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Trg hrvatskih velikana 3, HR-10000 Zagreb · T. +385 1 4564 555 · F. +385 1 4610 551
www.hnb.hr

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Announcement of the continued application of the countercyclical capital buffer rate of 0.5% for the Republic of Croatia

Regular assessment of the development of cyclical systemic risks in the first seven months of 2022 points to their further increase and continued upturn of the financial cycle. Risk growth is largely associated with the acceleration in the prices of residential real estate and faster bank lending, particularly in the financing of non-financial corporations seen in recent months. Still, the uncertainty related to geopolitical developments and their consequences invites caution and has prompted the CNB to decide to maintain the currently announced countercyclical buffer rate of 0.5% to be applied from 30 September 2023. However, further accumulation of cyclical vulnerabilities amid relatively favourable expectations of economic growth would prompt an announcement of a higher countercyclical buffer rate to further uphold banking system resilience. The information pursuant to Articles 119 and 123 of the Credit Institutions Act is given below.

Table 1 Indicators of cyclical systemic risk and benchmark CCyB rates

Indicator	Ratio/indicator value	Credit gap (deviation from the long-term trend)	Benchmark CCyB rate
Standardised (Basel) credit-to-GDP ratio	70.8%	-15.1 p.p.	0%
Specific credit-to-GDP ratio (absolute gap)	52.9% (narrow) and 70.8% (broad)	-9.2 p.p. to 0.7 p.p.	0% to 0.53%
Specific credit-to-GDP ratio (relative gap)		-11.5% to 1.3%	0% to 0.43%
Composite indicator	0.15 (65th percentile of distribution)	/	0.85% to 1.16%

Notes: Specific ratio values differ depending on the definition of credit (52.9% for a narrow definition of credit, which includes only domestic bank credit, and 70.8% for a broad definition). Differences in gap values arise from different definitions of gap (absolute gap is calculated as the difference while the relative gap is calculated as the ratio of the following variables: the credit-to-GDP ratio and its trend) and estimated statistical trends.

Source: CNB.

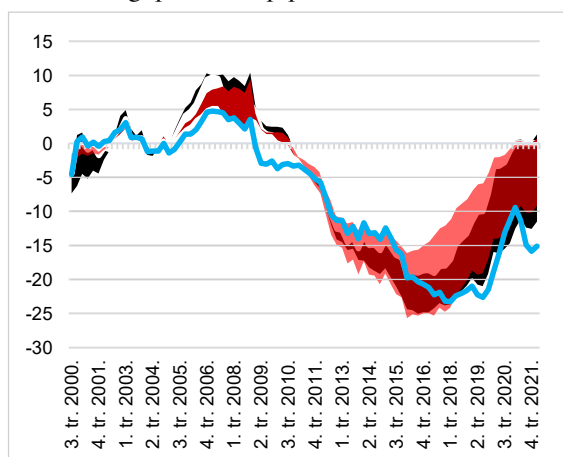
The growth rate of total loans to the private non-financial sector accelerated steadily in the first seven months of 2022, mostly fuelled by a rapid acceleration in corporate lending driven by rising operating expenses caused by higher prices of energy products and raw materials and an anticipation of increased borrowing costs. Household lending also accelerated, particularly lending for housing loans, which rose by 9.3% on an annual level at the end of July 2022. More ample housing lending went in parallel with a steady acceleration in the prices of residential real estate. Thus the prices rose 13.5% on an annual level in the first quarter of 2022, their highest growth rate since the global financial crisis, with their level exceeding by one fifth their peak level at that time. Thus, the price to income and rental costs ratio continues to diverge from long-term averages. Coupled with the increased risks associated with credit growth, this influences a further

gradual closing of the credit gap (Figure 1) and the increase in the composite indicator of cyclical risks (Figure 2), which continues to diverge from its median value. The reduction in the negative credit gap is associated with a gradual reduction in the long-term trend of the credit-to-GDP ratio, while the rise in private sector debt burden maintained a stable credit-to-GDP ratio. Still, current estimates of credit gap should be observed with caution as their developments are also affected by inflation, which raised the nominal GDP level in the observed period, and at the same time reduced the stock of real loans.

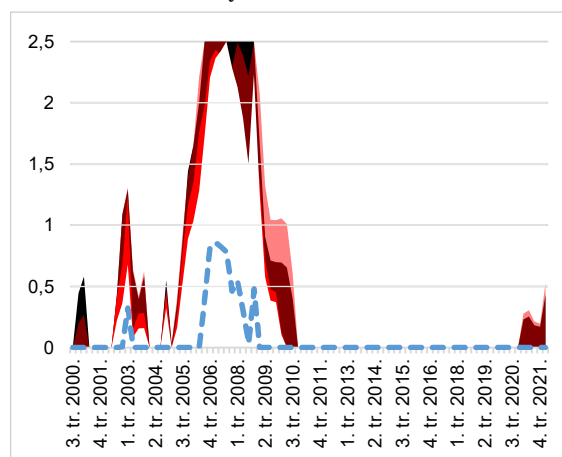
The described developments have brought the indicators of the cyclical systemic risk closer to the levels that would be consistent with higher benchmark countercyclical capital buffer rates than those currently announced. Considering the high level of uncertainty associated with the development in macroeconomic and geopolitical situation in Croatia and the rest of Europe, the currently announced countercyclical buffer rate of 0.5% will continue to apply after 30 September 2023. However, should the cyclical systemic risks continue to rise and should economic and financial conditions and economic growth outlook not deteriorate much in the coming months, an announcement of a higher countercyclical buffer rate, above the current level of 0.5%, would be befitting.

Figure 1 Range of credit gap indicators and affiliated benchmark CCyB rates

1.a Credit gap (% and p.p.)



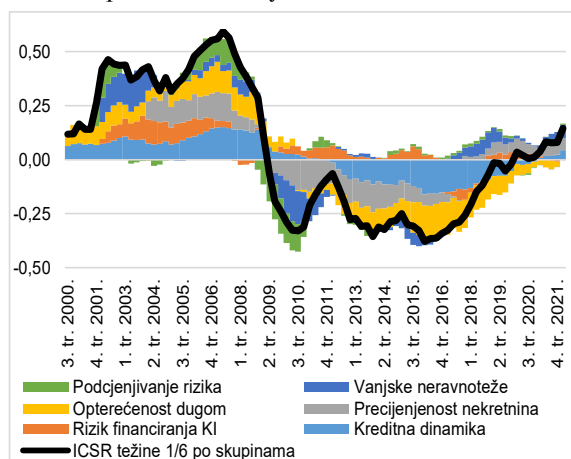
1.b Benchmark CCyB rates



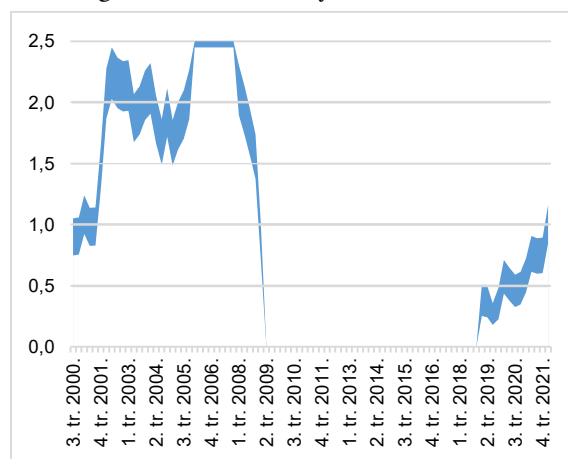
Notes: The left panel shows the Basel gap (blue curve) and the range of 12 credit gap indicators which have better signalling properties for the Republic of Croatia than the Basel gap. The red shaded areas indicate the range of absolute gaps, while the black shaded areas indicate relative gaps. The right panel shows the range of CCyB rates calibrated on the basis of the gaps in the left panel. The blue dashed curve indicates the calibration based on the Basel gap given in the left panel. For details on the methodology used to estimate credit gaps, see [Box 2](#) Improvements in the methodology of countercyclical buffer identification and calibration in Croatia, Macroprudential Diagnostics No. 16.

Figure 2 Composite indicator of the cyclical systemic risk (ICSR) and the affiliated range of benchmark CCyB rates

2.a Composition and dynamics of ICSR



2.b Range of calibrated CCyB rates



Notes: CI indicates credit institutions. The lower threshold for the calibration of the CCyB rate has been chosen to enable the rate to become positive before indicators included in ICSR calculation (Figure 2.a) reach median level, while the upper threshold is determined by the highest percentiles of ICSR distribution.

Source: CNB.