

Annual Report

2004

CROATIAN NATIONAL BANK

# International Relations

# 7



## 7.1 International Co-operation

### 7.1.1 Activities of the CNB in Connection with the Relations between the Republic of Croatia and the European Union

2004 was the year of the biggest EU enlargement since its creation. On 1 May 2004, eight Eastern and Central European countries and two island countries, Cyprus and Malta, entered the EU, which ended the long-lasting period of political and economic divisions. The EU thus gained 74 million new inhabitants and additional dynamic economic strength of EUR 475bn in GDP terms. In political terms, this enlargement implies a stronger and democratically more stable continent, and in economic terms, it implies a single market with over 450 million citizens and total GDP of EUR 10,210bn. According to these quantitative indicators, the EU today holds the top global position in terms of economic strength.

For the process of Croatia's accession to the EU, the year 2004 was also very important. The Republic of Croatia submitted its application for EU membership in February 2003 and its replies to the European Commission Questionnaire in October 2003, receiving a positive European Commission opinion on its application for EU membership on 20 April 2004. At its Brussels summit on 18 June, the Council of the European Union accepted the Commission's opinion and granted candidate status to Croatia. In line with the standard procedure, the EU Council established the European Partnership on 13 September, which identifies short- and medium-term priorities in the process of joining the EU. The pre-accession strategy, which was adopted on 6 October, among others, sets the amount of financial resources that Croatia may be provided in 2005 and 2006 through pre-accession funds Phare (a total of EUR 160m), ISPA (a total of EUR 60m) and SAPARD (EUR 25m). Finally, on 17 December, the EU Council decided to begin accession negotiations with Croatia on 17 March 2005, but made it subject to the confirmation of Croatian co-operation with the International Criminal Tribunal for the Former Yugoslavia.

Within its field of competence and in order to ease and expedite the inclusion in EMU, the CNB continued in 2004 to implement monetary policy whose main objective is low inflation. The CPI inflation was 2.7% in 2004. The CNB also continued with its policy of maintaining a stable exchange rate. This monetary policy orientation is in line with the convergence criteria (the Maastricht criteria). Also, the CNB continued to harmonise legislation within its sphere of competence with the *acquis communautaire*. It should be said that most laws and regulations in this field have already been largely harmonised with EU regulations.

In institutional terms, within organisational changes in the CNB, early 2004 saw the establishment of the European Relations Department within the newly-estab-

lished International Relations Area. The main task of the Department is to co-operate with EU institutions and monitor their activities. This primarily refers to the ECB and appropriate organisational units of the European Commission. The Department also co-operates with Croatian institutions in charge of the EU accession process. Furthermore, it monitors the achievement of the convergence criteria, EU policy towards the new EU members and candidate countries, coordinates activities related to harmonisation of laws within the CNB's sphere of competence with the *acquis communautaire*, and performs other activities related to Croatia's accession to the EU.

2004 saw the end of the several-year ratification process of the SAA, which was signed in Luxembourg in October 2001. After it was broadened to include also the ten new EU members, the SAA came into effect on 1 February 2005. To sum up in one place all activities related to the fulfilment of commitments under the SAA, the Government of the Republic of Croatia has for several years adopted the National Programme for Accession to the EU. At its session of 9 December 2004, the Government adopted the National Programme for 2005. The CNB co-operates in the preparation of this document, in the part that refers to economic criteria, free movement of services and capital, and EMU.

By getting EU candidate status, Croatia assumed the obligation to prepare the Pre-accession Economic Programme 2005-2007. This programme is aimed at preparing candidate countries for participation in procedures of multilateral supervision and co-ordination of economic policy currently applied in the EU as part of EMU. The real objective of the Programme is to create an appropriate medium-term monetary policy framework, which is complementary to the achievement of targeted macroeconomic goals, including public finance targets and priorities in the area of structural reforms. CNB experts also participated in the preparation of this document, in the part related to current economic developments, macroeconomic programme and the financial sector. The Pre-accession Economic Programme was adopted at the Government session of 30 November 2004.

Finally, concerning the forthcoming negotiations on Croatia's membership in the EU, it should be said that it has been conceived that CNB experts would participate in the work of negotiating teams. The areas of their field of competence would be free movement of capital, financial services and EMU.

## 7.1.2 International Monetary Fund (IMF)

The quota of the Republic of Croatia in the IMF remained unchanged in 2004 (SDR 365.1m), the same as its voting rights (0.18% of total voting rights). The Republic of Croatia can realise its interests within the IMF through the Dutch Constituency, which includes, in addition to the Republic of Croatia, another 11 countries (Armenia, Bosnia and Herzegovina, Bulgaria, Cyprus, Georgia, Israel, Macedonia, Moldova, the Netherlands, Romania and Ukraine). The Constituency is headed by the Dutch representative, Jeroen Kremers, who acts as Executive Director of the Constituency. A voting power of the Constituency is 4.85% of

the total votes in the IMF, which makes it the seventh strongest constituency (of the total of 24 constituencies).

Numerous contacts were made in 2004 with experts of the IMF, both through this institution's representative office and through repeated visits of IMF missions to Croatia and the CNB delegation visits to the IMF. Regular consultations related to Article IV of the Articles of Agreement of the IMF, which were conducted in mid-year, ran parallel to negotiations on a new stand-by arrangement. The Executive Board of the IMF approved the new stand-by arrangement of SDR 97m (USD 142.52m) in August 2004. The arrangement was to last for 20 months and was concluded as "precautionary" (the funds approved are not to be purchased) given the favourable financial position of the Republic of Croatia.

The Croatian authorities view the arrangement as a useful framework for the implementation of their macroeconomic policy in the period up to 2006. In this sense, the arrangement should help in solving major macroeconomic problems; primarily contribute to stabilisation of the external debt, whose rapid growth over recent years has been seen as the factor that influences the external vulnerability of the Croatian economy. By focusing on external debt stabilisation as the major part of the arrangement, the IMF assigned to fiscal policy a major role in the achievement of this objective. Fiscal consolidation and the establishment of fiscal discipline in general are in the core of the arrangement and performance criteria under the arrangement have been set accordingly.

With regard to other forms of co-operation with the IMF it should be mentioned that in 2004 Croatian representatives continued their regular participation in the work of IMF management bodies (Constituency, International Monetary and Financial Committee and Board of Governors). In particular, CNB representatives took part in the work of the Spring and Annual Meetings of the IMF Board of Governors in Washington, where they met with representatives of international financial institutions, commercial banks and investment companies. In addition, in the context of the newly-concluded arrangement, the IMF again conducted a safeguard assessment of the CNB in autumn 2004. A safeguard assessment of central banks is a standard mechanism that the IMF has been carrying out since 2000 in central banks of the countries that have arrangements with the IMF. Its purpose is to identify potential weaknesses in central bank systems that are connected with control, accounting, reporting, internal and external audit and legal aspects. The related report, which was completed in early 2005, contained very favourable findings for the CNB, and was adopted by the IMF management. Finally, regarding technical assistance, the IMF mission related to preparations for the introduction of open market operations – a new monetary policy instrument, visited the CNB in early 2004.

Finally, it should be said that, as the fiscal agent of the Republic of Croatia and a depository of the International Monetary Fund (as provided by the Act on Accepting Membership of the Republic of Croatia in the International Monetary Fund and Other International Financial Organisations on the Basis of Succession, official gazette *Narodne novine*, No. 89/1992), the CNB is responsible for keeping deposit accounts of the IMF and for regular servicing of the obligations arising from the arrangements concluded between the Republic of Croatia and the IMF. The obligations due in 2004 related to the charges on the 2002 stand-by arrangement (SDR 0.04m), and the charges on the new stand-by arrangement concluded in 2004 (SDR 0.24m). Also, as a member of the Special Drawing

Rights Department (of the IMF), Croatia regularly repaid its succession-related obligations arising from the allocation of special drawing rights in the amount of SDR 0.77m.

## 7.2 Bank for International Settlements (BIS)

The BIS, of which the CNB has been a shareholder since 1997, held its regular Annual General Meeting on 28 June 2004, at which it adopted its Annual Report and decided that dividends to be paid were to amount to SDR 225 per share.

In addition to the Annual General Meeting, central bank governors from the BIS member countries also meet regularly to discuss topical issues in the area of international banking and finance.

Within the activities of the BIS aimed at promoting co-operation among central banks, an important part is played by a number of committees and expert bodies in whose work CNB representatives actively participate. One of the initiatives for the exchange of information is the Central Bank Governance Network, which the BIS launched as early as 1999. It is used to exchange information among central banks through a protected electronic network. A CNB representative attended the first meeting of participants in this network, which was held in Hong Kong in late 2004.

CNB representatives also participate in the work of the Committee on Payment and Settlement Systems, as well regional groups of the Basle Committee on Banking Supervision. In the organisation of the Prudential Regulation and Bank Supervision Area, the CNB hosted the 17th Conference of the Group of Banking Supervisors from the Central and Eastern Europe, which was held in Dubrovnik at end-May 2004. The Conference was organised in co-operation with the Financial Stability Institute of the BIS.

Another important form of co-operation between the CNB and the BIS was achieved in the area of international reserves management.

## 7.3 Co-operation between the CNB and Other International Financial Institutions

The major part of CNB co-operation with other international financial institutions refers to its co-operation with development banks of which the Republic of Croatia is a member: the World Bank Group, the EBRD and the Inter-American

Development Bank (IDB). The Republic of Croatia's membership in these banks is regulated by special acts pursuant to which the Croatian MoF is the competent authority for co-operation with these banks and is authorised to perform all operations and transactions in the name of the Republic of Croatia that are permissible under these institutions' articles of association. The CNB is the depository, i.e. it keeps all deposit accounts owned by these international financial institutions, in the name and on behalf of these financial institutions, and performs financial transactions with these organisations as the payment agent of the Republic of Croatia. Withdrawals and repayments of funds based on structural loans, which the IBRD granted to the Republic of Croatia, are also executed through the CNB.

In addition to these legally prescribed tasks, CNB representatives, at numerous meetings with representatives of the World Bank and the EBRD, exchanged information on macroeconomic situation in Croatia and on the planned strategy of these development banks for the Republic of Croatia in the forthcoming period.

In 2004, the CNB also co-operated with other international financial institutions. Specially mentioned should be more intense contacts with the EIB. As in the preceding years, the CNB and other competent Croatian institutions were visited by IIF representatives in April and December and JCIF representatives in December 2004. The aim of these visits was to acquire information on Croatia's economic and political situation.

## 7.4 International Payment Operations

As the fiscal agent of the state, the CNB regularly executed international payment and collection transactions on behalf of the Croatian MoF, including financial obligations arising from Croatia's membership in international financial institutions: IMF, IBRD, IFC, IDB, EBRD and MIGA, as well as obligations arising from loans that these institutions granted to the Republic of Croatia (EFSAL, SAL). The CNB also executed international payment operations in its own name and for its account. These international transactions related to collections arising from the sale of coins and commemorative coin editions and regular payments based on obligations arising from services and goods used for CNB purposes.

The execution of international payment operations required continuous monitoring of the application of domestic and international standards in the area of finance and banking, international payments and trade (ISO standards, regulations and guidelines of the BIS, ICC, etc.), as well as EU regulations related to this area.

## 7.5 Correspondent Relations with Foreign Banks and Other Financial Institutions

The CNB has developed and maintained a correspondent network with over a hundred banks and financial institutions around the world. This network is the basis for all international financial activities of the CNB. Due attention is paid to collection of relevant information on the legal status of all correspondents, the analysis of their credit and investment ratings and their banking systems.

Additionally monitored are economic and political developments in certain countries and regions of special interest for the CNB itself and for the Croatian banking system and the economy as a whole. We especially point to the participation in the work of the Interministerial Committee for Export Insurance at the CBRD.

Over 50 meetings with representatives of foreign central and commercial banks, investment funds and credit and investment rating agencies, and other institutions were organised in 2004.

## 7.6 Foreign Exchange System and Foreign Exchange Policy Measures of the Republic of Croatia

The legal basis of the foreign exchange system of the Republic of Croatia is the Foreign Exchange Act (official gazette *Narodne novine*, No. 96/2003). Relevant subordinate legislation defines the instruments and measures for the implementation of foreign exchange policy.

Foreign exchange policy measures determine the degree of restrictions on capital movements between residents and non-residents. Regulations also determine the procedure for the issuance of authorisations based on applications to transfer capital from the Republic of Croatia, as well as the terms and methods of using foreign means of payment and kuna in relations between residents and between residents and non-residents.

In the process of harmonising Croatian legislation with the *acquis communautaire*, the Croatian foreign exchange system has been gradually changed, in line with the SAA provisions, EU guidelines and other documents regulating the terms and methods of conducting current and capital transactions.

The SAA, which was signed in 2001, came into full effect on 1 February 2005. The SAA provisions oblige the Republic of Croatia to abolish restrictions on pay-

ments and transfers based on current foreign exchange operations as well as restrictions on payments and transfers of one part of the remaining capital transactions. Restrictions on payments and transfers of the other part of the remaining capital transactions are still allowed and the SAA determines the dynamics of their abolishment. All remaining restrictions on payments and transfers based on capital transactions will be abolished with Croatia's accession to the EU.

In line with the SAA provisions and on the basis of macroeconomic assumptions, the guidelines for the process of liberalisation of the BOP capital account of the Republic of Croatia in the forthcoming period were adopted in 2004.

Within the implementation of the foreign exchange policy and performance of its tasks, the CNB in 2004 issued 26 certificates for computer software that must be used by authorised exchange offices. The project of certified computer software for authorised exchange offices has been designed to strengthen their fiscal and financial discipline and is directly related to the implementation of the anti-money laundering policy.

