented at two levels, the credit-investment standing of countries (with emphasis on the OECD countries) and the credit-investment standing of financial institutions.

The first group comprises banks (commercial and investment) that are business partners or potential business partners of the Croatian National Bank. These financial institutions receive special attention because monitoring their credit risk, i.e. the risk that their credit standing deteriorates, is an essential part of the whole risk management system. This risk is one of the elements used in determining the international reserves management policy. In addition to monitoring particular financial institutions, developments of the related banking and financial system, as well as economic and political developments are monitored. Lists are prepared containing financial institutions and countries fulfilling the CNB criteria for mutual co-operation.

The second group comprises countries and banks that fulfil the criteria pursuant to the Decision on the Reserve Requirements (official gazette *Narodne novine*, Nos. 44/2001, 77/2001, 87/2001 and 100/2001). It includes countries and banks with which the Republic of Croatia, i.e. Croatian commercial banks, have established good and developed co-operation.

The third group comprises transition countries, especially those that are candidates for EU membership and also those included in the Stability Pact, i.e. the countries in the "Balkan" region (Albania, Bosnia and Herzegovina, Macedonia, FR Yugoslavia), which, according to the international community and financial institutions, includes Croatia. The latter countries are especially important because Croatian banks and companies have re-established business co-operation with some of them. The CNB also monitors global banks and companies that increase their exposure to risky markets by operating in the region, thus directly exposing their Croatian business partners to this risk.

The fourth group comprises all other countries and their banking sectors that the Cro-

atian National Bank monitors for its own purposes or at the request of the Croatian government and its ministries and the Croatian Parliament and its committees, or for the purposes of co-operation with the Croatian Bank for Reconstruction and Development (CBRD).

The Croatian National Bank participates in the work of the Interministerial Committee for Export Insurance (ICEI) of the Croatian Bank for Reconstruction and Development. The government of the Republic of Croatia enacted the Decree on the Interministerial Committee for Export Insurance on 27 August 1998 (official gazette *Narodne novine*, No. 115/1998). The Decree established the ICEI, determined its tasks, and authorized the CBRD to conclude agreements with domestic exporters in the name and for the account of the Republic of Croatia. The ICEI comprises one representative from each of the following institutions: the Ministry of Finance, the Ministry of the Economy, the Ministry of Foreign Affairs, the Ministry of Agriculture and Forestry, the Croatian Chamber of Commerce and the Croatian National Bank. The CNB prepares materials and assesses the credit standing of countries and foreign banks for the purposes of the ICEI.

Multiple sources of data are used in preparing the relevant reports – reports by internationally recognized credit rating agencies, financial institutions' annual and other periodical reports, specialized magazines, reports and comments by international financial institutions, the CNB's archive, and other relevant sources.

5.8 Credit and Financial Relations and Succession Issues

The Croatian National Bank participates in resolving various issues related to the succession of the states of the former SFRY.

The provisions of Annex C to the Agreement on the Succession Issues, which was signed in Vienna on 29 June 2001, defined the basic assumptions for the distribution of the financial assets and liabilities of the former SFRY. The Committee on the Distribution of the Financial Assets and Liabilities referred to in Annex C to the Agreement on the Succession Issues was established soon afterwards to determine the actual balance of assets and liabilities. CNB employees were engaged in gathering and reconciling data presented by representatives of the National Bank of Yugoslavia, and in preparing information material for the Committee members. Special attention was paid to establishing contacts and the exchange of information with competent bodies and institutions of the other successor states of the former SFRY. CNB employees were appointed to the Task Force for clearing of the former SFRY's successor states, which has continuously worked on reconciling the balances in the clearing accounts of the former NBY with the former Soviet Union, German Democratic Republic, Czechoslovakia, Albania and Egypt.

Because of the increased interest of Croatian commercial banks, contacts were maintained with the competent financial bodies of the former SFRY's successor states (Banking Agency of the Federation of Bosnia and Herzegovina, Banking Agency of Republika Srpska, Central Bank of Bosnia and Herzegovina, and National Bank of the Republic of Macedonia). Contacts were established with the National Bank of Yugoslavia and the Central Bank of Montenegro.

In March 2001, the Croatian National Bank and the Ministry of Finance established a Commission for granting approvals to settle refinanced obligations arising from foreign credit relations prior to maturity pursuant to Article 18, paragraph 3 of the Foreign Credit Relations Act (official gazette *Narodne novine*, No. 43/1996).

As the debtor/guarantor for rescheduled loans, the government is keenly interested in these decisions. Therefore, the Ministry of Finance's representative has veto power on all decisions made by the Commission.

Over the last year, representatives of the CNB performed numerous specific activities related to participation in the work of intergovernmental commissions and committees of the Ministry of Finance, the Ministry for European Integration, the Croatian Chamber of Commerce and other government bodies.