REPUBLIC OF CROATIA

U.S.$1,250,000,000 6.625 PER CENT. NOTES DUE 2020

Issue price: 99.102 per cent.

The U.S.$1,250,000,000 6.625 per cent. Notes due 2020 (the "**Notes**") are issued by the Republic of Croatia (the "**Republic**" or "**Croatia**").

The Notes mature on 14 July 2020.

Application has been made to the *Commission de Surveillance du Secteur Financier* (the "**CSSF**") in its capacity as competent authority under the Luxembourg Act dated 10 July 2005 (the "**Luxembourg Act**") on prospectuses for securities to approve this document as a prospectus and to the Luxembourg Stock Exchange for the listing of the Notes on the Official List of the Luxembourg Stock Exchange and admission to trading on the Luxembourg Stock Exchange's regulated market.

The Notes will be rated Baa3 (stable outlook) by Moody's Investors Service, Inc., BBB (negative outlook) by Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies Inc. and BBB- (negative outlook) by Fitch Ratings Ltd. A rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation.

The Notes have not been and will not be registered under the United States Securities Act of 1933, as amended (the "Securities Act") or with any securities regulatory authority of any state or other jurisdiction of the United States and may not be offered, sold or delivered within the United States or to, or for the account or benefit of, U.S. persons except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act and applicable state securities laws. Accordingly, the Notes are being offered, sold or delivered: (a) in the United States only to qualified institutional buyers ("QIBs") (as defined in Rule 144A ("Rule 144A") under the Securities Act) in reliance on, and in compliance with, Rule 144A; and (b) to Persons (other than U.S. Persons) (each as defined in Regulation S) outside the United States in reliance on Regulation S ("Regulation S") under the Securities Act. Each purchaser of the Notes will be deemed to have made the representations described in "Subscription and Sale" and is hereby notified that the offer and sale of Notes to it is being made in reliance on the exemption from the registration requirements of the Securities Act provided by Rule 144A. In addition, until 40 days after the commencement of the offering, an offer or sale of any of the Notes within the United States by any dealer (whether or not participating in the offering) may violate the registration requirements of the Securities Act if the offer or sale is made otherwise than in accordance with Rule 144A.

The Notes will initially be represented by two global certificates in registered form (the "**Global Certificates**"), one of which will be issued in respect of the Notes offered and sold in reliance on Rule 144A (the "**Restricted Global Certificate**") and will be registered in the name of Cede & Co., as nominee for The Depository Trust Company ("**DTC**") and the other of which will be issued in respect of the Notes offered and sold in reliance on Regulation S (the "**Unrestricted Global Certificate**") and will be registered in the name of a nominee of a common depositary for Euroclear Bank S.A./N.V. ("**Euroclear**") and Clearstream Banking, société anonyme ("**Clearstream, Luxembourg**"). It is expected that delivery of the Global Certificates will be made on 14 July 2010 or such later date as may be agreed (the "**Closing Date**") by the Republic and the Joint Lead Managers (as defined under "*Subscription and Sale*").

Prospective investors should be aware that none of the statistical information in this Prospectus has been independently verified.

An investment in the Notes involves certain risks. Prospective investors should have regard to the factors described under the heading *"Risk Factors"* on page 6.

Joint Lead Managers

BARCLAYS CAPITAL CITI J.P. MORGAN

The date of this Prospectus is 13 July 2010.

THE REPUBLIC OF CROATIA

This Prospectus comprises a prospectus for the purposes of Article 5.4 of Directive 2003/71/EC (the "**Prospectus Directive**") and for the purposes of the Luxembourg Act.

The Republic accepts responsibility for the information contained in this Prospectus. To the best of the knowledge of the Republic (having taken all reasonable care to ensure that such is the case) the information contained in this Prospectus is in accordance with the facts and does not omit anything likely to affect the import of such information.

The Republic, having made all reasonable enquiries, confirms that this Prospectus contains all material information with respect to the Republic and the Notes which is material in the context of the issue and offering of the Notes, that the information contained in this Prospectus is true and accurate in every material respect and is not misleading, that the opinions and intentions expressed in this Prospectus are honestly held and that there are no other facts the omission of which makes misleading any statement herein, whether of fact or opinion.

The Joint Lead Managers (as described under "*Subscription and Sale*", below) have not independently verified the information contained herein. Accordingly, no representation, warranty or undertaking, express or implied, is made and no responsibility or liability is accepted by the Joint Lead Managers as to the accuracy or completeness of the information contained or incorporated in this Prospectus or any other information provided by the Republic in connection with the offering of the Notes. No Joint Lead Manager accepts any liability in relation to the information contained or incorporated by reference in this Prospectus or any other information provided by the Republic in connection with the offering of the Notes or their distribution.

No person is or has been authorised by the Republic to give any information or to make any representation not contained in or not consistent with this Prospectus or any other information supplied in connection with the offering of the Notes and, if given or made, such information or representation must not be relied upon as having been authorised by the Republic or any of the Joint Lead Managers.

Neither this Prospectus nor any other information supplied in connection with the offering of the Notes (a) is intended to provide the basis of any credit or other evaluation or (b) should be considered as a recommendation by the Republic or any of the Joint Lead Managers that any recipient of this Prospectus or any other information supplied in connection with the offering of the Notes should purchase the Notes. Each investor contemplating purchasing any Notes should make its own independent investigation of the financial condition and affairs, and its own appraisal of the creditworthiness, of the Republic. Neither this Prospectus nor any other information supplied in connection with the offering of the Notes constitutes an offer or invitation by or on behalf of the Republic or any of the Joint Lead Managers to any person to subscribe for or to purchase any Notes.

Neither the delivery of this Prospectus nor the offering, sale or delivery of the Notes shall in any circumstances imply that the information contained herein concerning the Republic is correct at any time subsequent to the date hereof or that any other information supplied in connection with the offering of the Notes is correct as of any time subsequent to the date indicated in the document containing the same. The Joint Lead Managers expressly do not undertake to review the financial condition or affairs of the Republic during the life of the Notes or to advise any investor in the Notes of any information coming to their attention.

This Prospectus does not constitute an offer to sell or the solicitation of an offer to buy the Notes in any jurisdiction to any person to whom it is unlawful to make the offer or solicitation in such jurisdiction. The distribution of this Prospectus and the offer or sale of Notes may be restricted by law in certain jurisdictions. The Republic and the Joint Lead Managers do not represent that this Prospectus may be lawfully distributed, or that the Notes may be lawfully offered, in compliance with any applicable registration or other requirements in any such jurisdiction, or pursuant to an exemption available thereunder, or assume any responsibility for facilitating any such distribution or offering. In particular, no action has been taken by the Republic or the Joint Lead Managers which is intended to permit a public offering of the Notes or the distribution of this Prospectus in any jurisdiction where action for that purpose is required. Accordingly, no Notes may be offered or sold, directly or indirectly, and neither this Prospectus nor any advertisement or other offering material may be distributed or published in any jurisdiction, except under circumstances that will result in compliance with any applicable laws and regulations. Persons into whose possession this Prospectus or any Notes may come must inform themselves about, and observe, any such restrictions on the distribution of this Prospectus and the offering and sale of Notes. In particular, there are restrictions on the distribution of this Prospectus and the offer or sale of the Notes in the United States, the European Economic Area (including the United Kingdom) and the Republic of Croatia, see "*Subscription and Sale*".

IN CONNECTION WITH THE ISSUE OF THE NOTES, CITIGROUP GLOBAL MARKETS LIMITED AS STABILISING MANAGER (THE "STABILISING MANAGER") (OR PERSON(S) ACTING ON BEHALF OF THE STABILISING MANAGER) MAY OVER-ALLOT NOTES OR EFFECT TRANSACTIONS WITH A VIEW TO SUPPORTING THE MARKET PRICE OF THE NOTES AT A LEVEL HIGHER THAN THAT WHICH MIGHT OTHERWISE PREVAIL. HOWEVER, THERE IS NO

ASSURANCE THAT THE STABILISING MANAGER (OR PERSONS ACTING ON BEHALF OF THE STABILISING MANAGER) WILL UNDERTAKE STABILISATION ACTION. ANY STABILISATION ACTION MAY BEGIN ON OR AFTER THE DATE ON WHICH ADEQUATE PUBLIC DISCLOSURE OF THE TERMS OF THE OFFER OF THE NOTES IS MADE AND, IF BEGUN, MAY BE ENDED AT ANY TIME, BUT IT MUST END NO LATER THAN THE EARLIER OF 30 DAYS AFTER THE CLOSING DATE OF THE NOTES AND 60 DAYS AFTER THE DATE OF THE ALLOTMENT OF THE NOTES. ANY STABILISATION ACTION OR OVER-ALLOTMENT MUST BE CONDUCTED BY THE RELEVANT STABILISING MANAGER(S) (OR PERSONS ACTING ON BEHALF OF ANY STABILISING MANAGER(S)) IN ACCORDANCE WITH ALL APPLICABLE LAWS AND RULES.

The Notes have not been approved or disapproved by the United States Securities and Exchange Commission or any other securities commission or other regulatory authority in the United States, nor have the foregoing authorities reviewed or passed upon the accuracy or adequacy of this Prospectus. Any representation to the contrary is a criminal offence.

This Prospectus is being submitted on a confidential basis in the United States to a limited number of QIBs for informational use solely in connection with the consideration of the purchase of the Notes. It may not be copied or reproduced in whole or in part nor may it be distributed or any of its contents disclosed to anyone other than the prospective investors to whom it is originally submitted.

Each purchaser or holder of interests in the Notes will be deemed, by its acceptance or purchase of any such Notes, to have made certain representations and agreements as set out in "*Subscription and Sale*".

NOTICE TO NEW HAMPSHIRE RESIDENTS

NEITHER THE FACT THAT A REGISTRATION STATEMENT OR AN APPLICATION FOR A LICENSE HAS BEEN FILED UNDER CHAPTER 421-B OF THE NEW HAMPSHIRE REVISED STATUTES WITH THE STATE OF NEW HAMPSHIRE NOR THE FACT THAT A SECURITY IS EFFECTIVELY REGISTERED OR A PERSON IS LICENSED IN THE STATE OF NEW HAMPSHIRE CONSTITUTES A FINDING BY THE SECRETARY OF STATE OF NEW HAMPSHIRE THAT ANY DOCUMENT FILED UNDER CHAPTER 421-B IS TRUE, COMPLETE AND NOT MISLEADING. NEITHER ANY SUCH FACT NOR THE FACT THAT AN EXEMPTION OR EXCEPTION IS AVAILABLE FOR A SECURITY OR A TRANSACTION MEANS THAT THE SECRETARY OF STATE HAS PASSED IN ANY WAY UPON THE MERITS OR QUALIFICATIONS OF, OR RECOMMENDED OR GIVEN APPROVAL TO, ANY PERSON, SECURITY OR TRANSACTION. IT IS UNLAWFUL TO MAKE, OR CAUSE TO BE MADE, TO ANY PROSPECTIVE PURCHASER, CUSTOMER OR CLIENT ANY REPRESENTATION INCONSISTENT WITH THE PROVISIONS OF THIS PARAGRAPH.

SERVICE OF PROCESS AND ENFORCEMENT OF CIVIL LIABILITIES

The Republic is a foreign sovereign nation, and a substantial portion of the assets of the Republic are located outside the United States and the United Kingdom. As a result, it may not be possible for investors to effect service of process within the United States or the United Kingdom upon the Republic, or to enforce judgements obtained in courts located in the United States or United Kingdom, including judgements predicated upon civil liability provisions of the securities laws of the United States or any state or territory within the United States.

A substantial part of the Republic's assets are located in the Republic of Croatia and the courts of the Republic of Croatia may refuse to recognise a judgement obtained in a foreign jurisdiction (including, but not limited to England and the United States) in certain cases according to the provisions of the Croatian Law on Resolving Conflicts of Law with Other Countries' Laws and Regulations in Certain Matters (Official Gazette No. 53/1991). Once recognised, a foreign judgement is equal to the judgment of a Croatian court and is fit for enforcement in the Republic of Croatia.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

Some of the statements contained in this Prospectus, as well as written and oral statements that Republic and its representatives make from time to time in reports, filings, news releases, conferences, teleconferences, web postings or otherwise, are or may be deemed to be forward-looking statements. Statements that are not historical facts, including, without limitation, statements about the Republic's beliefs and expectations, are forward-looking statements. These statements are based on current plans, objectives, assumptions, estimates and projections. When used in this Prospectus, the words "anticipates", "estimates", "expects", "believes", "intends", "plans", "aims", "seeks", "may", "will", "should" and any similar expressions generally identify forward-looking statements. Therefore, undue reliance should not be placed on them. The Republic has based these forward-looking statements on its current view with respect to future events and financial results. Forward-looking statements speak only as of the date on which they are made and the Republic undertakes no obligation to update publicly any of them in light of new information or future events. Forward-looking statements involve inherent risks and uncertainties. The Republic cautions that a number of important factors could cause actual results to differ materially from those contained in any forward-looking statement. Forward-looking statements include, but are not limited to: (i) plans with respect to the implementation of economic policy, including privatisations, and the pace of economic and legal reforms; (ii) expectations about the behaviour of the economy if certain economic policies are implemented; (iii) the outlook for gross domestic product, inflation, exchange rates, interest rates, foreign investment, trade and fiscal accounts; and (iv) estimates of external debt repayment and debt service.

In addition to the factors described in this Prospectus, including those discussed under the "*Risk Factors*", the following factors, among others, could cause future results to differ materially from those expressed in any forward-looking statements made herein:

- adverse external factors, such as global or regional economic slowdowns that may affect the Republic, higher international interest rates, reduced demand for the Republic's exports or increases in oil and gas prices, which could each adversely affect the Republic's economy and in particular could negatively affect the current account, balance of payments and international reserves and cause or contribute to recession or low growth in the Republic;
- adverse domestic factors, such as recession, declines in foreign direct investment ("**FDI**") and portfolio investment, high domestic inflation, high domestic interest rates, exchange rate volatility, a reduction in gas supplies, difficulties in borrowing in the domestic and foreign markets, trade and political disputes between the Republic and its trading partners, political uncertainty or lack of political consensus, which could each lead to lower growth in the Republic and lower international currency reserves;
- decisions of the Republic's official creditors regarding the provision of new debt or rescheduling of the existing debt and decisions of international organisations regarding the terms of their financial assistance to the Republic, and accordingly the net cash flow to or from the Republic over the life of the Notes;
- decisions of international financial institutions such as the International Monetary Fund (the "**IMF**"), the World Bank, the European Bank for Reconstruction and Development (the "**EBRD**") and the European Investment Bank (the "**EIB**") regarding the funding of new or existing projects over the life of the Notes; and
- political and economic factors in the Republic and abroad, which affect the timing and structure of economic reforms in the Republic, the success and timing of the Republic's accession to the European Union ("**EU**"), the climate for FDI and the pace, scale and timing of privatisations in the Republic.

DEFINED TERMS AND CONVENTIONS

The following terms are used to refer to economic concepts that are discussed in this Prospectus:

- Gross domestic product ("**GDP**") means the total value of goods and services produced inside a country during the relevant period. Unless otherwise stated references to GDP is to real, rather than nominal, GDP.
- Gross value added ("**GVA**") is the value of output less the value of intermediate consumption; it is a measure of the contribution to GDP made by an individual producer, industry or sector and is used to estimate GDP. GVA (measured by sector) plus taxes minus subsidies equals GDP.
- Imports comprise all goods and services imported from abroad intended either for consumption or for inward processing. Exports comprise all goods and services exported from Croatia, which originate from domestic production or internal trade.
- The registered unemployment rate is calculated as the ratio of the members of the active population who register with local employment agencies as being unemployed to the total active population. "**Active Population**" means people employed and people over the age of 15 registered as seeking employment.
- The inflation rate is measured by the year-on-year percentage change in the consumer price index ("**CPI**"), unless otherwise specified. The CPI index, measures inflation based on the price of a basket of approximately 740 goods and services weighted according to the Household Budget Survey and retail sales data. Croatia also measures inflation in terms of producer price index ("**PPI**"), which is the measure of wholesale prices at the producer level calculated based on a basket of approximately 400 industrial products. Unlike CPI, PPI does not take into account services. Year-on-year rates are calculated by comparing the average of the twelve monthly indices for the later period against the average of the twelve monthly indices for the prior period.
- The budget deficit is consolidated revenues minus consolidated expenditures of the general government. This is the principal measure of fiscal balance for countries participating in the European Economic and Monetary Union.
- The Standard International Trade Classification ("**SITC**") is a statistical classification of the commodities entering external trade. It is designed to provide the commodity aggregates required for the purposes of economic analysis and to facilitate the international comparison of trade-by-commodity data.
- Consolidated public debt ("**Consolidated Public Debt**") means total internal and external general government debt plus direct guarantee obligations (i.e. other than the guarantee obligations of HBOR) of Croatia.
- General government debt ("**general government debt**") consists of the sum of: (i) central government debt; (ii) extra budgetary debt (of government funds and agencies); and (iii) local government debt.

Capitalised terms which are used but not defined in any particular section of this Prospectus will have the meaning attributed thereto in "*Conditions of the Notes*" or any other section of this Prospectus.

Certain figures and percentages included in this Prospectus have been subject to rounding adjustments; accordingly figures shown in the same category presented in different tables may vary slightly and figures shown as totals in certain tables may not be an arithmetic aggregation of the figures which precede them.

References to a "**billion**" are to a thousand million.

All references in this document to "**U.S. dollars**", "**dollars**", "**U.S.$**", "**USD**" and "**$**" refer to United States dollars, and to "**HRK**" and "**Kuna**" refer to the lawful currency for the time being of the Republic. In addition, references to "**euro**", "**EUR**" and "**€**" refer to the currency introduced at the start of the third stage of European economic and monetary union pursuant to the Treaty establishing the European Community, as amended. References to "**Old EU Member States**" refer to Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, The Netherlands, Portugal, Spain, Sweden and United Kingdom whereas references to "**New EU Member States**" are to all other Member States of the European Union.

INFORMATION SOURCES

The statistical information in this Prospectus has been derived from a number of different identified sources. All statistical information provided in this Prospectus may differ from that produced by other sources for a variety of reasons, including the use of different definitions and cut-off times.

The source for most of the financial and demographic statistics for Croatia included in this Prospectus is data prepared by the Republic's Central Bureau of Statistics ("**CBS**"), a Croatian independent entity established to provide comprehensive statistical information, and the Croatian National Bank ("**CNB**"). The CBS harmonises, to the extent possible, its programmes and methodologies with the statistics of the EU. Certain other financial and statistical information contained herein has been derived from official Croatian government sources including the Ministry of Finance.

EXCHANGE RATES

The following table sets forth, for the periods indicated, the period end, average, high and low official mid-point rates published by the Croatian National Bank, expressed in Kuna per U.S. Dollar.

Year Ended 31 December	Period End	Average[(1)]	High	Low
2005	6.233626	5.949959	6.315817	5.556868
2006	5.578401	5.839170	6.233626	5.521655
2007	4.985456	5.365993	5.711720	4.933413
2008	5.155504	4.934417	5.801776	4.522752
2009	5.089300	5.280370	5.941123	4.803825
Month Ended				
31 January 2010	5.236361	5.098490	5.236361	5.009663
28 February 2010	5.342054	5.327413	5.402364	5.222468
31 March 2010	5.392463	5.346701	5.433298	5.259480
30 April 2010	5.473884	5.405008	5.502769	5.319151
31 May 2010	5.852635	5.752744	5.951009	5.440539
30 June 2010	5.897241	5.921915	6.088922	5.806633
July 2010 (through 6 July)	5.742232	5.804104	5.865387	5.742232

Source: Croatian National Bank

(1) Average of daily rates.

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OVERVIEW

This Overview does not purport to be complete and must be read as an introduction to this Prospectus and any decision to invest in the Notes should be based on a consideration of this Prospectus as a whole.

Words and expressions defined in "*Conditions of the Notes*" shall have the same meanings in this Overview.

THE REPUBLIC OF CROATIA

Territory and Population

The Republic occupies a total area of 56,538 square kilometres. The capital city, Zagreb, is located in the north of the country. The Dinaric Alps, which rise to 1,831 metres above sea level, run the length of the country. Croatia borders Slovenia to the north and Montenegro to the east and shares a sea border with Italy to the west and south. The Danube forms the eastern border with Serbia while the other two large rivers, the Sava and Drava, form the southern and northern borders with Bosnia Herzegovina and Hungary, respectively. The area of land between the rivers is dissected by many smaller tributaries. The Adriatic coastline is the most prominent feature of Croatia, running the entire length of the western border, from the Istrian peninsula in the north to Dubrovnik in the South with approximately 1,185 islands along the coast.

Constitution and Government Structure

A new constitution was adopted on 22 December 1990 and was substantially amended in December 1997, November 2000, March 2001 and June 2010 (the "**Constitution**"). It established a multi-party democracy, with an economy based on market principles and private ownership. Under the Constitution, the President of Croatia (the "**President**") is elected for five-year terms and may not serve more than two terms. The President appoints, with the consent of the President of the Parliament, a Prime Minister of the Government (the "**Prime Minister**") who, in turn, appoints Government Ministers. Dr. Ivo Sanader was appointed Prime Minister following elections in 2003 and was reappointed following elections in November 2007. In July 2009, Dr. Ivo Sanader voluntarily resigned and Ms. Jadranka Kosor, the Vice Prime Minister at the time, was appointed as the Prime Minister. The Constitution is based on the separation of powers between the legislature, executive and judiciary.

Judicial Reform

In 2008, the Government commenced a reform of the judiciary (the "**Judicial Reform**") in order to combat corruption and restore confidence in the judicial system. The Ministry of Justice is undertaking measures aimed at establishing a more efficient judicial system founded upon principles of independence and professionalism. The objectives of the Judicial Reform include strengthening the rule of law, improving the efficiency and effectiveness of the judicial system, shortening the period of time between the commencement and conclusion of training, and improving professionalism and ongoing training of the staff.

International Relations

After gaining independence, Croatia was admitted to the United Nations (the "**UN**") in May 1992. In the same year, Croatia became a participant country in the Organisation for Security and Co-operation in Europe ("**OSCE**") and became a member of the IMF. In 1996, Croatia became the 40th Member State of the Council of Europe. In October 2000, Croatia became a member of the World Trade Organisation ("**WTO**"), while in 2002 it acceded to the Central European Free Trade Area. Furthermore, Croatia was elected as a non-permanent member of the UN Security Council for the period 2008-2009, holding the Council's Presidency in December 2008. Croatia became a candidate country for EU accession in June 2004 and in 2010 the negotiation process entered the final phase, as discussed below. In April 2009, Croatia acceded to the North Atlantic Treaty Organization ("**NATO**").

European Union Accession

In October 2005, the EU Council of Ministers opened the accession negotiations of Croatia with the EU. In total, 35 chapters of the *acquis communautaire* (as defined below) will be negotiated. The screening exercise for Croatia was successfully completed in October 2006. It is currently expected that Croatia will conclude the accession negotiations by the end of 2010. In accordance with Article 141 of the Constitution, a national referendum on the EU accession must be held in Croatia. The Constitution has been substantially amended in June 2010, *inter alia,* in connection with the EU accession. The bill relating to the amendment to the Constitution has been promulgated by the Parliament on 16 June 2010. The key amendments include, *inter alia,* (1) the elimination of the quorum requirement in Article 86 and 141 of the Constitution, which currently provide that at a referendum the decision is made by the majority of the voters who have participated in the referendum, and (2) the addition of provisions relating to the European Union (membership and transfer of certain constitutional authorisations, participation in the EU institutions, EU law, etc.), the majority of which will come into force on the day of accession of Croatia to the European Union.

Economy

The framework and goals of the economic policy of Croatia are defined in a series of strategic documents of the Government, namely: the Strategic Development Framework for 2006-2013, the Government Programmes Strategy 2010-2012, the Economic and Fiscal Policy Guidelines and the Pre-accession Economic Programme (the "**PEP**"). Those documents provide the basis for the implementation of the economic policy in the medium term period, and they are prepared through consultations between the Government administration bodies and employers' and unions' representatives.

The main objective of the economic policy in the current macroeconomic environment is to preserve macroeconomic stability and create conditions for recovery and stable economic growth.

GDP

The effects of the global financial and economic crisis were first felt in Croatia in the second half of 2008 and intensified towards the end of the year. The negative impact of the crisis intensified further in 2009 with the largest GDP decline in the first quarter of 2009. In particular, real GDP growth slowed down from 5.5 per cent. in 2007 to 2.4 per cent. in 2008, while GDP contracted by 5.8 per cent. in 2009. The negative trends continued in the first quarter of 2010, during which GDP recorded an annual decrease of 2.5 per cent. in real terms, according to the CBS estimates.

Gross Value Added

GVA in real terms declined by 4.0 per cent. in 2009, decelerating by 6.8 per cent. as compared to 2008 when it grew by 2.8 per cent. This decline was largely attributable to the real GVAdecrease in the wholesale and retail trade sector and the mining, quarrying, manufacturing, electricity, gas and water supply sectors. The GVA dynamics and trends in 2009 are primarily due to the negative effects of the global financial and economic crisis. Negative GVA trends continued in the first quarter of 2010, during which period real GVA declined by 2.4 per cent. compared to the first quarter of 2009 (from HRK 68,902 as at 31 March 2009, as compared to HRK 67,272 as at 31 March 2010). This decrease was mainly due to real GVA decreases in the construction (18.7 per cent.), hotels and restaurants (5.5 per cent.) and transport, storage and communication (5.4 per cent.) sectors.

Inflation

Price stability has consistently been the primary goal of the Croatian National Bank's (the "**CNB**") monetary policy, which the CNB pursues primarily through the maintenance of the relatively stable HRK/EUR exchange rate. The average annual rate of inflation as measured by the consumer price index ("**CPI**") increased from 2.9 per cent. in 2007 to 6.1 per cent. in 2008. This was principally due to a relatively high carry-over effect from 2007, and to a sharp increase in prices of food and refined petroleum products in the first half of 2008. The surge in CPI peaked in July 2008 when their annual rate of change reached 8.4 per cent. The annual rate of change of CPI subsequently decreased to 2.9 per cent. in December 2008. Declines in inflation, which commenced in the second half of 2008, continued throughout 2009. The average annual inflation rate decreased from 6.1 per cent. in 2008 to 2.4 per cent. in 2009. Several factors contributed to downward pressures on prices, including weakened domestic demand for goods and services, reduced inflation pressures stemming from prices of imports and slower growth of unit labour costs. These downward pressures were to some extent offset by the growth in prices of subsidised products, such as gas, tobacco products, and medical and hospital services. Similar CPI trends continued at the beginning of 2010, bringing the average annual inflation rate further down to 0.8 per cent. in the first four months of 2010. This was mostly due to a decrease in meat and processed food prices during that period and the base comparison effect associated with the already relatively strong increase in food and regulated prices at the beginning of 2009. An opposite effect resulting in upward pressures on inflation stemmed from an increase in energy prices (gas and refined petroleum product prices). PPI, trending upwards since October 2009, continued to grow through April 2010.

Overview of the Risk Factors Relating to the Republic and the Notes

- An investment in a developing country such as Croatia is subject to substantially greater risks than an investment in a more developed country.
- Croatia may not succeed in implementing its proposed economic, financial and other reforms and policies which may adversely affect the Croatian economy and the Republic's ability to repay principal and make payments of interest on the Notes.
- The Republic's economy remains vulnerable to external shocks, including the ongoing global financial and economic crisis, which could have an adverse effect on the Republic's economic growth and its ability to service its public debt.
- Croatia may not join the European Union by the target date or at all.
- Depreciation in the Kuna may adversely affect the Croatian economic and financial condition.
- Proliferation of the Euro in the Croatian economy may adversely affect the CNB's ability to implement its monetary policies.
- Current account deficit may continue to rise.
- Private Croatian borrowers may not be able to repay or reschedule their debt which may have a material adverse effect on the Croatian economy.
- Foreign banks may diminish or discontinue their support of their subsidiaries operating in Croatia.
- If Government's revenue decreases, some or all of the Government's expenses continue to rise, and state-owned enterprises' dependence on public finances is not reduced, Croatia may not be able to service its public debt and, as a result, to repay principal and make payments of interest on the Notes.
- Corruption and money laundering issues may hinder the growth of the Croatian economy, delay or foreclose EU accession and otherwise have a material adverse effect on Croatia.
- Croatia's legal system is not fully developed and presents greater risks and uncertainties than a more developed legal system.
- The uncertainties relating to the Croatian judicial system could have a negative effect on the economy and thus on the ability of Croatia to repay principal and make payments of interest on the Notes.
- Croatia may not be able to refinance its debt on favourable terms or at all.
- Croatia depends on the tourism industry as a significant source of revenue and any deterioration in the tourism industry may adversely affect the Republic's economy and its ability to service its debt.
- Deterioration in Croatia's relations with its major energy suppliers may adversely affect the supply of energy resources and therefore have a negative effect on the Croatian economy.
- Official economic data may not be accurate.
- There can be no assurance that Croatia's credit rating will not change.
- The Notes may not be a suitable investment for all investors.
- The terms of the Notes may be modified, waived or substituted without the consent of all the Holders of the Notes.
- Event of default.
- EU Savings Directive.
- Law governing the terms of the Notes may change.
- Definitive Notes not denominated in an integral multiple of U.S.$100,000 or its equivalent may be illiquid and difficult to trade.
- Croatian court may not recognise the choice of English law as the law governing the Notes.
- There may be no active trading market for the Notes.
- A claimant may not be able to enforce a court judgment against certain assets of Croatia in certain jurisdictions.
- Fluctuations in exchange rates and interest rates may adversely affect the value of the Notes.
- Legal investment considerations may restrict certain investments.
- Credit ratings may not reflect all risks.

THE OFFERING

Issuer:	The Republic of Croatia
Description of Notes:	U.S.$1,250,000,000 6.625 per cent. Notes due 2020 (the "**Notes**"), to be issued by the Republic on 14 July 2010 (the "**Closing Date**").
Joint Lead Managers:	Barclays Bank PLC, Citigroup Global Markets Limited, J.P. Morgan Securities Ltd.
Interest:	6.625 per cent. per annum payable semi-annually in arrear on 14 January and 14 July in each year.
Events of Default:	Events of Default under the Notes include the non-payment of any interest due in respect of the Notes or any of them for a period of 15 days from the due date for payment thereof, breach of other obligations under the Notes (which breach is not remedied within 45 days) and certain events related to the Republic. Notes may only be declared due and payable, upon an Event of Default, if the holders of at least 25 per cent. in aggregate principal amount of the outstanding Notes give notice in writing to the Republic. Furthermore if the Republic receives notice in writing from holders of at least 50 per cent. in aggregate principal amount of the outstanding Notes to the effect that the Event of Default giving rise to a declaration of acceleration is cured and that such holders wish the relevant declaration to be withdrawn, the relevant declaration shall be withdrawn and shall have no further effect.
Negative Pledge:	The terms of the Notes contain a negative pledge provision given by the Republic in respect of Public External Indebtedness as described in Condition 4.
Cross Default:	The terms of the Notes contain a cross default provision, applying to the Public External Indebtedness of the Republic, as described in Condition 10.
Status of the Notes:	The Notes will constitute direct, unconditional, (subject to the provisions of Condition 4) unsecured and unsubordinated and general obligations of the Republic and will rank *pari passu* among themselves and at least (save for certain obligations required to be preferred by law) equally with all other present and future unsecured obligations of the Republic.
Meetings of Noteholders:	The Conditions of the Notes contain provisions for calling meetings of Noteholders to consider matters affecting their interests generally. These provisions permit defined majorities to bind all Noteholders including Noteholders who did not attend and vote at the relevant meeting and Noteholders who voted in a manner contrary to the majority. The Conditions also contain provisions for the appointment of a Noteholders' representative committee.
Modification:	The Conditions of the Notes contain a provision permitting the Notes and the Conditions of the Notes to be amended without the consent of the Noteholders to correct a manifest error.
Taxation:	All payments in respect of the Notes by or on behalf of the Republic shall be made without withholding or deduction for, or on account of any Taxes as provided in Condition 8.
Listing and admission to trading:	Application has been made to the CSSF to approve this document as a prospectus and to the Luxembourg Stock Exchange for the listing of the Notes on the Official List of the Luxembourg Stock Exchange and admission to trading on the Luxembourg Stock Exchange's regulated market.

Governing Law:	The Notes and any non-contractual obligations arising out of or in connection with the Notes are governed by and shall be construed in accordance with, English law, provided however, that the due authorisation and execution of the Notes by and on behalf of the Republic shall be governed by the laws of the Republic.
Form:	The Notes will be issued in registered form in denominations of U.S.$100,000 and integral multiples of U.S.$1,000 in excess thereof.
Credit Ratings:	The Notes are expected to be assigned on issue a rating of Baa3 (stable outlook) by Moody's Investors Service, Inc. ("**Moody's**"), BBB (negative outlook) by Standard & Poor's Rating Services, a division of The McGraw-Hill Companies Inc. ("**S&P**") and BBB- (negative outlook) by Fitch Ratings Ltd. ("**Fitch**"). A credit rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation.
Selling Restrictions:	The Notes have not been and will not be registered under the Securities Act and are subject to certain restrictions on transfers. See "*Subscription and Sale*" below.
Use of Proceeds:	The net proceeds of the issue of the Notes will be applied by the Republic for general budgetary governmental purposes.

RISK FACTORS

Investment in the Notes involves a high degree of risk. Prospective investors should carefully consider the following risk factors, together with the other information set out in this Prospectus, before making a decision to invest in the Notes and should understand that the risks set forth below could, individually or in the aggregate, have a material adverse effect on Croatia's capacity to repay principal and make payments of interest on the Notes or otherwise fulfil its obligations under the Notes. Most of these factors are contingencies which may or may not occur and the Issuer is not in a position to express a view on the likelihood of any such contingency occurring. Additional risks and uncertainties not currently known to the Republic or that the Republic currently deems to be immaterial may also materially affect the Republic's economy and its ability to fulfil its obligations under the Notes. In any such case, investors may lose all or part of their investment in the Notes. Words and expressions defined in "*Conditions of the Notes*" or elsewhere in this Prospectus have the same meanings in this section.

Risk Factors Relating to Croatia

An investment in a developing country such as Croatia is subject to substantially greater risks than an investment in a more developed country

An investment in a country such as Croatia, which achieved independence just over 18 years ago and whose economy is in transition, is subject to substantially greater risks than an investment in a country with a more developed economy and more developed political and legal systems. Although progress has been made in reforming Croatia's economy and political and judicial systems, the development of Croatia's legal infrastructure and regulatory framework is still ongoing. As a consequence, an investment in Croatia carries risks that are not typically associated with investing in more mature markets. Accordingly, investors should exercise particular care in evaluating the risks involved and must decide for themselves whether, in light of those risks, such investment is appropriate. Generally, investments in developing countries, such as Croatia, are only suitable for sophisticated investors who can fully appreciate the significance of the risks involved.

In addition, international investors' reactions to the events occurring in one country sometimes appear to demonstrate a "contagion" effect, in which an entire region or class of investment is disfavoured by international investors. The Republic could be adversely affected by negative economic or financial developments in other countries. There can be no assurance that any crises similar to the ongoing global financial and economic crisis will not negatively affect investor confidence in developing markets, including the Republic.

Croatia may not succeed in implementing its proposed economic, financial and other reforms and policies which may adversely affect the Croatian economy and the Republic's ability to repay principal and make payments of interest on the Notes

Since 1993, Croatia has undergone substantial political transformation from a constituent republic in a federal socialist state to an independent sovereign democracy. In parallel with this transformation, Croatia has been pursuing a programme of economic structural reform with the objective of establishing a market-based economy through privatisation of state enterprises and deregulation of the economy. However, this process is not complete. Croatia has made progress in the transition to a functioning market-based economy, but the rebuilding of Croatia's economic and institutional infrastructure to a Western European standard requires further investment and may take years to complete.

There can be no assurance that the economic and financial initiatives and the reforms described in this Prospectus will continue, will not be reversed or will achieve their intended aims. Failure of the Government of Croatia (the "**Government**") to implement its proposed economic, financial and other reforms and policies may negatively affect the Croatian economy and, as a result, have a material adverse effect on Croatia's capacity to repay principal and make payments of interest on the Notes.

The Republic's economy remains vulnerable to external shocks, including the current global financial and economic crisis, which could have an adverse effect on the Republic's economic growth and its ability to service its public debt

The Republic's economy remains vulnerable to external shocks such as the current global financial and economic crisis. Although in recent years Croatia has made significant gains in stabilising its currency, increasing its GDP, decreasing inflation and increasing real wages, the current global financial and economic crisis negatively affected the Croatian economy. During the crisis, Croatia has experienced a decline in GDP and FDI, and an increase in net lending/borrowing of the consolidated general government. According to CBS, Croatia's real GDP contracted by

5.8 per cent. in 2009, as compared to GDP growth of 2.4 per cent. in 2008, 5.5 per cent. in 2007 and 4.7 per cent. in 2006. According to CBS estimates, real GDP recorded a year-on-year decrease of 2.5 per cent. in the first quarter of 2010. Net FDI decreased by 63.3 per cent. in 2009 compared to 2008 and by 6.0 per cent. in 2008 compared to 2007, while in the first quarter of 2010 net FDI increased by 14.4 per cent. compared to the same period in 2009. In the first three months of 2010, net lending/borrowing of the consolidated general government was 1.5 per cent. of GDP.

Despite the fact that Croatia's GDP growth averaged 4.3 per cent. in real terms between 1994 and 2008, this growth pattern has not been sustained in 2009 and may not be sustainable in the future, as indicated by serious external imbalances. One of the main drivers of economic expansion in Croatia between 2001-2008 was domestic demand, which grew at an average rate of 5.9 per cent. per year. Private consumption was boosted by the expansion of credit and investment was heavily concentrated in private construction. Capital inflows dropped in 2009 by 27.1 per cent. as a result of the global financial and economic crisis, and in particular due to increased risk aversion by international investors and declining international liquidity, while external debt continued to rise but at a much slower pace. The gross external debt in Euro terms grew from EUR 13.6 billion (53.3 per cent. of GDP) in 2001 to EUR 43.1 billion (94.9 per cent. of GDP or 267.1 per cent. of exports of goods and services) in 2009. The gross external debt in Euro terms slightly decreased in the first quarter of 2010, and amounted to EUR 43.0 billion (94.6 per cent. of GDP) as of 31 March 2010. There can be no assurance that Croatia will return to the growth pattern experienced during 2001-2008 given that it relied heavily on substantial inflows of foreign capital during this period. As the global economy recovers in the future, the positive economic trends of recent years in Croatia may not continue over the longer term and may reverse.

Croatia may not join the European Union by the target date or at all

Croatia commenced negotiations regarding its accession to the EU in October 2005. The Republic's accession depends on many political and economic factors, including the successful conclusion of ongoing negotiations with the relevant EU bodies relating to the level of Croatia's harmonisation with EU law. In addition, in connection with the trial of the former General of the Armed Forces of Croatia, Mr. Ante Gotovina, the International Criminal Tribunal for the former Yugoslavia (the "**ICTY**") has requested that Croatia produce the so-called "artillery logs" which are the artillery journals relating to the Operation Storm. While the efforts to retrieve the artillery logs are ongoing, the ICTY's request to produce them remains outstanding and until such request is fulfilled or withdrawn, the ICTY may insist that Croatia is not in full compliance with the ICTY which, in turn, may result in delays in closing certain chapters of the EU accession negotiations. For the purposes of negotiating Croatia's accession to the EU the total body of EU law with which Croatia is to be harmonised has been divided into 35 chapters (the "***acquis communautaire***"). Although the shared objective of the negotiations is accession to the EU, these negotiations are an open-ended process, the outcome and timing of which cannot be guaranteed.

Currently, out of 35 chapters in total, 33 chapters have been formally opened (of which, 20 chapters have been provisionally closed and 13 remain open) and 2 chapters are yet to be opened. See "*Overview of the Republic of Croatia — International Relations — European Union Accession*". Croatia hopes to join the EU by 2012. However, there may not be a uniform desire among the Croatian population to join the EU and there can be no assurance that a national referendum in Croatia would vote to join the EU. There can be no assurance that Croatia will succeed in joining the EU by the target date or at all. In addition, delays or other adverse developments in Croatia's accession to the EU may have a negative effect on the Republic's economic performance and credit ratings.

Depreciation in the Kuna may adversely affect the Croatian economic and financial condition

Croatia's public external debt is denominated in foreign currencies, with Euro-denominated debt accounting for 71.3 per cent. of total public external debt as at 31 March 2010. Therefore Croatia remains vulnerable to currency risk. In the event of a significant devaluation of the Kuna, the negative impact on the service obligations in respect of the debt denominated in foreign currencies will not be completely offset by the positive impact on the service obligations in respect of debt denominated in Kuna. Any significant devaluation of the Kuna may have an adverse effect on the Republic's ability to repay its debt denominated in foreign currencies, including the amounts due under the Notes.

In addition, as at 31 April 2010, over 85 per cent. of corporate debt and almost 75 per cent. of household debt were denominated in, or linked to, foreign currency. Only a small fraction of this debt is hedged. In 2009, almost all new lending was linked to foreign currencies. Despite the fact that foreign currency deposits now account for over 80 per cent. of all deposits and that large foreign currency deposits by households reduce currency mismatches at the aggregate level, this does not eliminate macro-level mismatches and there are likely to be mismatches at the individual level between borrowers and depositors as well. The devaluation of the Kuna against foreign currencies may negatively affect the capacity of corporate and household borrowers to repay their debt and as a result adversely affect the financial and economic condition of Croatia.

Proliferation of the Euro in the Croatian economy may adversely affect the CNB's ability to implement its monetary policies

In recent years, the role of the Euro in the Croatian economy and circulation of the Euro in Croatia substantially increased as a result of sizeable Euro capital inflows from abroad, including from persons working abroad who send money to their families in Croatia; the tourism industry, in particular the population's willingness to accept Euro from tourists; and the fact that a majority of corporate and household loans are Euro-denominated or Euro-indexed. As the Government's domestic monetary policy mostly impacts Kuna and has limited impact on other currencies including the Euro, significant proliferation of the Euro in the Croatian economy and widespread use of Euro by the Croatian population may undermine the ability of the CNB to implement its monetary policies. Similarly, the policies of the European Central Bank affecting the Euro may indirectly impact the Croatian economy. Any limitations on the ability of the CNB to implement its monetary policies may have an adverse effect on the Croatian economy and thus on the ability of Croatia to repay principal and make payments of interest on the Notes.

The current account deficit may continue to rise

Croatia's current account deficit tripled between 2004 and 2008, mainly due to the widening trade deficit. The current account deficit increased by 202.6 per cent. in Euro terms from EUR 1.4 billion (4.4 per cent. of GDP) in 2004 to EUR 4.3 billion (9.2 per cent. of GDP) in 2008. The current account deficit decreased by 43.6 per cent. in Euro terms in 2009 and amounted to EUR 2.4 billion (5.4 per cent. of GDP). The decrease was mainly attributable to a narrowing of the deficit in trade in goods. The decreased deficit resulted from the fact that the decline in imports was greater than the decline in exports which was, in turn, due to a decline in the negative trade balance in road vehicles and petroleum and petroleum products as well as a surplus in trade in other transport equipment. In the first quarter of 2010, the current account produced a deficit of EUR 1.4 billion, a 23.9 per cent. decrease compared to the same period in 2009. Unlike in neighbouring countries, Croatia's exports as percentage of GDP remained flat over the past decade while imports have grown steadily as a result of rising consumption. As a result, the trade deficit increased by 62.8 per cent. from EUR 6.9 billion in 2004 to EUR 11.2 billion in 2008. However, due to the effects of the global financial and economic crisis on both domestic and foreign demand, the trade deficit decreased by 31.4 per cent. in 2009 compared to 2008 and amounted to EUR 7.7 billion. This trend continued in the first four months of 2010, with the trade deficit decreasing further by 23.0 per cent. to EUR 1.9 billion from EUR 2.5 billion in the same period in 2009. The decreases in the trade deficit and corresponding decreases in the current account deficit in 2009 and the first quarter of 2010 are largely attributable to imports falling at a more rapid pace than exports as a result of decreased private consumption due to slowing economic activity. Since the economic activity is expected to pick-up in the near future, the decreases in the current account and trade deficits may not be sustainable and may reverse. In addition, the export sector has benefited little from the strong capital inflows (including foreign direct investment) experienced in recent years as most capital inflows were used in consumption and non-tradable sectors such as construction, real estate and wholesale and retail trade, resulting in increased imports and a widening current account deficit. The existing current account deficit and any future increases therein may have an adverse effect on the Croatian economy and thus on the ability of Croatia to repay principal and make payments of interest on the Notes.

Private Croatian borrowers may not be able to repay or reschedule their debt which may have a material adverse effect on the Croatian economy

Private debt in Croatia grew rapidly in recent years as corporate and household sectors accumulated a heavy debt burden. Household debt in Croatia as a share of GDP is one of the highest among Central and Eastern European countries. Non-publicly guaranteed private sector external debt relates almost entirely to foreign borrowing by the corporate sector and banks. Non-publicly guaranteed private sector external debt grew strongly in recent years and amounted to EUR 30.9 billion (68.1 per cent. of 2009 GDP) in March 2010, as compared to EUR 30.9 billion (68.1 per cent. of 2009 GDP), EUR 28.8 billion (60.8 per cent. of 2008 GDP), EUR 23.5 billion (54.9 per cent. of 2007 GDP), EUR 20.8 billion (53.2 per cent. of 2006 GDP) and EUR 17.0 billion (47.5 per cent. of 2005 GDP) at 31 December 2009, 2008, 2007, 2006 and 2005, respectively. However, the growth of non-publicly guaranteed private sector external debt experienced a slowdown in the last quarter of 2008 as a result of the global financial and economic crisis. As at 31 March 2010, principal repayments on non-publicly guaranteed private sector external debt due in the remaining part of 2010 and 2011 amounted to EUR 9.5 billion and EUR 6.6 billion, respectively. These figures do not include the effects of round-tripping transactions, i.e., transactions which involve Croatian equity investment abroad to companies which then lend back to the investing company in Croatia. See "*Foreign Trade and International Balance of Payments — Capital and Financial Account*". Failure of private borrowers to repay or reschedule their debt may have a material adverse effect on the Croatian economy. In turn, this may affect Croatia's ability to repay principal and make payments of interest on the Notes.

Foreign banks may diminish or discontinue their support of their subsidiaries operating in Croatia

As of March 2010, foreign banks owned approximately 91 per cent of banks' assets in Croatia. Foreign banks may rebalance their global loan portfolio in a manner adversely affecting Croatia as a result of events related or unrelated to Croatia. In addition, foreign banks may decrease funding to their subsidiaries operating in Croatia due to actual or perceived deterioration in asset quality, particularly in the event of a weaker than expected economic performance. As a result of these or other factors, or other potential shocks, foreign banks may revise their business strategies in, or relating to, Croatia and in particular their decision to fund their subsidiaries in Croatia. This may lead to, among other things, a loss of confidence in the Kuna which, in turn, may result in significant devaluation of Kuna. Resulting balance sheet mismatches may negatively affect the Croatian economy and, as a result, have an adverse effect on Croatia's capacity to repay principal and make payments of interest on the Notes.

If Government revenue decreases, some or all of the Government's expenses continue to rise, and state-owned enterprises' dependence on public finances is not reduced, Croatia may not be able to service its public debt and, as a result, to repay principal and make payments of interest on the Notes

According to the plan for 2010, General Government revenue is expected to increase from HRK 128.1 billion in 2009 to a projected HRK 130 billion in 2010. Expenses relating to public wages, social benefits and interest payments in the aggregate represented on average 26 per cent. of Croatia's GDP between 2005 and 2009. In the same period, costs relating to the healthcare system increased by 51.7 per cent. from HRK 13.7 billion in 2005 to HRK 20.8 billion in 2009, while expenses relating to pensions increased by 28.9 per cent. from HRK 26.7 billion in 2005 to HRK 34.4 billion in 2009. In the absence of adequate reform, the risk of increases in expenses relating to pensions and healthcare over the long-term is compounded by the fact that the old-age dependency ratio (the proportion of people aged 65 or older compared to the working population (people aged 15 to 64)), which increased from 1:0.252 in 2005 to 1:0.257 in 2009, may continue to rise. Expenses related to General Government subsidies increased from HRK 6 billion to HRK 8.1 billion in the same period. Without sufficient structural reforms aimed at reducing the dependence of state-owned enterprises on public finances and at fostering greater economic efficiency through broader private sector participation, recent revenue raising measures could prove inadequate to cover the continued increases in public debt and interest payments. As a result, the primary deficit could become greater and debt servicing in turn more demanding. Government payment capacity may become further affected by economic cyclical trends and the risk of a delayed recovery of key economic sectors. Reduced revenues, coupled with increasing expenses related to public wages, social benefits, interest payments, healthcare system, pensions and subsidies, may adversely affect Croatia's ability to repay principal and make payments of interest on the Notes.

Corruption and money laundering issues may hinder the growth of the Croatian economy, delay or foreclose EU accession and otherwise have a material adverse effect on Croatia

Independent analysts have identified corruption and money laundering as problems in Croatia. In the 2009 Transparency International Corruption Perceptions Index, Croatia was ranked 66 out of 180 countries under review. In 2008, the Republic commenced a reform of the judicial system in order to combat corruption and restore confidence in the judicial system. See "*Overview of the Republic of Croatia — Constitution and Government Structure — The Judicial System*". The Act on Prevention of Money Laundering and Financing of Terrorism (Official Gazette of Republic of Croatia No. 87/08 — "Act") came into force on 1 January 2009 and is aimed at harmonising Croatian law on prevention of money laundering and financing of terrorism with the provisions of the Third EU Money Laundering Directive (Directive 2005/60/EC). However, there is no certainty as to the success of these measures. Any future allegations or evidence of corruption or money laundering in Croatia may have an adverse effect on the Croatian economy, in particular on Croatia's ability to attract foreign investment, and thus could negatively affect Croatia's ability to repay principal and make payments of interest on the Notes.

Croatia's legal system is not fully developed and presents greater risks and uncertainties than a more developed legal system

Since gaining independence in 1992, the Croatian legal system has been developing to support the transition to a market-based economy. New laws have been introduced and revisions have been made with respect to, amongst others, company, property, competition, securities, labour and taxation laws in order to harmonise them with EU laws. However, the Republic's legal system remains in transition and is therefore subject to greater risks and uncertainties than a more mature legal system. In particular, risks associated with the Croatian legal system include: (i) potential inconsistencies between and among the Constitution and various laws, presidential decrees, governmental, ministerial and local orders, decisions, resolutions and other acts; (ii) provisions in the laws and regulations that are ambiguously worded or lack specificity and thereby raise difficulties when implemented or interpreted; (iii) difficulty in predicting the outcome of judicial application of Croatian legislation; and (iv) the fact that not all Croatian resolutions, orders and decrees and other similar acts are readily available to the public or available in an understandable, organised form.

These and other factors that have an impact on Croatia's legal system make an investment in the Notes subject to greater risks and uncertainties than an investment in a country with a more mature legal system.

The uncertainties relating to the Croatian judicial system could have a negative effect on the economy and thus on the ability of Croatia to repay principal and make payments of interest on the Notes

The independence of the judicial system and its immunity from economic and political influences in Croatia remain questionable. The application and interpretation of the Constitution remain complicated and, accordingly, it is difficult to ensure smooth and effective resolution of discrepancies between the Constitution and applicable Croatian legislation on the one hand and among various laws of Croatia on the other hand.

The court system is underfunded compared to more mature jurisdictions. As Croatia is a civil law jurisdiction, judicial decisions under Croatian law generally have no precedential effect. For the same reason, courts are generally not bound by earlier court decisions taken under the same or similar circumstances, which can result in the inconsistent application of Croatian legislation to resolve the same or similar disputes. Furthermore, to date only a small number of judicial decisions have been publicly available and, therefore, the role of judicial decisions as guidelines in interpreting applicable Croatian legislation to the public at large is generally limited.

In 2008, the Republic commenced a reform of the judicial system. See "*Overview of the Republic of Croatia — Constitution and Government Structure — The Judicial System*". Despite these efforts, judicial decisions in Croatia remain difficult to predict. In addition, court orders are not always enforced or followed by law enforcement institutions. The uncertainties of the Croatian judicial system could have a negative effect on the economy and thus on the ability of Croatia to repay principal and make payments of interest on the Notes.

Croatia may not be able to refinance its debt on favourable terms or at all

The Republic has substantial amounts of internal and external public debt. As at 31 March 2010, Croatia's general government debt excluding Government guarantees was HRK 120.0 billion (36.0 per cent. of 2009 GDP), of which HRK 84.4 billion (70.3 per cent.) was internal debt and HRK 35.7 billion (29.7 per cent.) was external debt. As of 31 March 2010, the average maturity of the public external outstanding debt was 8 years whereas the average maturity of the public internal outstanding debt was 4.5 years. Any deterioration in financing conditions as a result of market, economic or political factors, which may be outside the Republic's control, may jeopardize the debt repayment ability of the Republic and adversely affect the Republic's ability to implement its economic strategy and reforms.

Croatia depends on the tourism industry as a significant source of revenue and any deterioration in the tourism industry may adversely affect the Republic's economy and its ability to service its debt

It is estimated that approximately 9 million tourists visit Croatia annually. Tourism contributes substantially to Croatia GDP. Revenue generated by the tourism industry depends on various factors including consumer spending power, which may be adversely affected by economic downturns, and public perception of the attractiveness and safety of a potential tourist destination.

Negative developments affecting these and other factors may adversely affect the tourism industry and have negative effects on the Croatian economy and thus on the ability of Croatia to repay principal and make payments of interest on the Notes.

Deterioration in Croatia's relations with its major energy suppliers may adversely affect the supply of energy resources and therefore have a negative effect on the Croatian economy

Croatia's economy depends on its trade flows with certain other countries largely because Croatia imports a large percentage of its energy requirements. If bilateral trade relations with Croatia's major energy suppliers were to deteriorate or if supplies of oil and/or natural gas to Croatia were to be restricted, the Republic's economy could be adversely affected. In addition, an increase in the price for natural gas could adversely affect the pace of economic growth of Croatia. Furthermore, although higher gas prices have increased pressure for reforms in the energy sector, for modernisation of major energy-consuming industries of Croatia through the implementation of energy-efficient technologies and for the modernisation of production facilities, there can be no assurance that these reforms and modernisations will be implemented or will succeed. Any major changes in relations with major energy suppliers to Croatia, in particular any such changes adversely affecting supplies of energy resources to Croatia, may have adverse effects on the Croatian economy.

Official economic data may not be accurate

Although a range of government ministries including the Ministry of Finance, along with the CNB and the CBS, produce statistics on Croatia and its economy, there can be no assurance that these statistics are as accurate or as reliable as those compiled in more developed countries. Prospective investors in the Notes should be aware that figures relating to Croatia's GDP and many other aggregate figures cited in this Prospectus may be subject to some degree of uncertainty and may not be prepared in accordance with international standards. Furthermore, standards of accuracy of statistical data may vary from ministry to ministry or from period to period due to the application of different methodologies. In this Prospectus, data are presented as provided by the relevant ministry to which the data is attributed, and no attempt has been made to reconcile such data to the data compiled by other ministries or by other organisations, such as the IMF or World Bank. Since 2005 Croatia has produced data in accordance with the IMF's Special Data Dissemination Standard. There can be no assurance, however, that this IMF standard has been fully implemented or correctly applied. The existence of a sizeable unofficial or unobserved economy may also affect the accuracy and reliability of statistical information. Prospective investors should be aware that none of the statistical information in this Prospectus has been independently verified.

There can be no assurance that Croatia's credit rating will not change

Long-term debt of the Republic is currently rated BBB (Outlook Negative) by S&P, Baa3 (Outlook Stable) by Moody's and BBB- for foreign currency and BB for domestic currency (Outlook Negative) by Fitch. A security rating is not a recommendation to buy, sell or hold securities and may be subject to suspension, reduction or withdrawal at any time by the assigning rating agency. Any adverse change in an applicable credit rating could adversely affect the trading price for the Notes.

Risk Factors Relating to an Investment in the Notes

The Notes may not be a suitable investment for all investors

Each potential investor in the Notes must determine the suitability of that investment in light of its own circumstances. In particular, each potential investor should:

- have sufficient knowledge and experience to make a meaningful evaluation of the Notes, the merits and risks of investing in the Notes and the information contained in this Prospectus or any applicable supplement;
- have access to, and knowledge of, appropriate analytical tools to evaluate, in the context of its particular financial situation, an investment in the Notes and the impact the Notes will have on its overall investment portfolio;
- have sufficient financial resources and liquidity to bear all of the risks of an investment in the Notes, including where the currency for principal or interest payments is different from the potential investor's currency;
- understand thoroughly the terms of the Notes and be familiar with the behaviour of any relevant financial markets; and
- be able to evaluate (either alone or with the help of a financial adviser) possible scenarios for economic, interest rate and other factors that may affect its investment and its ability to bear the applicable risks.

The terms of the Notes may be modified, waived or substituted without the consent of all the Holders of the Notes

The conditions of the Notes contain provisions for calling meetings of Noteholders to consider matters affecting their interests generally. These provisions permit defined majorities to bind all Noteholders including Noteholders who did not attend and vote at the relevant meeting and Noteholders who voted in a manner contrary to the majority. Any such change in the terms of the Notes may adversely affect the trading price of the Notes.

The conditions of the Notes contain a provision permitting the Notes and the conditions of the Notes to be amended without the consent of the Noteholders to correct a manifest error.

Event of Default

The conditions of the Notes contain a provision which, if an Event of Default occurs, allows the holders of at least 25 per cent. in aggregate principal amount of the outstanding Notes to declare all the Notes to be immediately due and payable by providing notice in writing to the Republic, whereupon the Notes shall become immediately due and payable, at their principal amount with accrued interest, without further action or formality.

The conditions of the Notes also contain a provision permitting the holders of at least 50 per cent. in aggregate principal amount of the outstanding Notes to notify the Republic to the effect that the Event of Default or Events of Default giving rise to any above mentioned declaration is or are cured following any such declaration and that such holders wish the relevant declaration to be withdrawn. The Republic shall give notice thereof to the Noteholders, whereupon the relevant declaration shall be withdrawn and shall have no further effect.

EU Savings Directive

Under EC Council Directive 2003/48/EC on the taxation of savings income, Member States are required to provide to the tax authorities of another Member State details of payments of interest (or similar income) paid by a person within its jurisdiction to an individual resident in that other Member State or to certain limited types of entities established in that other Member State. However, for a transitional period Luxembourg and Austria are instead required (unless during that period they elect otherwise) to operate withholding system in relation to such payments (the ending of such transitional period being dependent upon the conclusion of certain other agreements relating to information exchange with certain other countries). A number of non-EU countries and territories including Switzerland have adopted similar measures (a withholding system in the case of Switzerland).

On 15 September 2008 the European Commission ("**EC**") issued a report to the Council of the European Union on the operation of the Directive, which included the Commission's advice on the need for changes to the Directive. On 13 November 2008 the EC published a more detailed proposal for amendments to the Directive, which included a number of suggested changes. If any of those proposed changes are made in relation to the Directive, they may amend or broaden the scope of the requirements described above.

If a payment were to be made or collected through a Member State which has opted for a withholding system and an amount of, or in respect of, tax were to be withheld from that payment, neither the Republic nor any Agent nor any other person would be obliged to pay additional amounts with respect to any Note as a result of the imposition of such withholding tax. The Republic is required to maintain an Agent in a Member State that is not obliged to withhold or deduct tax pursuant to the Directive.

Law governing the terms of the Notes may change

The conditions of the Notes are based on English law in effect as at the date of this Prospectus. No assurance can be given as to the impact of any possible judicial decision or change to English law or administrative practice after the date of this Prospectus.

Definitive Notes not denominated in an integral multiple of U.S.$100,000 or its equivalent may be illiquid and difficult to trade

The Notes have denominations consisting of a minimum of U.S.$100,000 plus integral multiples of U.S.$1,000 in excess thereof. It is possible that the Notes may be traded in amounts that are not integral multiples of U.S.$100,000. In each such a case a holder who, as a result of trading such amounts, holds an amount which is less than U.S.$100,000 in his account with the relevant clearing system at the relevant time may not receive a Certificate in respect of such holding (should Certificates be printed) and would need to purchase a principal amount of Notes such that its holding amounts to U.S.$100,000.

If Certificates are issued, holders should be aware that Certificates which have a denomination that is not an integral multiple of U.S.$100,000 or its equivalent may be illiquid and more difficult to trade than Notes denominated in an integral multiple of U.S.$100,000 plus integral multiples of U.S.$1,000 in excess thereof.

Croatian court may not recognise the choice of English law as the law governing the Notes

The Notes are governed by English law and the Republic has submitted to the non-exclusive jurisdiction of the courts of England to settle any disputes that may arise out of or in connection with any Note. In respect of any proceedings between (i) the Republic and a Croatian natural or legal person (which proceedings also includes a non-Croatian natural or legal person) or (ii) the Republic and a non-Croatian natural or legal person, a Croatian court will recognise and give effect to the choice of English law as the law governing the Notes if the merits of the dispute in question have an international element. In respect of recognition and/or enforcement of an English/foreign court judgement, Croatian courts may refuse to recognise such judgements only in certain cases according to the provisions of the Croatian Law on Resolving Conflicts of Law with Other Countries' Laws and Regulations in Certain Matters (Official Gazette No. 53/1991). Once recognised, the foreign judgement is equal to the judgment of a Croatian court and is fit for enforcement in the Republic of Croatia.

There may be no active trading market for the Notes

Although an application has been made to list on the Official List and trade the Notes on the Regulated Market "Bourse de Luxembourg" of the Luxembourg Stock Exchange, there is no assurance that such application will be accepted or that an active trading market for the Notes will develop or, if one does develop, that it will be liquid or maintained. If an active trading market in the Notes does not develop or is not maintained, the market price and liquidity of the Notes may be adversely affected.

The market for securities issued by Croatia is influenced by economic and market conditions in Croatia and, to a varying degree, economic conditions in other Eastern European markets as well as global, emerging and developed markets generally. There can be no assurance that events which would cause volatility of the sort that occurred in worldwide financial markets in 1998 and 2008 will not occur again, or that any such volatility will not adversely affect the price or liquidity of the Notes.

In addition, if the Notes are traded after their initial issuance, they may trade at a discount to their initial offering price, depending upon prevailing interest rates, the market for similar securities, general economic conditions and the financial condition of the Republic. As a result of the above factors, investors may not be able to sell their Notes easily or at prices that will provide them with a yield comparable to similar investments that have a developed secondary market.

A claimant may not be able to enforce a court judgment against certain assets of Croatia in certain jurisdictions

Croatia is a sovereign state. There is a risk that, notwithstanding the waiver of sovereign immunity by Croatia, a claimant will not be able to enforce a court judgment against certain assets of Croatia in certain jurisdictions (including the imposition of any arrest order or attachment or seizure of such assets and their subsequent sale) without Croatia having specifically consented to such enforcement at the time when the enforcement is sought.

The foreign exchange reserves of Croatia are controlled and administered by the CNB, which is an independent central bank legally distinct from the Government. Accordingly, such reserves would not be available to satisfy any claim or judgment in respect of the Notes.

Fluctuations in exchange rates and interest rates may adversely affect the value of the Notes

The Issuer will pay principal and interest on the Notes in U.S.$. This presents certain risks relating to currency conversions if an investor's financial activities are denominated principally in a currency or currency unit (the "**Investor's Currency**") other than U.S.$. These include the risk that exchange rates may significantly change (including changes due to devaluation of the U.S.$ or revaluation of the Investor's Currency) and the risk that authorities with jurisdiction over the Investor's Currency may impose or modify exchange controls. An appreciation in the value of the Investor's Currency relative to U.S.$ would decrease (1) the Investor's Currency-equivalent yield on the Notes, (2) the Investor's Currency equivalent value of the principal payable on the Notes and (3) the Investor's Currency equivalent market value of the Notes.

Government and monetary authorities may impose (as some have done in the past) exchange controls that could adversely affect an applicable exchange rate. As a result, investors may receive less interest or principal than expected, or no interest or principal. In addition, investment in the Notes involves the risk that subsequent changes in market interest rates may adversely affect the value of the Notes.

Legal investment considerations may restrict certain investments

The investment activities of certain investors are subject to legal investment laws and regulations, or review or regulation by certain authorities. Each potential investor should consult its legal advisers to determine whether and to what extent (1) the Notes are legal investments for it, (2) the Notes can be used as collateral for various types of borrowing and (3) other restrictions apply to its purchase or pledge of the Notes. Financial institutions should consult their legal advisors or the appropriate regulators to determine the appropriate treatment of the Notes under any applicable risk-based capital or similar rules.

Credit ratings may not reflect all risks

Moody's, S&P and Fitch have assigned credit ratings to the Notes. The ratings may not reflect the potential impact of all risks related to structure, market, additional factors discussed above, and other factors that may affect the value of the Notes. A credit rating is not a recommendation to buy, sell or hold securities and may be revised or withdrawn by the rating agency at any time.

CONDITIONS OF THE NOTES

The following is the text of the Conditions of the Notes which (subject to modification and except for the paragraphs in italics) will be endorsed on the Certificates issued in respect of the Notes:

The U.S.$1,250,000,000 6.625 per cent. Notes due 2020 (the "**Notes**", which expression shall in these Conditions, unless the context otherwise requires, include any further notes issued pursuant to Condition 14 (*Further Issues*) and forming a single series with the Notes) of the Republic of Croatia (the "**Republic**") are issued subject to and with the benefit of an Agency Agreement dated 14 July 2010 (such agreement as amended and/or supplemented and/or restated from time to time, the "**Agency Agreement**") made between the Republic, Citigroup Global Markets Deutschland AG as registrar (the "**Registrar**"), Citibank, N.A., London Branch as fiscal agent and transfer agent (the "**Fiscal Agent**" and "**Transfer Agent**") and the other initial paying agents named in the Agency Agreement (together with the Fiscal Agent, the "**Paying Agents**") and the other agents named in it (together with the Fiscal Agent, the Registrar and the other Paying Agents, the "**Agents**"). The holders of the Notes (the "**Noteholders**") are entitled to the benefit of a Deed of Covenant dated 14 July 2010 (the "**Deed of Covenant**") and made by the Republic. The original of the Deed of Covenant is held by the Fiscal Agent on behalf of the Noteholders at its specified office.

The statements in these Conditions include summaries of, and are subject to, the detailed provisions of and definitions in the Agency Agreement. Copies of the Agency Agreement are available for inspection during normal business hours by the holders of the Notes (the "**Noteholders**") appertaining to the Notes at the specified office of each of the Paying Agents. The Noteholders are entitled to the benefit of, are bound by, and are deemed to have notice of, all the provisions of the Agency Agreement and the Deed of Covenant applicable to them. References in these Conditions to the Fiscal Agent, the Registrar, the Paying Agents and the Agents shall include any successor appointed under the Agency Agreement.

*The owners shown in the records of Euroclear Bank S.A./N.V. (**"Euroclear"**), Clearstream Banking, société anonyme (**"Clearstream, Luxembourg"**) and the Depository Trust Company (**"DTC"**) of book-entry interests in Notes are entitled to the benefit of, are bound by, and are deemed to have notice of, all the provisions of the Agency Agreement applicable to them.*

1. FORM, DENOMINATION AND TITLE

1.1 Form and Denomination

The Notes are issued in registered form in amounts of U.S.$100,000 and integral multiples of U.S.$1,000 in excess thereof (referred to as the "**principal amount**" of a Note). A note certificate (each a "**Certificate**") will be issued to each Noteholder in respect of its registered holding of Notes. Each Certificate will be numbered serially with an identifying number which will be recorded on the relevant Certificate and in the Register (as defined below) which the Republic will procure to be kept by the Registrar.

The Notes are not issuable in bearer form.

1.2 Title

The Registrar will maintain a register (the "**Register**") in respect of the Notes in accordance with the provisions of the Agency Agreement. Title to the Notes passes only by registration in the Register. The holder of any Note will (except as otherwise required by law) be treated as its absolute owner for all purposes (whether or not it is overdue and regardless of any notice of ownership, trust or any interest or any writing on, or the theft or loss of, the Certificate issued in respect of it) and no person will be liable for so treating the holder. In these Conditions "**Noteholder**" and (in relation to a Note) "**holder**" means the person in whose name a Note is registered in the Register.

For a description of the procedures for transferring title to book-entry interests in the Notes, see the Agency Agreement and Condition 2 (Transfers of Notes and Issue of Certificates).

2. TRANSFERS OF NOTES AND ISSUE OF CERTIFICATES

2.1 Transfers

A Note may be transferred by depositing the Certificate issued in respect of that Note, with the form of transfer on the back duly completed and signed, at the specified office of the Registrar or any of the Agents.

For a description of certain restrictions on transfers of interests in the Notes, see "Transfer Restrictions" and the Agency Agreement.

2.2 Delivery of new Certificates

Each new Certificate to be issued upon transfer of Notes will, within five business days of receipt by the Registrar or the relevant Agent of the duly completed form of transfer endorsed on the relevant Certificate, be mailed by uninsured mail at the risk of the holder entitled to the Note to the address specified in the form of transfer. For the purposes of this Condition, **business day** shall mean a day on which commercial banks and foreign exchange markets are open for business in the city in which the specified office of the Agent with whom a Certificate is deposited in connection with a transfer is located.

Except in the limited circumstances described herein (see "The Global Certificates — Registration of Title" and "The Global Certificates — Exchange For Certificates"), owners of interests in the Notes will not be entitled to receive physical delivery of Certificates. Issues of Certificates upon transfer of Notes are subject to compliance by the transferor and transferee with the certification procedures described above and in the Agency Agreement and, in the case of Restricted Certificates, compliance with the Securities Act Legend.

Where some but not all of the Notes in respect of which a Certificate is issued are to be transferred a new Certificate in respect of the Notes not so transferred will, within five business days of receipt by the Registrar or the relevant Agent of the original Certificate, be mailed by uninsured mail at the risk of the holder of the Notes not so transferred to the address of such holder appearing on the Register or as specified in the form of transfer.

2.3 Formalities free of charge

Registration of transfer of Notes will be effected without charge by or on behalf of the Republic or any Agent but upon payment (or the giving of such indemnity as the Republic or any Agent may reasonably require) in respect of any tax or other governmental charges which may be imposed in relation to such transfer.

2.4 Closed Periods

No Noteholder may require the transfer of a Note to be registered during the period of 15 days ending on the due date for any payment of principal, premium or interest on that Note.

2.5 Regulations

All transfers of Notes and entries on the Register will be made subject to the detailed regulations concerning transfer of Notes scheduled to the Agency Agreement. The regulations may be changed by the Republic with the prior written approval of the Registrar. A copy of the current regulations will be mailed (free of charge) by the Registrar to any Noteholder who requests one.

3. STATUS

The Notes constitute direct, unconditional, (subject to the provisions of Condition 4 (*Negative Pledge*) unsecured and unsubordinated and general obligations of the Republic. The Notes rank *pari passu,* without any preference among themselves, and at least *pari passu* in right of payment with all other present and future unsecured obligations of the Republic, save only for such obligations as may be preferred by mandatory provisions of applicable law.

4. NEGATIVE PLEDGE AND OTHER COVENANTS

4.1 Negative Pledge

So long as any of the Notes remains outstanding (as defined in the Agency Agreement), the Republic will not grant or permit to be outstanding any mortgage, charge, lien, pledge or other security interest (each a "**Security Interest**"), other than a Permitted Security Interest, over any of its present or future assets or revenues or any part thereof, to secure any Public External Indebtedness of the Republic or any other person or any guarantee of the Republic in respect of Public External Indebtedness, unless the Republic shall, in the case of granting of the security, before or at the same time, and in any other case, promptly, procure that the Republic's obligations under the Notes are secured equally and rateably therewith.

Certain Definitions:

In these Conditions:

Permitted Security Interest means:

(a) any Security Interest upon property (or any revenues therefrom) to secure Public External Indebtedness incurred for the purpose of financing the acquisition or construction of such property (or property which forms part of a class of assets of a similar nature where the Security Interest is by reference to the constituents of such class from time to time);

(b) any Security Interest existing on property (or any revenues therefrom) at the time of its acquisition;

(c) any Security Interest arising by operation of law which has not been foreclosed or otherwise enforced against the assets to which it applies;

(d) any Security Interest securing or providing for the payment of Public External Indebtedness incurred in connection with any Project Financing provided that such Security Interest only applies to (i) properties which are the subject of such Project Financing or (ii) revenues or claims which arise from the operation, failure to meet specifications, exploitation, sale or loss of, or failure to complete, or damage to, such properties; or

(e) the renewal or extension of any Security Interest described in sub paragraphs (a) and (b) above, provided that the principal amount of the original financing secured thereby is not increased.

Project Financing means any arrangement for the provision of funds which are to be used principally to finance a project for the acquisition, construction, development or exploitation of any property pursuant to which the persons providing such funds agree that the principal source of repayment of such funds will be the project and the revenues (including insurance proceeds) generated by such project.

Public External Indebtedness means any obligation for borrowed money which is (a) in the form of or represented by notes, bonds or other similar securities and which is listed or capable of being listed on any stock exchange and (b) denominated or payable, or at the option of the holder thereof payable, in a currency other than the lawful currency of the Republic provided that, if at any time the lawful currency of the Republic is the euro, then any indebtedness as described in (a) denominated or payable, or at the option of the holder thereof payable, in euro, shall be included in "Public External Indebtedness".

5. INTEREST

5.1 Interest Rate and Interest Payment Dates

The Notes bear interest on their outstanding principal amount from and including 14 July 2010 at the rate of 6.625 per cent. per annum, payable semi-annually in arrear on 14 January and 14 July in each year (each an "**Interest Payment Date**"). The first payment (representing a half year's interest) for the period from and including 14 July 2010 to but excluding 14 January 2011 and amounting to U.S.$3,312.50 per U.S.$100,000 principal amount of Notes shall be made on 14 January 2011.

5.2 Interest Accrual

Each Note will cease to bear interest from and including its due date for redemption unless, upon due presentation, payment of the principal in respect of the Note is improperly withheld or refused or unless default is otherwise made in respect of payment. In such event, interest will continue to accrue until whichever is the earlier of:

(a) the date on which all amounts due in respect of such Note have been paid; and

(b) the day on which notice has been given to the Noteholders that the Fiscal Agent or the Registrar has received all sums due in respect of the Notes up to such day (except, in the case of payment to the Fiscal Agent or the Registrar to the extent that there is any subsequent default in payment in accordance with these Conditions).

5.3 Calculation of Broken Interest

When interest is required to be calculated in respect of a period of less than a half-year, it shall be calculated on the basis of a 360-day year consisting of 12 months of 30 days each and, in the case of an incomplete month, the number of days elapsed on the basis of a month of 30 days.

6. PAYMENTS

6.1 Payments in respect of Notes

Payment of principal and interest will be made by transfer to the registered account of the Noteholder or by U.S.$ cheque drawn on a bank that processes payments in U.S.$ mailed to the registered address of the Noteholder if it does not have a registered account. Payments of principal and payments of interest due otherwise than on an Interest Payment Date will only be made against surrender of the relevant Certificate at the specified office of any of the Agents. Interest on Notes due on an Interest Payment Date will be paid to the holder shown on the Register at the close of business on the date (the "**record date**") being the fifteenth day before the due date for the payment of interest.

For the purposes of this Condition, a Noteholder's registered account means the U.S.$ account maintained by or on behalf of it with a bank that processes payments in U.S.$, details of which appear on the Register at the close of business, in the case of principal, on the second business day (as defined below) before the due date for payment and, in the case of interest, on the relevant record date, and a Noteholder's registered address means its address appearing on the Register at that time.

6.2 Payments subject to Applicable Laws

Payments in respect of principal and interest on Notes are subject in all cases to any fiscal or other laws and regulations applicable in the place of payment, but without prejudice to the provisions of Condition 8 (*Taxation*).

6.3 No commissions

No commissions or expenses shall be charged to the Noteholders in respect of any payments made in accordance with this Condition.

6.4 Payment on Business Days

Where payment is to be made by transfer to a registered account, payment instructions (for value the due date or, if that is not a Business Day (as defined below), for value the first following day which is a Business Day) will be initiated and, where payment is to be made by cheque, the cheque will be mailed, on the Business Day preceding the due date for payment or, in the case of a payment of principal or a payment of interest due otherwise than on an Interest Payment Date, if later, on the Business Day on which the relevant Certificate is surrendered at the specified office of an Agent.

Noteholders will not be entitled to any interest or other payment for any delay after the due date in receiving the amount due if the due date is not a Business Day, if the Noteholder is late in surrendering its Certificate (if required to do so) or if a cheque mailed in accordance with this Condition arrives after the due date for payment.

In this Condition "**Business Day**" means a day (other than a Saturday or Sunday) on which commercial banks are open for business in London, New York City and, in the case of presentation of a Note Certificate, in the place in which the Note Certificate is presented.

6.5 Partial Payments

If the amount of principal or interest which is due on the Notes is not paid in full, the Registrar will annotate the Register with a record of the amount of principal, premium (if any) or interest in fact paid.

6.6 Agents

The names of the initial Agents and their initial specified offices are set out at the end of these Conditions. The Republic reserves the right at any time to vary or terminate the appointment of any Agent and to appoint additional or other Agents provided that:

(a) there will at all times be a Fiscal Agent;

(b) there will at all times be an Agent (which may be the Fiscal Agent) having a specified office in a major European city;

(c) the Republic undertakes that it will ensure that it maintains a Paying Agent in a Member State of the European Union that is not obliged to withhold or deduct tax pursuant to European Council Directive 2003/48/EC or any law implementing or complying with, or introduced in order to conform to, such Directive; and

(d) a Registrar.

Notice of any termination or appointment and of any changes in specified offices given to the Noteholders promptly by the Republic in accordance with Condition 12 (*Notices*).

7. REDEMPTION AND PURCHASE

7.1 Redemption at Maturity

Unless previously redeemed or purchased and cancelled as provided below, the Republic will redeem the Notes at their principal amount on 14 July 2020.

7.2 Purchases

The Republic may at any time purchase Notes at any price in the open market or otherwise. The Notes so purchased, while held on behalf of the Republic, shall not entitle the holder to vote at any meetings of the Noteholders and shall not be deemed to be outstanding for the purposes of calculating the quorum of meetings of Noteholders or for the purpose of Condition 13 (*Meetings of Noteholders; Modification; and Noteholders' Representative Committee*).

7.3 Cancellations

All Notes which are (a) redeemed or (b) purchased by or on behalf of the Republic may, but need not, be cancelled at the election of the Republic. Any Notes so cancelled will not be reissued or resold.

8. TAXATION

8.1 Payment without Withholding

All payments in respect of the Notes by or on behalf of the Republic shall be made without withholding or deduction for, or on account of, any present or future taxes, duties, assessments or governmental charges of whatever nature imposed, levied collected, withheld or assessed by or on behalf of the Republic or any political subdivision or any authority thereof or therein having power to tax (together "**Taxes**"), unless the withholding or deduction of the Taxes is required by law. In that event, the Republic will pay such additional amounts as may be necessary in order that the net amounts received by the Noteholders after the withholding or deduction shall equal the respective amounts which would have been receivable in respect of the Notes in the absence of the withholding or deduction; except that no additional amounts shall be payable in relation to any payment in respect of any Note:

(a) to a holder, or to a third party on behalf of a holder, if such holder is liable to such Taxes in respect of such Note by reason of his having some connection with the Republic other than the mere holding of the Note; or

(b) if such Note is surrendered for payment more than 30 days after the Relevant Date (as defined below), except to the extent that the holder would have been entitled to such additional amounts on surrender of such Note for payment on the last day of such period of 30 days assuming that day to have been a Business Day (as defined in Condition 6 (*Payments*)); or

(c) where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to European Council Directive 2003/48/EC or any law implementing or complying with, or introduced in order to conform to, such Directive; or

(d) to a holder, or to a third party on behalf of a holder who would have been able to avoid such withholding or deduction by presenting the relevant Note to another Paying Agent in a Member State of the European Union.

8.2 Interpretation

In these Conditions **Relevant Date** means the date on which the payment first becomes due but, if the full amount of the money payable has not been received by the Fiscal Agent on or before the due date, it means the date on which, the full amount of the money plus any accrued interest having been so received, notice to that effect has been duly given to the Noteholders by the Republic in accordance with Condition 12 (*Notices*).

8.3 Additional Amounts

Any reference in these Conditions to any amounts in respect of the Notes shall be deemed also to refer to any additional amounts which may be payable under this Condition.

9. PRESCRIPTION

Claims in respect of principal and interest will become prescribed unless made within 10 years (in the case of principal) and five years (in the case of interest) from the Relevant Date, as defined in Condition 8 (*Taxation*).

10. EVENTS OF DEFAULT

10.1 If any of the following events (each an "Event of Default") occurs and is continuing:

(a) if default is made in the payment of any interest due in respect of the Notes or any of them and the default continues for a period of 15 days from the due date for payment thereof; or

(b) if the Republic fails duly to perform or observe any of its other obligations under these Conditions and such failure continues unremedied for 45 days after written notice thereof has been delivered by any Noteholder to the Fiscal Agent; or

(c) the Republic ceases to be a member of the International Monetary Fund ("**IMF**") or to be eligible to use the general resources of the IMF, and such situation continues unremedied for 45 days after written notice thereof has been delivered by any Noteholder to the Fiscal Agent; or

(d) (a) the acceleration of the maturity (other than by optional or mandatory redemption or other prepayment) of any Public External Indebtedness of the Republic, (b) the Republic defaults in the payment of any principal of or interest on any of its Public External Indebtedness when and as the same shall become due and payable, and such default continues for more than the period of grace, if any, originally applicable thereto or (in the case of interest where such grace period does not exist or is less than 30 days) 30 days, or (c) the Republic defaults in the payment when due and called upon (after the expiry of the period of grace, if any, originally applicable thereto or (in the case of payment where such grace period does not exist or is less than 30 days) 30 days) of any guarantee or indemnity of the Republic in respect of any Public External Indebtedness, provided that the aggregate amount of the relevant Public External Indebtedness in respect of which one or more of the events mentioned in this paragraph (iv) have occurred equals or exceeds US$70,000,000 or its equivalent; or

(e) if the Republic shall declare a general moratorium on the payment of principal of, or interest on the Public External Indebtedness of the Republic,

then the holders of at least 25 per cent. in aggregate principal amount of the outstanding Notes may, by notice in writing to the Republic (with a copy to the Fiscal Agent), declare all the Notes to be immediately due and payable, whereupon they shall become immediately due and payable at their principal amount together with accrued interest without further action or formality. Notice of any such declaration shall promptly be given to all other Noteholders by the Republic.

10.2 If the Republic receives notice in writing from holders of at least 50 per cent. in aggregate principal amount of the outstanding Notes to the effect that the Event of Default or Events of Default giving rise to any above mentioned declaration of acceleration is or are cured following any such declaration and that such holders wish the relevant declaration to be withdrawn, the Republic shall give notice thereof to the Noteholders (with a copy to the Fiscal Agent), whereupon the relevant declaration shall be withdrawn and shall have no further effect but without prejudice to any rights or obligations which may have arisen before the Republic gives such notice (whether pursuant to these Conditions or otherwise). No such withdrawal shall affect any other or any subsequent Event of Default or any right of any Noteholder in relation thereto.

11. REPLACEMENT OF CERTIFICATES

If any Certificate is lost, stolen, mutilated, defaced or destroyed it may be replaced at the specified office of the Registrar or the Fiscal Agent upon payment by the claimant of the expenses incurred in connection with the replacement and on such terms as to evidence and indemnity as the Republic may reasonably require. Mutilated or defaced Certificates must be surrendered before replacements will be issued.

12. NOTICES

12.1 Notices to the Noteholders

All notices to the Noteholders will be valid if mailed to them at their respective addresses in the Register maintained by the Registrar and published in a leading English language newspaper of general circulation in Europe (which is expected to be the *Financial Times*) and so long as the Notes are listed on the Luxembourg Stock Exchange and the rules of that Exchange so require, published in a daily newspaper in Luxembourg (which is expected to be the *Luxemburger Wort*) and/or the website of the Luxembourg Stock Exchange, *www.bourse.lu*. The Republic shall also ensure that notices are duly given or published in a manner which complies with the rules and regulations of any stock exchange or other relevant authority on which the Notes are for the time being listed. Any notice shall be deemed to have been given on the second day after being so mailed or on the date of publication or, if so published more than once or on different dates, on the date of the first publication.

All notices to the Republic will be valid if sent to the Republic at the Ministry of Finance of the Republic of Croatia, Zagreb or such other address as may be notified by the Republic to the Noteholders in accordance with the above paragraph of this Condition.

13. MEETINGS OF NOTEHOLDERS; MODIFICATION; AND NOTEHOLDERS' REPRESENTATIVE COMMITTEE

13.1 Convening Meetings of Noteholders

The Agency Agreement contains provisions for convening meetings of Noteholders to consider matters relating to the Notes, including the modification of any provision of these Conditions or the provisions of the Agency Agreement. Such a meeting may be convened by the Republic or the Fiscal Agent and shall be convened by the Republic or the Fiscal Agent at any time upon the request in writing of holders of at least 10 per cent. of the aggregate principal amount of the outstanding Notes.

13.2 Quorum

The quorum at any meeting of Noteholders convened to vote on an Extraordinary Resolution will be:

(a) one or more persons present and holding or representing at least 50 per cent. of the aggregate principal amount of the outstanding Notes; or

(b) where a meeting is adjourned and rescheduled owing to a lack of quorum, at any rescheduled meeting of Noteholders, one or more persons present and holding or representing at least 25 per cent. of the aggregate principal amount of the outstanding Notes;

provided, however, that any proposals relating to a Reserved Matter may only be approved by an Extraordinary Resolution passed at a meeting of Noteholders at which one or more persons present and holding or representing at least 75 per cent. of the aggregate principal amount of the outstanding Notes form a quorum.

13.3 Reserved Matters

In these Conditions, "**Reserved Matter**" means any proposal:

(a) to change the date, or the method of determining the date, for payment of principal, interest or any other amount in respect of the Notes, to reduce or cancel the amount of principal, interest or any other amount payable on any date in respect of the Notes or to change the method of calculating the amount of principal, interest or any other amount payable in respect of the Notes on any date;

(b) to change the currency in which any amount due in respect of the Notes is payable or the place in which any payment is to be made;

(c) to change the quorum required at any meeting of Noteholders or the majority required to pass an Extraordinary Resolution, Written Resolution or any other resolution of Noteholders or the number or percentage of votes required to be cast, or the number or percentage of Notes required to be held, in connection with the taking of any decision or action by or on behalf of the Noteholders or any of them;

(d) to change this definition, the definition of "Extraordinary Resolution", the definition of "outstanding" or the definition of "Written Resolution" in these Conditions or in the Agency Agreement;

(e) to change or waive the provisions of the Notes set out in Condition 3 (*Status*);

(f) to change the law governing the Notes, the courts to the jurisdiction of which the Republic has submitted in the Notes, the Republic's obligation to maintain an agent for service of process in England or the Republic's waiver of immunity, in respect of actions or proceedings brought by any Noteholder, set out in Condition 15 (*Governing Law and Submission to Jurisdiction*);

(g) to approve any exchange or substitution of the Notes for, or the conversion of the Notes into, any other obligations or securities of the Republic or any other person; or

(h) in connection with any proposed exchange, substitution or conversion of the type referred to in paragraph (g) to amend any of the provisions of the Notes describing circumstances in which Notes may be redeemed or declared due and payable prior to their scheduled maturity date as set out in Condition 10 (*Events of Default*).

13.4 Modifications

Any modification of any provision of these Conditions may be made if approved by an Extraordinary Resolution or a Written Resolution. In these Conditions, "Extraordinary Resolution" means a resolution passed at a meeting of Noteholders duly convened and held in accordance with the Agency Agreement by a majority of at least:

(a) in the case of a Reserved Matter, 75 per cent. of the aggregate principal amount of the outstanding Notes; or

(b) in the case of a matter other than a Reserved Matter, 66⅔ per cent. of the aggregate principal amount of the outstanding Notes which are represented at that meeting.

Any Extraordinary Resolution duly passed at any such meeting shall be binding on all the Noteholders, whether present or not and whether they voted in favour or not.

13.5 Written resolutions

In addition, the Agency Agreement contains provisions relating to Written Resolutions. A "Written Resolution" is a resolution in writing signed by or on behalf of the holders of at least 75 per cent. of the aggregate principal amount of the outstanding Notes, in the case of a Reserved Matter, or 66⅔ per cent. of the aggregate principal amount of the outstanding Notes, in the case of a matter other than a Reserved Matter. Any Written Resolution may be contained in one document or several documents in the same form, each signed by or on behalf of one or more Noteholders. Any Written Resolution shall be binding on all of the Noteholders, whether or not signed by them.

13.6 Manifest error, etc.

The Notes, these Conditions and the provisions of the Agency Agreement may be amended without the consent of the Noteholders to correct a manifest error. In addition, the parties to the Agency Agreement may agree to modify any provision thereof, but the Republic shall not agree, without the consent of the Noteholders, to any such modification unless it is of a formal, minor or technical nature or it is not materially prejudicial to the interests of the Noteholders.

13.7 Notes controlled by the Republic

For the purposes of (i) ascertaining the right to attend and vote at any meeting of Noteholders or the right to sign, or authorise the signature of, any Written Resolution, (ii) this Condition 13 and Schedule 5 to the Agency Agreement, and (iii) Condition 10 (*Events of Default*), those Notes (if any) which are held in circumstances where the Republic has the power to direct the casting of votes in respect of such Notes, whether directly or indirectly, shall (unless and until ceasing to be so held) be disregarded and be deemed not to remain outstanding. Without prejudice to the generality of the previous sentence, the Republic shall be deemed to have the power to direct the casting of votes in respect of a Note if the Note is held by or on behalf of the Republic or by or on behalf of any person which is owned or controlled directly or indirectly by the Republic or by any public sector instrumentality of the Republic, where:

(a) **public sector instrumentality** means the Republic of Croatia, any department, ministry or agency of the government of the Republic of Croatia or any corporation, trust, financial institution or other entity owned or controlled by the government of the Republic of Croatia; and

(b) **control** means the power, directly or indirectly, through the ownership of voting securities or other ownership interests or otherwise, to direct the management of or elect or appoint a majority of the board of directors or other persons performing similar functions in lieu of, or in addition to, the board of directors of a corporation, trust, financial institution or other entity.

In advance of any meeting of Noteholders or Written Resolution the Republic shall provide to the Fiscal Agent a certificate of the Republic setting out the total number of Notes which are held in circumstances where the Republic has at the date of such certificate the power to direct the casting of votes in respect of such Notes. The Fiscal Agent shall make any such certificate available for inspection during normal business hours at its specified office and, upon reasonable request, will allow copies of such certificate to be taken.

13.8 Noteholders' Representative Committee

(a) Appointment

The Noteholders may, by a resolution passed at a meeting of Noteholders duly convened and held in accordance with the Fiscal Agency Agreement by a majority of not less than 50 per cent. in principal amount of the Notes then outstanding, or by notice in writing to the Republic (with a copy to the Fiscal Agent) signed by or on behalf of the holders of not less than 50 per cent. in principal amount of the Notes then outstanding, appoint any person or persons as a committee to represent the interests of the Noteholders if any of the following events has occurred:

(i) an Event of Default;

(ii) any event or circumstance which could, with the giving of notice, lapse of time, the issuing of a certificate and/or fulfilment of any other requirement provided for in Condition 10 (*Events of Default*) become an Event of Default; or

(iii) any official public announcement by the Republic to the effect that the Republic is seeking or intends to seek a restructuring of the Notes (whether by amendment, exchange offer or otherwise),

provided, however, that no such appointment shall be effective if the holders of more than 25 per cent. of the principal amount of the Notes then outstanding have either (I) objected to such appointment by notice in writing to the Republic (with a copy to the Fiscal Agent) during a specified period following notice of the appointment being given (if such notice of appointment is made by notice in writing to the Republic) where such specified period shall be either 30 days or such other longer or shorter period as the committee may, acting in good faith, determine to be appropriate in the circumstances, or (II) voted against such resolution at a meeting of Noteholders duly convened and held in accordance with the provisions of the Agency Agreement. Such committee shall, if appointed by notice in writing to the Republic give notice of its appointment to all Noteholders in accordance with Condition 12 (*Notices*) as soon as practicable after the notice is delivered to the Republic.

(b) Powers

Such committee in its discretion may, among other things, (I) engage legal advisers and financial advisers to assist it in representing the interests of the Noteholders, (II) adopt such rules as it considers appropriate regarding its proceedings, (III) enter into discussions with the Republic and/or other creditors of the Republic, (IV) designate one or more members of the committee to act as the main point(s) of contact with the Republic and provide all relevant contact details to the Republic, (V) determine whether or not there is an actual or potential conflict of interest between the interests of the holders of the Notes then outstanding and the interests of the holders of debt securities of any one or more other series issued by the Republic and (VI) upon making a determination of the absence of any actual or potential conflict of interest between the interests of the holders of the Notes then outstanding and the interests of the holders of debt securities of any one or more other series issued by the Republic, agree to transact business at a combined meeting of the committee and such other person or persons as may have been duly appointed as representatives of the holders of securities of each such other series. Except to the extent provided in this paragraph (b) (*Powers*), such committee shall not have the ability to exercise any powers or discretions which the Noteholders could themselves exercise. The Republic shall pay any fees and expenses which are reasonably incurred by any such committee (including, without limitation, the costs of giving notices to Noteholders and the reasonable fees and expenses of the committee's legal advisers and financial advisers, if any) within 30 days of the delivery to the Republic of a reasonably detailed invoice and supporting documentation.

14. FURTHER ISSUES

The Republic may from time to time without the consent of the Noteholders create and issue further notes, having terms and conditions the same as those of the Notes, or the same except for the amount of the first payment of interest, which may be consolidated and form a single series with the outstanding Notes even if such further Notes may have more than *de minimis* original issue discount for U.S. Federal income tax purposes and even if doing so impacts the value of the Notes.

15. GOVERNING LAW AND SUBMISSION TO JURISDICTION

15.1 Governing Law

The Notes, the Agency Agreement and the Deed of Covenant, and any non-contractual obligations arising out of or in connection with the Notes, the Agency Agreement and the Deed of Covenant, are governed by, and will be construed in accordance with, English law, provided, however, that the due authorisation and execution of the Notes by and on behalf of the Republic shall be governed by the laws by the Republic.

15.2 Jurisdiction

The Republic irrevocably agrees for the benefit of the Noteholders that the courts of England are to have jurisdiction to settle any disputes which may arise out of or in connection with the Agency Agreement or the Notes (including any disputes relating to any non-contractual obligations arising out of or in connection with the Agency Agreement or the Notes) and that accordingly any suit, action or proceedings arising out of or in connection therewith (together referred to as "**Proceedings**") may be brought in the courts of England.

The Republic irrevocably and unconditionally waives and agrees not to raise any objection which it may have now or subsequently to the laying of the venue of any Proceedings in the courts of England and any claim that any Proceedings have been brought in an inconvenient forum and further irrevocably and unconditionally agrees that a final non-appealable judgment in any Proceedings brought in the courts of England shall be conclusive and binding upon the Republic and may be enforced in the courts of any other jurisdiction to which the Republic is or may be subject. Nothing in this Condition shall limit any right to take Proceedings against the Republic in any other court of competent jurisdiction, nor shall the taking of Proceedings in one or more jurisdictions preclude the taking of Proceedings in any other jurisdiction, whether concurrently or not.

The Republic irrevocably appoints the Ambassador of the Republic of Croatia in the United Kingdom, currently residing at the Embassy of the Republic of Croatia, 21 Conway Street, London W1P 5HL or, in his absence, his designate as its authorised agent for service of process in England. If for any reason such agent shall cease to be such agent for service of process, the Republic shall appoint a new agent for service of process in England and deliver to the Fiscal Agent a copy of the new agent's acceptance of that appointment within 30 days.

To the extent that the Republic is lawfully entitled to do so, the Republic waives any right to claim sovereign or other immunity from jurisdiction or execution in respect of any proceedings arising solely out of or in connection with the Notes with the exception of execution, attachment or other legal or judicial process or remedy against property which is used solely or mainly for official purposes (including but not limited to ambassadorial and consular real estate, buildings and the contents thereof in the Republic or elsewhere, or any bank accounts of embassies or consulates, in each case necessary for the proper, official, ambassadorial or consular functioning of the Republic and the assets necessary for the proper functioning of the Republic as a sovereign power). The waiver of immunities in this Condition 15 constitutes a limited and specific waiver for the purpose of the Notes and under no circumstances shall it be interpreted as a general waiver by the Republic.

16. RIGHTS OF THIRD PARTIES

No rights are conferred on any person under the Contracts (Rights of Third Parties) Act 1999 to enforce any term of this Note, but this does not affect any right or remedy of any person which exists or is available apart from that Act.

THE GLOBAL CERTIFICATES

The Global Certificates contain the following provisions which apply to the Notes in respect of which they are issued whilst they are represented by the Global Certificates, some of which modify the effect of the Conditions. Terms defined in the Conditions have the same meaning in paragraphs 1 to 7 below.

1. FORM OF THE NOTES

The Notes sold in reliance on Regulation S ("**Regulation S**") under the United States Securities Act of 1933 (the "**Securities Act**") (the "**Unrestricted Global Certificate**") will be represented on issue by an Unrestricted Global Certificate, which will be deposited with, and registered in the name of a nominee for the common depositary for, Euroclear and Clearstream, Luxembourg. Beneficial interests in an Unrestricted Global Certificate may be held only through Euroclear or Clearstream, Luxembourg or their participants at any time. By acquisition of a beneficial interest in the Unrestricted Global Certificate, the purchaser thereof will be deemed to represent, among other things, that it acquired such beneficial interest in accordance with Regulation S and that it will only offer, sell, pledge or otherwise transfer such beneficial interest in an offshore transaction in accordance with Rule 903 or Rule 904 of Regulation S. See "*Subscription and Sale*" and "*Transfer Restrictions*".

The Notes sold in reliance on Rule 144A under the Securities Act ("**Rule 144A**") (the "**Restricted Global Certificate**") will be represented on issue by a Restricted Global Certificate, which will be deposited with a custodian for, and registered in the name of a nominee of, DTC. Beneficial interests in a Restricted Global Certificate may only be held through DTC or its participants at any time. Beneficial interests in a Restricted Global Certificate may only be held by persons who are QIBs, holding their interests for their own account or for the account of one or more QIBs. By acquisition of a beneficial interest in a Restricted Global Certificate, the purchaser thereof will be deemed to represent, among other things, that it is a QIB and that, if in the future it determines to transfer such beneficial interest, it will transfer such interest in accordance with the procedures and restrictions contained in the Restricted Global Certificate. See "*Subscription and Sale*".

The Unrestricted Global Certificate and the Restricted Global Certificate are referred to herein as the "**Global Certificates**". Beneficial interests in Global Certificates will be subject to certain restrictions on transfer set out therein and under "*Transfer Restrictions*" and in the Agency Agreement and such Global Certificates will bear a legend as set out under "*Subscription and Sale*". On or prior to the 40th day after the later of the commencement of the offering and 14 July 2010 (the "**Closing Date**"), ownership of interests in an Unrestricted Global Certificate will be limited to persons who have accounts with Euroclear or Clearstream, Luxembourg, or persons who hold interests through Euroclear or Clearstream, Luxembourg, and any sale or transfer of such interests to U.S. persons shall not be permitted during such period unless such resale or transfer is made pursuant to Rule 144A as provided below.

No beneficial interest in an Unrestricted Global Certificate may be transferred to a person who takes delivery in the form of a beneficial interest in a Restricted Global Certificate unless (i) the transfer is to a person that is a QIB, (ii) such transfer is made in reliance on Rule 144A, and (iii) the transferor provides the Registrar with a written certification substantially in the form set out in the Agency Agreement to the effect that the transferor reasonably believes that the transferee is a QIB, that the transfer is being made in a transaction meeting the requirements of Rule 144A and that such transaction is in accordance with any applicable securities laws of any state of the United States or any other jurisdiction. No beneficial interest in the Restricted Global Certificate may be transferred to a person who takes delivery in the form of a beneficial interest in an Unrestricted Global Certificate unless the transfer is to a non-U.S. person in an offshore transaction in reliance on Regulation S and the transferor provides the Registrar with a written certification substantially in the form set out in the Agency Agreement to the effect that the transfer is being made to a person who is a non-U.S. person in accordance with Regulation S.

Any beneficial interest in an Unrestricted Global Certificate that is transferred to a person who takes delivery in the form of an interest in a Restricted Global Certificate will, upon transfer, cease to be an interest in such Unrestricted Global Certificate and become an interest in the Restricted Global Certificate, and, accordingly, will thereafter be subject to all transfer restrictions and other procedures applicable to beneficial interests in a Restricted Global Certificate for as long as it remains such an interest. Any beneficial interest in a Restricted Global Certificate that is transferred to a person who takes delivery in the form of an interest in an Unrestricted Global Certificate will, upon transfer, cease to be an interest in each Restricted Global Certificate and become an interest in the Unrestricted Global Certificate and, accordingly, will thereafter be subject to all transfer restrictions and other procedures applicable to beneficial interests in an Unrestricted Global Certificate for so long as it remains such an interest. No service charge will be made for any registration of transfer or exchange of Notes, but the Republic may require payment of a sum sufficient to cover any tax or other governmental charge payable in connection therewith.

Except in the limited circumstances described below, owners of beneficial interests in the Global Certificates will not be entitled to receive physical delivery of Notes.

2. ACCOUNTHOLDERS

For so long as any of the Notes are represented by the Global Certificates, each person (other than another clearing system) who is for the time being shown in the records of DTC or Euroclear or Clearstream, Luxembourg (as the case may be) as the holder of a particular aggregate principal amount of such Notes (each an "**Accountholder**") (in which regard any certificate or other document issued by DTC or Euroclear or Clearstream, Luxembourg (as the case may be) as to the aggregate principal amount of such Notes standing to the account of any person shall be conclusive and binding for all purposes) shall be treated as the holder of such aggregate principal amount of such Notes (and the expression "Noteholders" and references to "holding of Notes" and to "holder of Notes" shall be construed accordingly) for all purposes other than with respect to payments on such Notes, the right to which shall be vested, as against the Republic, solely in the nominee for the relevant clearing system (the "**Relevant Nominee**") in accordance with and subject to the terms of the Global Certificates. Each Accountholder must look solely to DTC or Euroclear or Clearstream, Luxembourg, as the case may be, for its share of each payment made to the Relevant Nominee.

3. CANCELLATION

Cancellation of any Note following its redemption or purchase by the Republic will be effected by reduction in the aggregate principal amount of the Notes in the Register and by the annotation of the appropriate schedule to the relevant Global Certificate.

4. PAYMENTS

Payments of principal and interest in respect of Notes represented by a Global Certificate will be made upon presentation or, if no further payment falls to be made in respect of the Notes, against presentation and surrender of such Global Certificate to or to the order of the Fiscal Agent or such other Agent as shall have been notified to the holders of the Global Certificates for such purpose.

Distributions of amounts with respect to book-entry interests in the Unrestricted Global Certificates held through Euroclear or Clearstream, Luxembourg will be credited, to the extent received by the Fiscal Agent, to the cash accounts of Euroclear or Clearstream, Luxembourg participants in accordance with the relevant system's rules and procedures.

Holders of book-entry interests in the Restricted Global Certificates holding through DTC will receive, to the extent received by the Fiscal Agent, all distribution of amounts with respect to book-entry interests in such Notes from the Fiscal Agent through DTC. Distributions in the United States will be subject to relevant U.S. tax laws and regulations.

A record of each payment made will be endorsed on the appropriate schedule to the relevant Global Certificate by or on behalf of the Fiscal Agent and shall be *prima facie* evidence that payment has been made.

5. NOTICES

So long as the Notes are represented by a Global Certificate and such Global Certificate is held on behalf of a clearing system, notices to Noteholders may be given by delivery of the relevant notice to that clearing system for communication by it to entitled Accountholders in substitution for notification as required by Condition 12 (*Notices*) except that, so long as the Notes are listed on the Luxembourg Stock Exchange and the rules of that Exchange so require, notices shall also be published in a daily newspaper having general circulation in Luxembourg (which is expected to be the *Luxemburger Wort*. Any such notice shall be deemed to have been given to the Noteholders on the second day after the day on which such notice is delivered to Euroclear and/or Clearstream, Luxembourg (as the case may be) as aforesaid.

Whilst any of the Notes held by a Noteholder are represented by a Global Certificate, notices to be given by such Noteholder may be given by such Noteholder (where applicable) through Euroclear and/or Clearstream, Luxembourg and otherwise in such manner as the Fiscal Agent and Euroclear and Clearstream, Luxembourg may approve for this purpose.

6. REGISTRATION OF TITLE

The Registrar will not register title to the Notes in a name other than that of the Relevant Nominee for a period of 15 calendar days preceding the due date for any payment of principal, or interest in respect of the Notes.

7. EXCHANGE FOR CERTIFICATES

Exchange

Each Restricted Global Certificate will be exchangeable, free of charge to the holder, in whole but not in part, for Restricted Certificates and each Unrestricted Global Certificate will be exchangeable, free of charge to the holder, in whole but not in part, for Unrestricted Certificates (together with the Restricted Certificates, the "**Certificates**") upon the occurrence of an Exchange Event.

For these purposes an **Exchange Event** means that:

(a) circumstances described in Condition 10 (*Events of Default*) have occurred;

(b) in the case of an Unrestricted Global Certificate only, if Euroclear and/or Clearstream, Luxembourg is closed for business for a continuous period of 14 days (other than by reason of holiday, statutory or otherwise) or announces that it is permanently to cease business or does in fact do so and no successor or alternative clearing system is available; or

(c) in the case of a Restricted Global Certificate only, if DTC notifies the Issuer that it is no longer willing or able to discharge properly its responsibilities as depositary with respect to the relevant Global Certificate or DTC ceases to be a "clearing agency" registered under the U.S. Securities Exchange Act of 1934, as amended (the "**Exchange Act**") or is at any time no longer eligible to act as such and no qualified successor clearing system has been identified within 90 days of receipt of such notice from DTC,

provided that, in the case of any exchange pursuant to (b) or (c) above, the holder has given the Registrar not less than 30 days' notice at its specified office of such holder's intention to effect such exchange.

In exchange for the relevant Global Certificate, as provided in the Agency Agreement, the Registrar will deliver or procure the delivery of an equal aggregate principal amount of duly executed Certificates in or substantially in the form set out in the Agency Agreement.

Delivery

In such circumstances, the relevant Global Certificate shall be exchanged in full for Certificates and the Republic will, at the cost of the Republic (but against such indemnity as the Registrar or Transfer Agent may require in respect of any tax or other duty of whatever nature which may be levied or imposed in connection with such exchange), cause sufficient Certificates to be executed and delivered to the Registrar for completion and dispatch to the relevant Noteholders. A person having an interest in a Global Certificate must provide the Registrar with (a) a written order containing instructions and such other information as the Republic and the Registrar may require to complete, execute and deliver such Certificates and (b) in the case of the Restricted Global Certificate only, a fully completed, signed certification substantially to the effect that the exchanging holder is not transferring its interest at the time of such exchange or, in the case of simultaneous sale pursuant to Rule 144A, a certification that the transfer is being made in compliance with the provisions of Rule 144A to a purchaser that the transferor reasonably believes to be a QIB. Certificates issued in exchange for a beneficial interest in the Restricted Global Certificate shall bear the legend applicable to transfers pursuant to Rule 144A, as set out under "*Subscription and Sale*".

Legends and transfers

The holder of a Certificate may transfer the Notes represented thereby in whole or in part in the applicable denomination by surrendering it at the specified office of any Transfer Agent, together with the completed form of transfer thereon. Upon the transfer, exchange or replacement of a Certificate bearing the legend referred to under "*Subscription and Sale*", or upon specific request for removal of the legend on a Certificate, the Republic will deliver only Certificates that bear such legend, or will refuse to remove such legend, as the case may be, unless there is delivered to the Republic and the Registrar such satisfactory evidence, which may include an opinion of counsel, as may reasonably be required by the Republic that neither the legend nor the restrictions on transfer set out therein are required to ensure compliance with the provisions of the Securities Act. Restricted Certificates will bear the same legend as the legend for the Restricted Global Certificates set out under "*Subscription and Sale*". The Restricted Certificates may not at any time be held by or on behalf of U.S. persons that are not QIBs. Before any Unrestricted Certificate may be offered, resold, pledged or otherwise transferred to a person who takes delivery in the form of a Restricted Certificate, the transferor and/or transferee, as applicable, will be required to provide the Registrar with a written certification substantially in the form set out in the Agency Agreement to the effect that the transferor reasonably believes that the transfer is (i) to a person that is a QIB and (ii) such transfer is made in reliance on Rule 144A. Unrestricted Certificates will bear the same legend as the legend for the Unrestricted Global Certificates set out under "*Subscription and Sale*". Before any Restricted Certificates may be offered, resold, pledged or otherwise transferred to a person who takes delivery in the form of an Unrestricted Certificate, the transferor and/or transferee, as applicable, will be required to provide the relevant Registrar with a written certification substantially in the form set out in the Agency Agreement to the effect that the transfer is being made to a person who is a non-U.S. person in accordance with Regulation S.

USE OF PROCEEDS

The net proceeds of the issue of the Notes, amounting to approximately U.S.$1,235,650,000, will be applied by the Republic for general budgetary governmental purposes.

OVERVIEW OF THE REPUBLIC OF CROATIA

Territory and Population

The Republic occupies a total area of 56,538 square kilometres. The capital city, Zagreb, is located in the north of the country. The Dinaric Alps, which rise to 1,831 metres above sea level, run the length of the country. Croatia borders Slovenia to the north, Montenegro to the east and shares a sea border with Italy to the west and south. The Danube forms the eastern border with Serbia while the other two large rivers, the Sava and Drava, form the southern and northern borders with Bosnia Herzegovina and Hungary, respectively. The area of land between the rivers is dissected by many smaller tributaries. The Adriatic coastline is the most prominent feature of Croatia, running the entire length of the western border, from the Istrian peninsula in the north to Dubrovnik in the South with approximately 1,185 islands along the coast.

According to the CBS census, as at 31 March 2001, the total population of the five largest Croatian towns was as follows: Zagreb is the largest city in the country, with a population of 779,145, and is considered a leading industrial, cultural and scientific centre in Croatia. Other cities of significant size are Split (population 188,694), Rijeka (population 144,043), Osijek (population 114,616) and Zadar (population 72,718). According to the 2001 census, the total population of the country was 4,437,460.

The telephone number of the Ministry of Finance of Croatia is +385 1 45 91 333.

The following table sets forth the age distribution of Croatia's population at the end of the periods indicated:

	Year ended 31 December					
	2005		2006		2007	
Age	People	Per cent. of total	People	Per cent. of total	People	Per cent. of total
	(thousands)		*(thousands)*		*(thousands)*	
Youth (0-14)	703.1	15.8	692.9	15.6	687.0	15.5
Working age (15-64)	2,986.2	67.2	2,989.7	67.3	2,984.5	67.3
Pensioners (65 and over)	752.8	16.9	758.6	17.0	764.9	17.2
Total	**4,442.8**	**100.0**	**4,441.2**	**100.0**	**4,436.4**	**100.0**

Source: Croatian Central Bureau of Statistics

The table above shows a trend towards a higher proportion of pensioners within the overall population relative to those of working age and youth.

The following table sets out a breakdown of population by religious group in 2001:

	Population	Per cent. of total
	(thousands)	
Roman Catholics(1)	3,903,854	88.0
Orthodox Christians(2)	236,793	5.3
Muslims(3)	56,777	1.3
Other	240,036	5.4
Total	**4,437,460**	**100.0**

Source: Croatian Central Bureau of Statistics

(1) Includes members of the Roman Catholic Church, the Greek Catholic Church and the Old Catholic Church.

(2) Aggregated members of Orthodox Christian Churches.

(3) Includes members of all other religions and non believers

As of 31 December 2009, Croatia was divided among 21 countries including the City of Zagreb which is a separate county, 127 towns/cities and 429 municipalities in Croatia.

History

In October 1918, following the defeat of the Austrio-Hungarian Empire in World War I, a Croatian National Council took power in Zagreb and called for union with the other South Slavic parts of the Austrio-Hungarian Empire. Dalmatia, a separate Habsburg crown land since 1815, also recognised the authority of the Croatian National

Council. In December 1918, the Kingdom of the Serbs, Croats and Slovenes was proclaimed in Belgrade and in 1929, the name of the country was changed to the Kingdom of Yugoslavia.

Following World War II, Communist-led forces proclaimed a new Yugoslavia. A federal state of six republics was set up, substantially restoring the old borders of Bosnia and Croatia, but splitting Macedonia off from Serbia and setting up two autonomous regions within Serbia. All power was given to the non-ethnic Communist party led by General Tito. In 1948, the former Yugoslavia broke off relations with the former Soviet Union ("**USSR**") and initiated a certain amount of economic liberalisation.

The late 1980s brought dramatic changes in international politics. Reforms in Eastern Europe, which culminated in the disintegration of the USSR and the Warsaw Pact, and the end of the cold war, caused a transformation of the Eastern Bloc. This also had a profound effect on the former Yugoslavia where reformers began to reject the existing federal concepts and embrace democratic ideas.

The first free elections in Croatia since World War II took place in April and May 1990 and resulted in a clear victory for the Croatian Democratic Union Party which gained 205 of the 350 seats in Hrvatski Sabor, the Croatian Parliament (the "**Parliament**"). However the growing nationalism in Serbia at this time caused concern amongst ethnic Serbs living in Croatia.

The disintegrating Yugoslav federal government made it clear that changes would have to be made to Yugoslavia's constitution. In May 1991, 83.56 per cent. of the Croatian electorate turned out for a referendum on independence. Over 94 per cent. of the votes were in favour of independence, and Croatia's declaration of independence on 25 June 1991 coincided with Slovenia's decision to do the same.

However, in May 1991, fighting between rebel Croatian Serb forces and Croatian police units broke out in the area bordering Bosnia-Herzegovina (around Knin), in Baranja (north of Osijek) and Slavonia (the region west of the Danube River). The Yugoslav National Army (the "**YNA**") intervened in support of the rebel Croatian Serbs. During the summer and early autumn of 1991 (the "**1991 War**"), rebel Croatian Serb forces and the YNA took control of more than one quarter of Croatia's territory.

Rebel Croatian Serbs proclaimed the independence of the occupied territories on 19 December 1991, although they never gained international recognition. Despite this, Croatia declared itself an independent sovereign state but was not immediately recognised by other countries. After the introduction of a law on Human Rights and Minorities by the Parliament, Croatia was recognised by the EU on 15 January 1992, followed by the United States on 7 April 1992.

In May 1995, Croatian forces re-established control over the entire region of Western Slavonia. On 4 August 1995, the Croatian army sought to re-establish control over the rebel Croatian Serb held areas bordering Bosnia Herzegovina and the majority of the Serb population left the area for the Former Republic of Yugoslavia ("**FRY**") and Bosnia-Herzegovina, although some have now returned.

In November 1995, an agreement was reached to return the area of Eastern Slavonia to Croatian rule by peaceful reintegration overseen by the international community, which was completed by 1998.

International Relations

After gaining independence, Croatia was admitted to the UN in May 1992. In the same year, Croatia became a participant country in the OSCE and became a member of the IMF. In 1996, Croatia became the 40th Member State of the Council of Europe. See "*The Economy*" for a discussion of the economic programs and reforms between 1995 and 2000. Since 2000, following the reform programmes of subsequent governments, various integration processes with international organisations became a higher priority. In October 2000, Croatia became a member of the WTO, while in 2002 it acceded to the Central European Free Trade Area. Croatia is also a member of the International Development Association, the International Finance Corporation, the EBRD, the International Labour Organisation, the Bank for International Settlements and the Inter-American Development Bank. Croatia has been active in regional cooperation in Central and South East Europe through its membership in the Central European Initiative, the South-East European Cooperation Process and the Regional Cooperation Council. Furthermore, Croatia was elected as a non-permanent member of the UN Security Council for the period 2008-2009, holding the Council's Presidency in December 2008. Croatia became a candidate country for EU accession in June 2004 and in 2010 the negotiation process entered the final phase, as discussed below. In April 2009, Croatia acceded to NATO.

The IMF has taken the lead in assisting Croatia in maintaining macroeconomic stability since 1994. See "*The Economy — Stabilisation of the Economy*". On 29 March 2006, the Executive Board of the IMF completed its second review under the Stand By Arrangement for Croatia, which was approved by the IMF on 4 August 2004. A

Stand By Arrangement is an IMF credit facility providing assurance to a member country that it can draw up sums up to a specified amount, usually over a period of 12 to 18 months, to help with short-term balance of payments. In completing the review, the Executive Board also granted an extension of the arrangement until 15 November 2006 as well as an augmentation of access to an amount equivalent to 99 million Special Drawing Rights ("**SDR**") (approximately U.S.$146.3 million). In November 2006, the Executive Board of the IMF successfully completed its third review under the Stand By Arrangement for Croatia. The expiry of the mentioned Stand By Arrangement and the decision not to conclude another Stand By Arrangement opened a new phase of relations between Croatia and the IMF wherein Croatia has the opportunity to demonstrate its ability to implement the adopted economic policy, particularly concerning fiscal discipline and the remaining structural reforms. Since 2007, the IMF has conducted routine annual missions to Croatia, as part of the ongoing process of cooperation.

Together with the IMF, the International Bank for Reconstruction and Development (the "**IBRD**" or "**World Bank**") also maintains a close collaborative relationship with Croatia in supporting its reforms. The IBRD has taken the lead in policy dialogue on structural and institutional reforms in a number of sectors. This reform agenda includes measures to: (i) reduce the level of public expenditure and the size of the Government administration; (ii) restructure the pension and health sectors; (iii) enhance labour market flexibility; (iv) strengthen market institutions and the competitiveness of the economy; (v) mitigate the social cost of reforms and poverty through restructuring of social welfare programs; and (vi) continue the process of judicial reform.

European Union Accession

In October 2001, after having accepted the EU guidelines for negotiating and concluding the Stabilisation and Association Agreement ("**SAA**") between Croatia and the EU Member States, Croatia started accession negotiations with the EU. The SAA was initialled on 14 May 2001 and signed at the Meeting of the Council of Ministers in Luxembourg on 29 October 2001. On the basis of the SAA, Croatia became a candidate for accession to the EU. The SAA was ratified in the Croatian Parliament on 5 December 2001, in the European Parliament on 12 December 2001 and in the EU member countries at the end of October 2004. The SAA came into force on 1 February 2005.

On 21 February 2003, Croatia submitted its application for EU membership. On 10 July 2003, the EC submitted to Croatia the EU accession application questionnaire regarding the political, economic and administrative situation in Croatia and Croatia sent its answers on 9 October 2003. Croatia signed an additional Protocol 7 of the SAA with the EC, regulating the trade with the EU that was temporarily in effect from 1 May 2004, and came into force on 1 February 2005. The EC gave a positive opinion (*avis*) on the application of Croatia for full membership to the EU on 20 April 2004.

On 18 June 2004, the European Council decided to promote Croatia as an official candidate for EU membership. In accordance with the candidate status for EU membership, Croatia had to prepare the Pre-Accession Economic Programme (the "**PEP**") for the period 2005-2007, which was adopted by the Government on 30 November 2004. This was the first economic document on the basis of which the EC assessed the implementation of reforms in Croatia. The PEP is a strategic document for EU membership candidate countries regulating the economic policy and structural reforms that are necessary for their successful accession to the EU. The PEP is prepared and submitted to the EC on an annual basis during the period prior to accession to the EU.

The Government adopted the 2006-2008 PEP on 8 December 2005 in accordance with the proclaimed goal of EU accession, representing the framework for all activities related to negotiations with the EU member countries. In January 2009, the Government adopted the PEP for the period 2009-2011. The 2009-2011 PEP reflects economic policy aimed at stimulating long-term sustainable growth and supporting macroeconomic stability, with a focus on raising Croatia's competitiveness and increasing living standards in Croatia. The dialogue with the EC on the issues covered by the PEP continues after PEP submission in the form of technical expert meetings and high-level discussions that enable assessment of the programme. In 2009, given the changed macroeconomic conditions, revised macroeconomic and fiscal projections for the 2009-2011 period were presented to the EC. In January 2010, the Government adopted the 2010-2012 PEP.

In October 2005, the EU Council of Ministers opened the accession negotiations of Croatia with the EU. In total, 35 chapters of the *acquis communautaire* will be negotiated. Once a chapter has been screened and if no significant problems have been identified, a candidate may open such a chapter for negotiations. In certain cases, a candidate initiates certain reforms aimed at preparing a chapter for negotiations. The screening exercise for Croatia was successfully completed in October 2006. Slovenia imposed a veto on Croatia's EU accession negotiations in December 2008 due to a bilateral border issue between Croatia and Slovenia, however, in September 2009, Slovenia lifted its veto and the two countries have agreed to settle the border dispute before the international judicial body on the basis of international law. Due in part to the delay in negotiations as a result of the Slovenian veto, it is currently expected that Croatia will conclude the accession negotiations by the end of 2010. In accordance with Article 141 of the Constitution, a national referendum on the EU accession must be held in Croatia. As previously noted, the Constitution has been substantially amended in June 2010, *inter alia*, in connection with the EU accession. The bill relating to the amendment to the Constitution has been promulgated by the Parliament on 16 June 2010. The key amendments include, *inter alia*, (1) the elimination of the quorum requirement in Articles 86 and 141 of the Constitution, which currently provide that at a referendum the decision is made by the majority of the voters who have participated in the referendum, and (2) the addition of provisions relating to the European Union (membership and transfer of certain constitutional authorisations, participation in the EU institutions, EU law, etc.), the majority of which will come into force on the day of accession of Croatia to the European Union.

The meeting of Inter-Governmental Conference on the Croatian EU accession held in Brussels on 19 April 2010, saw the temporary closure of negotiations in Chapter 1 — Free Movement of Good. Currently, out of 35 chapters in total, 33 chapters have been formally opened (of which, 20 chapters have been provisionally closed and 13 remain open) and 2 chapters are yet to be opened. The following table summarises the current status of the chapters of the *acquis communautaire*.

Chapter	Status
Company Law	Provisionally Closed
Customs Union	Provisionally Closed
Economic and Monetary Policy	Provisionally Closed
Education and Culture	Provisionally Closed
Enterprise and Industrial Policy	Provisionally Closed
External Relations	Provisionally Closed
Freedom of Movement for Workers	Provisionally Closed
Information Society and Media	Provisionally Closed
Intellectual Property Law	Provisionally Closed
Science and Research	Provisionally Closed
Statistics	Provisionally Closed
Trans-European Networks	Provisionally Closed
Agriculture and Rural Development	Opened
Consumer and Health Protection	Provisionally Closed
Energy	Provisionally Closed
Financial and Budgetary Provisions	Opened
Financial Control	Opened
Financial Services	Provisionally Closed
Food Safety, Veterinary and Phytosanitary Policy	Opened
Free Movement of Capital	Opened
Free Movement of Goods	Provisionally Closed
Justice, Freedom and Security	Opened
Public Procurement	Provisionally Closed
Regional Policy and Coordination of Structural Instruments	Opened
Right of Establishment & Freedom to Provide Services	Provisionally Closed
Social Policy and Employment	Provisionally Closed
Taxation	Provisionally Closed
Transport Policy	Opened
Competition Policy	Opened
Environment	Opened
Fisheries	Opened
Foreign, Security and Defence Policy	Opened
Judiciary and Fundamental Rights	Opened
Institutions	Not opened
Other Issues[1]	Not opened

Source: Ministry of Finance

(1) The chapter on "Other Issues" includes miscellaneous issues which arise during the negotiations but which are not covered under any other negotiating chapter. No such issues have been identified as yet. The chapter on "Other Issues" is addressed at the end of the negotiation process.

Key Challenges to EU Accession

1. Judiciary and Fundamental Rights

A number of changes, some of which are ongoing, are needed in respect of the Judiciary and Fundamental Rights chapter. For a discussion of the ongoing judicial reform, see "*— Constitution and Government Structure — The Judicial System*" below.

2. Competition Policy

Another potentially challenging item is Croatia's comparative economic competitiveness. A long period of nominal exchange rate stability coupled with the recent strong depreciation of several competitor country currencies as well as large trade deficits raise concerns about the adequacy of Croatia's competitiveness compared to neighbouring countries. In addition, the export sector has benefited little from the strong capital inflows (including FDI) experienced in recent years and has been affected by relatively high unit labour costs. Unlike in neighbouring countries, the share of Croatia's export sector in GDP remained constant over the past decade. Croatia's share in world and EU imports has also stagnated. As a result, growing imports responding to a household consumption and foreign direct investment boom gave rise to large trade and current account deficits. In order to improve Croatia's economic competitiveness, the key challenge ahead is to improve tradable sector performance, in particular by increasing exports.

In addition, certain reforms, primarily relating to the Government's subsidies, in particular subsidies to the shipbuilding industry, are needed in connection with the Competition Policy chapter. The subsidies of the shipbuilding industry have been largely decreasing since 2006. See "*The Economy — Government's Subsidies*". The Government subsidises the shipbuilding industry by making payments to shipyards equal to approximately 6 per cent. of the value of each contract entered into by shipyards. In 2009, subsidies in real prices to the shipbuilding industry amounted to HRK 311.4 million. The budgeted amount of subsidies in real prices to the shipbuilding industry for 2010 is HRK 106.0 million. In addition, all Government financial guarantees relating to the shipbuilding industry are treated as subsidies, the values of which are measured as the achieved savings in the borrowing costs. If a guarantee covers not more than 80 per cent. of the underlying borrowing, the provision of such guarantee is not treated as non-competitive behaviour according to the applicable EU standards. For a description of the ongoing efforts to privatise the shipbuilding industry, see "*The Economy — Privatisation Programme*" below.

Constitution and Government Structure

The Constitution was adopted on 22 December 1990 and was substantially amended in December 1997, November 2000, April 2001 and June 2010. It established a multi-party democracy, with an economy based on market principles and private ownership. Under the Constitution, the President is elected for five-year terms and may not serve more than two terms. The President appoints, with the consent of the President of the Parliament, a Prime Minister who, in turn, appoints Government Ministers. Dr. Ivo Sanader was appointed Prime Minister following elections in 2003 and was reappointed following elections in November 2007. In July 2009, Dr. Ivo Sanader voluntarily resigned and Ms. Jadranka Kosor, the Vice Prime Minister at the time, was appointed as the Prime Minister. The Constitution is based on the separation of powers between the legislature, executive and judiciary.

Legislature

Croatia has a single chamber Parliament, which consists of 153 elected members who are elected by national general elections for a four-year term. The Parliament has the power to pass laws, amend the Constitution, adopt the State budget, declare war or peace, pass resolutions, adopt national security and defence strategy, realise civil control over the armed forces and the security services, decide on alterations of the Croatian borders, call referenda, carry out elections, as well as exercise certain supervisory powers over the Government. Laws are passed by majority vote provided that a majority of members are present, except that laws which deal with certain constitutional rights can only be passed by (in certain cases) a two thirds majority of all members or (in other cases) a majority of all members. The President promulgates laws validly enacted by the Parliament. If, in the President's view, the law does not conform to the Constitution, he may initiate proceedings to review the constitutionality of the law before the Constitutional Court.

The State Budget is passed by the Parliament by which State revenues and receipts are estimated and State expenditures and expenses for one year are established in accordance with law.

During a state of war, the President may issue decrees on the grounds and within the authority received from the Parliament. If the Parliament is not in session, the President may issue decrees required in connection with the war, which must be submitted for approval to the Parliament as soon as the Parliament is in a position to convene. In case of an immediate threat to the independence, unity and existence of the Republic, or if the governmental bodies are prevented from performing their institutional duties, the President has the power, at the proposal of the Prime Minister and with her counter signature, to issue such decrees. If the President does not submit a decree to the Parliament for approval or if the Parliament does not approve it, the decree ceases to be in force.

International agreements ratified in accordance with the Constitution and published in the National Gazette are part of the internal legal order of the Republic and are subordinate only to the provisions of the Constitution. Their provisions may be changed or repealed only as specified in such agreements, or in accordance with the general principles of international law.

Pursuant to the Constitution, the Parliament may call a referendum on a proposal for the amendment of the Constitution, on a law, or any other issue within its competence. The President of the Republic may, at the proposal of the Government and with the counter-signature of the Prime Minister, call a referendum on a proposal for the amendment of the Constitution or any other issue which he considers to be important for the independence, unity and existence of the Republic. The Parliament shall call a referendum upon the issues mentioned above when so demanded by ten per cent. of all voters in the Republic. At such a referendum, the decision shall be made by the majority of the voters who have taken part in the referendum. Decisions made at referenda are binding and a law thereon shall be passed.

The Executive

The President is elected by the popular vote of Croatian citizens. The President gives the mandate to the Prime Minister to appoint the Government based on the number of seats in Parliament held by each political party and consultation with each relevant political party, and provided that the Prime Minister has the confidence of the majority of all members of the Parliament. The President is the Commander in Chief of the armed forces. The President may dissolve Parliament if: (a) the President receives a proposal from the Government (countersigned by the Prime Minister) and, after consultation with the leaders of each of the political parties which comprise the Parliament, the Parliament adopts a vote of no confidence; or (b) Parliament does not adopt the State budget within 120 days from the date when the State budget was presented as a bill. Elections for members of the Parliament must be held not later than 60 days after the expiry of the mandate or dissolution of the Parliament.

The following table sets forth the current members of the Government.

Name	Title
Jadranka Kosor	Prime Minister
Božidar Pankretić	Vice Prime Minister and Minister of Regional Development, Forestry and Water Management
Duro Popijač	Minister of Economy, Labour and Entrepreneurship
Đurđa Adlešič	Vice Prime Minister
Slobodan Uzelac	Vice Prime Minister
Božidar Kalmeta	Minister of the Sea, Transport and Infrastructure
Božo Biškupić	Minister of Culture
Branko Vukelić	Minister of Defence
Damir Bajs	Minister of Tourism
Darko Milinović	Vice Prime Minister and Minister of Health and Social Welfare
Davorin Mlakar	Minister of Public Administration
Gordan Jandroković	Minister of Foreign Affairs and European Integration
Dražen Bošnjaković	Minister of Justice
Ivan Šuker	Vice Prime Minister and Minister of Finance
Marina Matulović Dropulić	Minister of Environmental Protection, Physical Planning and Construction
Petar Čobanković	Minister of Agriculture, Fisheries and Rural Development
Radovan Fuchs	Minister of Science, Education and Sports
Tomislav Ivić	Minister of the Family, Veterans' Affairs and Intergenerational Solidarity
Tomislav Karamarko	Minister of Interior
Jagoda Premužić	Secretary of the Government

The Judicial System

Croatia's three-tier judicial system is independent. On the first level are the municipal courts, followed by the county courts, and finally by the Croatian Supreme Court (the "**Supreme Court**") which is the highest court in Croatia. The Supreme Court hears appeals of decisions of first instance county courts, the High Commercial Court of Croatia, the Administrative Court of Croatia, and any other court when prescribed by the law. The Supreme Court has the authority to decide on the conflict of jurisdiction between the courts in Croatia. Other specialised courts exist to deal with commercial and administrative law matters. Judges are appointed by the High Judiciary Council of Croatia (the "**Council**"), comprising of 11 members, 7 of which are selected from amongst judges, 2 amongst university law professors and 2 amongst members of the Parliament (whereat one has to be a member of the opposition), and are elected for a four-year term by the Parliament and may not serve more than two subsequent terms. Judicial office is permanent. The Council, according to the Constitution and law, decides independently on appointment, promotion, transfer, dismissal and disciplinary responsibilities of the judges and court presidents, with the exception of the president of the Supreme Court.

The Constitutional Court of Croatia consists of 13 judges who are elected for a term of eight years by the Parliament (by two-thirds majority vote of all representatives) from among notable jurists, especially judges, public prosecutors, lawyers and university professors of law, in a way and within a procedure prescribed by the constitutional act. It has the authority to annul unconstitutional laws or regulations and to decide on jurisdictional questions among the legislature, executive and judiciary, and on the impeachability of the President. It has jurisdiction to protect the constitutional freedom and rights of citizens.

The screening of the Judiciary and Fundamental Rights Chapter of the *acquis communautaire* was held during September 2006 and October 2006. During this first phase of screening, the EC representatives held presentations on the *acquis communautaire* in the area of the judiciary, with special emphasis on the independence, efficiency and reform of the judiciary, as well as presentations in the field of human rights. The bilateral phase of screening was held on 17 and 18 October 2006 when Croatian representatives presented to the EC the legislation and level of alignment accomplished in this chapter. The Committee welcomed certain progress in implementation of the judiciary and public administration reforms, and on the Government's anti-corruption programme, however, it also noted that there is considerable scope for further improvement on these issues.

Judicial Reform

In 2008, the Government commenced the Judicial Reform in order to combat corruption and restore confidence in the judicial system. The Ministry of Justice is undertaking measures aimed at establishing a more efficient judicial system founded upon principles of independence and professionalism. The objectives of the Judicial Reform include strengthening the rule of law, improving the efficiency and effectiveness of the judicial system, shortening the period of time between the commencement and conclusion of training, and improving professionalism and ongoing training of the staff.

To facilitate the implementation of the Judicial Reform, the Government adopted on 25 June 2008 a revised Action Plan (the "**Action Plan**") which is an integral part of the Judicial Reform strategy. The Action Plan comprises more than 170 specific measures describing the efforts to be made in order to lay the foundation for an independent, impartial, professional and efficient judicial system.

Within the Judicial Reform, particular attention is paid to the independence of the judicial system. The Act on the Amendments to the Courts Act adopted in September 2008 added several new features to the process of appointing judges in order to ensure objective, transparent and uniform work of judicial councils. On 21 May 2009, the Judicial Council Standing Orders (the "**Standing Orders**") were passed, which provide for the manner in which judicial councils operate, convene meetings, evaluate judges' performance, make opinions on candidates for judges, propose candidates for court presidents, and assess and determine complaints of infringement of the Code of Judges' Ethics. The Standing Orders are designed to establish objective and transparent criteria for decision-making in connection with evaluating judges' performance. In December 2009, the new amendments to the Courts Act have been adopted, dealing with, *inter alia,* additional criteria for evaluation of the judges, conditions for appointment of judges, etc.

The Judicial Trainees and Bar Examination Act, passed in July 2008 (and amended in July 2009), prescribes terms and conditions for traineeships to courts, State Attorney's offices and professional programmes, and professional practice for attorney and notary public trainees and lawyers.

The Judicial Academy Act has been promulgated on 17 December 2009 and has entered into force on 1 January 2010. It is designed to introduce uniform, objective and transparent criteria for admission to a judicial or State attorney's position via the selection of students at the National School for the Judiciary. The goal of the National School is to provide the candidates with knowledge and skills required for autonomous, accountable, independent and impartial performance of the chairperson's role.

Reduction of the backlog of court cases is another important objective of the Judicial Reform. Current efforts focus on more expedited resolution of cases that are more than three years old. The Supreme Court monitors the progress of resolution of such cases by the municipal and county courts. The Supreme Court also prepared an action plan aimed at resolving such cases. At the beginning of the Justice Reform 1.8 million cases remained unresolved, whereas as of late 2009, despite the fact that approximately 1.7 million new cases are filed annually, approximately 890,000 cases in total were pending at all court levels.

In addition, a new enforcement system is intended to improve the judgment enforcement process by making the process more simplified and professional, to be accomplished in part by empowering enforcement officers. The draft Enforcement Act is intended to reduce the reasons for launching legal remedies in order to obtain enforcement, the circumstances under which enforcement can be postponed or challenged by third parties, narrow the pool of movable assets excluded from enforcement and provide rules governing the disclosure by competent institutions of information on assets of persons subject to enforcement. The draft Public Enforcement Officers Act is intended to establish a Public Enforcement Officers' Chamber, which will contain a Public Enforcement Officers Register and regulate the remuneration of public enforcement officers.

Anti-Corruption and Organised Crime

For the purpose of combating corruption and organised crime, three enforcement bodies have been established (together the "**USKOK System**"):

- The Office for the Suppression of Corruption and Organised Crime — USKOK ("**USKOK**")
- The National Police of the Corruption and Organised Crime Suppression Office — PN USKOK ("**PN USKOK**")
- Corruption and Organised Crime Cases Court Departments — the "USKOK Courts" (the "**USKOK Courts**")

USKOK Courts were established in Zagreb, Split, Rijeka and Osijek county and municipal courts in October 2008. Decisions of the USKOK Courts can be appealed to the Supreme Court. On 1 March 2009, the USKOK System began operation and the judges were appointed. From inception until 1 September 2009, 864 persons were reported to USKOK for corruption related offences. Investigations were initiated against 364 persons during that period. A total of 231 persons were indicted, 53 of which for abusing a position of authority, 47 for receiving bribes, 84 for giving bribes, 43 for illegal intermediation, two for receiving bribery in business operations and two for giving bribes in business operations. The courts reached verdicts in 108 of these cases, of which 94 were convictions, 11 were acquittals and 3 cases were postponed or rejected for lack of evidence.

Past and ongoing corruption cases include investigations against the former Minister of the Interior, officials and private individuals involved in the privatisation process, and cases relating to the shipbuilding industry and university administration fraud.

In June 2010, the anti-corruption office USKOK indicted the former Deputy Prime Minister Damir Polancec for abuse of office and powers. Under the indictment filed with the Zagreb County Court, Polancec was accused of abusing the office and powers between July and October 2008 to help certain attorney obtain an illegal gain, arranging for the attorney to conduct a legal study amounting to HRK 500,000 despite knowing that the study was not needed. Polancec is also under investigation in connection with several transactions entered into by a major Croatian food group but no charges have been filed as of yet.

New legislation regulating public procurement was passed in 2007 and entered into force on 1 January 2008 (with the exception of certain provisions which will enter into force once Croatia joins the EU). Amendments to the Public Procurement Act, which entered into force on 1 January 2009, aligned the Act fully with the chapters of the EU *acquis communautaire*. The so-called "anti-corruption clause" was incorporated into the Act which seeks to prevent conflicts of interest in the area of public procurement. In November 2009, the Government adopted a Regulation on Office for Central Public Procurement (OG 138/09). The Concessions Act and the Public Private Partnership Act were adopted as well. The Public Procurement System Directorate of the Ministry of Economy, Labour and Entrepreneurship and the State Commission for Control of Public Procurement Procedures supervise the public procurement procedure to ensure that it is transparent and implemented consistently.

Recently Enacted Legislation

The Parliament passed the Anti-Money Laundering and Terrorist Financing Law (the "**AML/TFL**") on 15 July 2008. AML/TFL entered into force on 1 January 2009. AML/TFL is based on Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purposes of money laundering and terrorist financing and other relevant international standards. The AML/TFL contributed to the harmonization of the Croatian anti-money laundering and terrorist financing legislation with the international Anti-Money Laundering and Combating the Financing of Terrorism ("**AML/CFT**") standards. Currently, Croatia's AML/CFT measures are equivalent, in all material respects, to those in EU Member States.

In the financial sector, recently enacted legislation includes the Credit Institutions Act (OG 117/08, 74/09 and 153/09), the Act on Financial Collateral (OG 76/07), the Act on the Takeover of Joint Stock Companies (OG 109/07 and 36/09), the Act on the Croatian National Bank (OG 75/08), the Act on Amendments to the Insurance Act (OG 82/09), the Capital Market Act (OG 88/08, 146/08 and 74/09), the Act on Criminal Offences Against the Capital Market (OG 152/08), the Act on Electronic Money Institutions (OG 117/08 and 74/09), the Act on Settlement Finality in Payment and Financial Instruments Settlement Systems (OG 117/08), the Act on Amendments to the Deposit Insurance Act (OG 119/08 and 153/09), the Financial Conglomerates Act (OG 147/08), the Act on Amendments to the Act on Compulsory Insurance within the Transport Sector (OG 75/09), the Act on Amendments to the Credit Unions Act (OG 25/09), the Consumer Credit Act (OG 75/09), the Accounting Act (OG 109/07), the Act on Amendments to the Audit Act (OG 139/08), the Regulation on Amendments to the Foreign Exchange Act (OG 153/09) and the new Payment System Act (OG 133/09; which shall enter into force on 1 January 2011, with exception of certain provisions that shall enter into force on the day of accession of Croatia to the European Union).

The Political Parties

The major political parties that participated in parliamentary elections on 25 November 2007 were the Croatian Democratic Union ("**HDZ**"), Social Democratic Party ("**SDP**"), Croatian People's Party ("**HNS**") and Croatian Peasant Party ("**HSS**"). HDZ won the highest number of seats in the Parliament and Dr. Ivo Sanader was reappointed as Croatia's Prime Minister. In July 2009, Dr. Ivo Sanader voluntarily resigned and Ms. Jadranka Kosor, the Vice Prime Minister at the time, was appointed as the Prime Minister. The HDZ has adopted a strategy in favour of a pro-European, mainstream conservative orientation that is committed to democracy, the rule of law, human rights and minority rights. The Government has initiated a number of key reforms, including of the defence system, which is being reorganised in order to prepare the country for its future obligations as a member of the NATO alliance.

Presidential Elections

On 27 December 2009, a first round of presidential elections was held and President Ivo Josipović, of the SDP, won 32.42 per cent. of votes, which was not sufficient to win the elections outright. A second round of presidential elections was held on 10 January 2010 between first-round winner President Ivo Josipović and first-round runner-up Milan Bandić, and Mr. Josipović confirmed his leadership with a victory of 60.26 per cent. of votes, becoming the first elected president nominated by the SDP. According to the Constitution, presidential elections should be held not less than 30 and not more than 60 days before the expiry of the term of office of the incumbent President. It is therefore expected that the next presidential elections will be held in 2015.

Parliamentary Elections

The most recent elections of deputies for the Parliament were held on 25 November 2007. The next elections are scheduled to take place in November 2011. The following table sets out the current composition of the Parliament:

Party	Seats	Percentage
Croatian Democratic Union (HDZ)	66	43.13
Social Democratic Party of Croatia (SDP)	56	36.60
Croatian Peasant Party (HSS)(1)	6	3.92
Croatian People's Party (HNS)	5	3.27
Istrian Democratic Council (IDS)	3	1.96
Croatian Democratic Alliance of Slavonia and Baranja (HDSSB)	3	1.96
Independent Democratic Serbian Party (SDSS)	3	1.96
Croatian Social Liberal Party (HSLS)(1)	2	1.30
Croatian Party of Rights (HSP)	1	0.66
Croatian Party of Pensioners (HSU)	1	0.66
Croatian Democratic Action Party (SDA HR)	1	0.66
Independent Deputies	6	3.92
Total	**153**	**100.00**

Source: Internet Editorial Staff of the Croatian Parliament, 28 September 2009

(1) HSS and HSLS formed an 8-seat coalition.

In the November 2007 elections, HDZ secured additional support from the HSS-HSLS coalition, the HSU and representatives from the ethnic and national minority parties and representatives including SDSS and SDA HR.

The most recent elections for the local and regional self-governments took place on 17 May 2009. These were the first local elections where municipality, city and county mayors have been elected directly.

Croatia is divided into 21 counties containing 127 towns/cities and 429 municipalities. The Croatian Constitution reserves certain functions, including police services, education and other local services, for the county and local governments.

Co-Operation with the ICTY

The ICTY requested the warrant for the arrest and extradition of the former General of the Armed Forces of Croatia, Mr. Ante Gotovina. Contact by the responsible Croatian bodies and the State Chief Attorney of Croatia, who was in charge of the co-ordination of all activities, with the representatives of the ICTY Prosecution contributed to the locating and arrest of Mr. Gotovina on 7 December 2005 in the Canary Islands. On 10 December 2005, Mr. Gotovina was transferred to the ICTY, and he appeared before the ICTY panel of judges and gave his plea. The trial of Mr. Gotovina commenced in March 2008. Prosecution completed presenting its case in March 2009. The Defence presented its case between May 2009 and January 2010. Closing arguments are scheduled to begin in August 2010.

Domestic War Crime Trials

The process of making the Croatian judiciary capable of conducting war crime trials and taking over the cases from the ICTY includes the passing of amendments to existing legislation (Criminal Code), the passing of new acts (the Witness Protection Act, the Rome Statute Application Act), and the special training of Croatian judges and State attorneys. In April 2005 after monitoring such trials, a favourable report on the ability of the Croatian judiciary to prosecute war crimes was submitted by the OSCE. The decision of the ICTY dated 14 September 2005 to transfer the case against the retired Generals Ademi and Norac to the Croatian judiciary was in line with the above OSCE report. At the end of 2006, the Zagreb State Attorney filed an indictment with the Zagreb County Court against Messrs. Ademi and Norac. The submission of the indictment follows the September 2005 decision by the ICTY Referral Bench to transfer the ICTY indictment against Messrs. Ademi and Norac to Croatia.

In May 2008, Mr. Ademi was acquitted of all charges and Mr. Norac (who had been sentenced in 2003 to a 12-year prison sentence for war crimes committed against civilians in the Gospić area in 1991) was convicted on two counts of war crimes against civilians in Medacki dzep in 1993 and was sentenced to seven years in prison.

THE ECONOMY

Unless otherwise specifically noted, the statistical information presented in this section has been extracted, without material change, from reports published by, or information obtained from, the Central Bureau of Statistics, Croatian National Bank and the Ministry of Finance of Croatia.

Overview of Post Independence Developments

Following Croatia's declaration of independence on 25 June 1991, the Socialist Federal Republic of Yugoslavia expelled Croatia from the Yugoslav monetary system on 27 June 1991. The central bank of the former Yugoslavia retained all foreign exchange reserves, leaving Croatia with no hard currency reserves. The 1991 War also prevented Croatia from accessing external sources of financing. The 1991 War left approximately one third of the country's territory outside of Government control and significantly disrupted lines of communication, both within the country and with many of Croatia's international trading partners.

The hostilities also caused significant damage to the country's infrastructure, housing and industrial plants. The 1991 War displaced hundreds of thousands of people and substantially reduced tourism, which had previously accounted for a substantial part of Croatia's economy. It is expected that ongoing expenditures relating to the 1991 War, including reconstruction, veteran's pensions and costs associated with providing refuge to the significant number of refugees and displaced persons from the Balkan region will continue to range from 2.0 to 2.5 per cent. of GDP for the year. The Government expects these expenditures to decrease as a share of GDP in the long-term, as reconstruction of war damage reaches completion.

Croatia's industrial base was further disrupted by the loss of previous markets in the former Yugoslavia and the loss of trade routes to the South and the East through the former Yugoslavia. Between 1989 and 1993, Croatia's real economic output shrank significantly and disposable incomes fell sharply. The drop in economic activity, alongside growing expenses linked to the refugee crisis and other mounting pressures on public expenditure, led to an increased public deficit and resulted in high levels of inflation.

Stabilisation of the Economy

Background to the Stabilisation Programme

At the time of the breakout of the 1991 War, Croatia was still using the currency of the former Yugoslavia. External borrowing was virtually impossible as the country was not recognised internationally and war risks meant that commercial lenders were unwilling to extend credit. The deficit could only be financed by money creation, aggravating an already high inflation rate. Croatia introduced a new, temporary currency, the Croatian Dinar ("**HRD**"), in December 1991 and initially maintained a fixed exchange rate against the Deutsche Mark ("**DEM**"). At first, this helped to reduce inflation, but lack of public confidence in the HRD led to foreign currency substitution and inflation soon reignited. In addition, the CNB policy of increasing its foreign exchange reserves in the domestic market resulted in increased issuance of the domestic currency, further aggravating inflationary pressures. In 1994, the HRD was replaced by a new, permanent currency, the Croatian Kuna ("**HRK**").

The 1993 Stabilisation Programme

In October 1993, the Government adopted a stabilisation programme (the "**Stabilisation Programme**") with the short-term objective of eradicating hyperinflation and, in the longer term, transitioning into an effective market economy. The Stabilisation Programme had four general targets:

- stabilising and strengthening of the Croatian economy;
- introducing a competitive environment and appropriate ownership structure with a reduced role for the Government in the economy;
- protecting of low income population groups from the inflationary redistribution of income; and
- establishing preconditions for sustainable economic development and growth.

The implementation of the Stabilisation Programme by the Government, the CNB and the Ministries of Finance and of Economy, Labour and Entrepreneurship, among others, broke the inflationary cycle. The Stabilisation Programme continues to serve as the basis for economic policy in Croatia and has been adhered to by each subsequent Government since its original adoption in 1993. The economic goals and policies of the Government are designed to align with a monetary policy that will meet the conditions for long-term low inflation by minimizing fiscal imbalances. In the longer term, the aim of these policies is to establish the full external convertibility of the

Kuna, to achieve long-term price stability, to reduce unemployment and to establish an appropriate internal and external balance in terms of sustained and sustainable growth.

The implementation of the Stabilisation Programme resulted in a reduction in inflation from over 1,000 per cent. in 1992 and 1993 to 2.4 per cent. in 2009 on the basis of CPI (as defined below) based on CBS statistics. Once the initial monetary stabilisation had been achieved, the Government embarked on the second stage of the stabilisation programme which included the rehabilitation of the banking system and acceleration of privatisation of businesses previously owned and operated by the State. On 14 October 1995 the Government entered into the Stand By Arrangement with the IMF which provided access to additional funding. This agreement also opened the door to additional financing from the World Bank and the EBRD. Since the 1995 Stand By Arrangement expired, there have been two further Stand By Arrangements, one approved in 2001 and the other in 2004. The last Stand By Arrangement expired in November 2006.

The Privatisation Programme

Overview

Croatia commenced its privatisation programme in 1991. The aim of the programme was to privatise approximately 3,000 State-owned enterprises. The methods of privatisation were, to a certain extent, dictated by the system of State ownership and socialist self-management in the former Yugoslavia. The Government decided that such enterprises would be provided with a degree of autonomy in shaping their privatisation: each enterprise would propose features of its privatisation, such as equity or debt structures, or debt/equity swaps. These would then either be accepted or rejected, but not modified, by the CPF. Through the privatisation programme, former and current employees, pensioners and management of the privatised entities acquired ownership.

Privatisation has been implemented in two phases: the first under the 1991 Law on the Transformation of Socially Owned Enterprises (the "**Law on Transformation**") and the second under the Privatisation Law (the "**Privatization Law**") enacted in mid-1993 which came into force on 22 March 1996. The Croatian Privatisation Fund (*Hrvatski fond za privatizaciju*) ("**CPF**") is the governmental agency responsible for privatisation. It was established by the Croatian Privatization Fund Act, at the request of the IMF and World Bank. The CPF was created by merging two former agencies: the Agency for Reconstruction and Development and the Croatian Development Fund.

The Government awards concessions according to the procedures outlined in the Concessions Act (Official Gazette no. 125/08) (the "**Concessions Act**"). The Concessions Act regulates the process by which non-Government entities acquire the right to use Croatia's natural resources and resources of interest, the right to engage in activities of national interest to Croatia and the construction and utilisation of facilities and plants necessary to carry out those activities.

Privatisation Process

Under the Law on Transformation, shares in the relevant enterprise, which would be valued on the basis of the estimated net book value of the enterprise, had to be offered to the enterprise's former and current employees, then to State employees and employees at public enterprises, and finally to other citizens of Croatia. All such subscribers were entitled to purchase shares at a basic discount of 20 per cent., plus a further discount of 1 per cent. for each year of employment in Croatia (up to a maximum discount of 60 per cent. on acquisition with a value up to and including DEM 20,000).

The Privatisation Law introduced a further limit in that no more than 50 per cent. of the value of any company could be purchased by subscribers entitled to such discounts. Those individuals acquiring shares were allowed to pay in instalments over a five-year period (subsequently increased to 20 years). To the extent that shares above the DEM 20,000 threshold were purchased, no discount was available but the instalment payment option was available; such shares as well as the discounted shares could be purchased with Frozen Foreign Exchange Deposits, ("**FFEDs**"). In January 1994, the Government changed its policy to allow a partial distribution of shares in companies to be privatised. Private subscribers were entitled to obtain outright that part of their full entitlement of shares that represented their discount, merely by paying either the first annual instalment or 5 per cent. of the price of the non-discounted portion. Subscribers who obtained their "discounted shares" in this way were under no liability, in practice, to pay the remaining instalments under the contract to purchase the remaining "non-discounted shares". The sequence and progress of individual privatisation stages are determined by decisions of the Government and approved by the Parliament.

The remaining shares, namely those which were not acquired by employees, former employees, State employees and employees of public enterprises or other citizens of Croatia, were transferred to the CPF and the State Pension Funds.

The CPF disposes of the shares in its portfolio by way of public auction, tender or private sale. However, since such cash generating methods did not prove effective, the remaining shares were divested by way of a mass voucher privatisation scheme, specially designed for the war-affected population.

The mass voucher privatisation involved a distribution of the shares not sold in the first phase of privatisation. The vouchers were given to individuals affected by the hostilities, such as injured servicemen, war widows and their families, families of interned or missing soldiers or civilians, former political prisoners and displaced persons and refugees (around 5 per cent. of the total population). Under Croatian law, vouchers are not securities and are not tradable. Individual voucher holders could bid for single company shares or invest in a voucher fund. More than 90 per cent. of the voucher holders chose to invest in voucher funds, which in turn placed the majority of the bids for shares.

The cash proceeds from the privatisation of enterprises have accrued to the Government. Up to and including 1995, cash proceeds were transferred to the general budget. Since 1996, all proceeds realised by the CPF have been transferred to the Croatian Bank for Reconstruction and Development ("**HBOR**"). The Government initially saw the privatisation programme as a significant source of revenue for the general budget, however, receipts from privatisation have not been as large as expected due partly to the option granted to investors to pay for their shares with FFEDs.

To aid in the privatisation programme, legislation was passed to establish several individual privatisation investment funds (each a "**Privatisation Investment Fund**") were established. The Privatisation Investment Funds were listed on the Zagreb Stock Exchange ("**ZSE**") in 1999 and had five years to restructure their portfolio and transform themselves into regular closed-end investment funds. The strategy of most Private Investment Funds is to sell their holdings in privatised companies and invest the proceeds in other listed securities.

In accordance with the Government's policy for promoting economic prosperity within Croatia (the "**Strategic Development Framework 2006-2013**"), the main goals in the field of privatisation are:

- completion of the privatisation process of State-owned companies managed by the CPF and their rehabilitation, including in particular, completion of the privatisation process of the shipbuilding industry by 2010;
- support of the employees through labour market institutions and welfare policy; and
- transformation of the CPF into an institution that will manage State property efficiently and actively.

Out of approximately 3,000 companies that started their transition process at the beginning of the 1990s, the portfolio of the CPF, as of July 2010, was comprised of 774 companies and total equity of HRK 57 billion, of which HRK 14.2 billion was State-owned. The CPF was a minority owner of 90 per cent. of these companies (629 companies), holding up to 25 per cent. of their shares. The CPF's shareholding in 66 of the companies ranged from 25 per cent. to 50 per cent., and in 79 of the companies its shareholding exceeded 50 per cent.

As of July 2010, the portfolio of State majority-owned companies that have not yet been privatised can be broken down by sectors as follows: 27 companies in the industry sector, 16 in the tourism sector, 10 in the agriculture sector and 26 companies in other sectors.

In the industry sector, the shipbuilding industry is the most significant part of the portfolio owned by CPF. Currently, this industry is being prepared for privatisation in accordance with the Decision on the Intention to Privatise and the Principles of Privatisation of Five Shipyards Majority-Owned by the Government that was adopted by in May 2008. On 31 September 2009, CPF announced that only two valid bids were received for the privatisation of five of Croatia's shipyards. The CPF subsequently revised the terms of the privatisation, and in May 2010, in the second round of privatisation, the CPF received a total of four bids for three Croatian shipyards which are being privatised.

After the privatisation of the ferrous metallurgy sector (comprised mainly of the sale of the Split Iron Plant, the Sisak Pipe Rolling Mill and the TLM Šibenik Aluminium Factory), activities were launched to resolve the issue of the long-term sustainability of the shipbuilding industry. This industry is considered to be the most complex and demanding industry in privatisation terms and still remains in the portfolio of the CPF.

The CPF is currently conducting the bidding process for 3 hotel complexes (Modra Špila, Podgora and Živogošće). Neither the CPF nor the Government anticipates any significant revenues from those privatisation efforts to be recognized in the Government's 2010 Budget.

Privatisation of Utilities (including Oil and Gas)

HT-hrvatske telekomunikacije d.d. ("**Croatia Telecom**") has been partly privatised, with Deutsche Telekom purchasing 35 per cent. of the shares in Croatian Telecom in 1999 for US$850 million and an additional 16 per cent. in 2001 for EUR 500 million. An additional 7 per cent. of Croatian Telecom shares were sold to its employees in 2005 and 7 per cent. of shares in Croatian Telecom were transferred to the Fund for Croatian Homeland War Veterans and their Family Members ("**FOND HB**"). Croatia currently has three fixed telephony operators and a high level of competition in the mobile markets.

On 5 October 2007, Croatia sold 32.5 per cent. of Croatian Telecom's existing ordinary shares by Initial Public Offering ("**IPO**"), thus reducing its shareholding from 42 per cent. to 9.5 per cent., of which 2.5 per cent. was reserved for bonus shares under the IPO retail preferential offering. Since 5 October 2007, Croatia Telecom ordinary shares have been listed on the ZSE, while Global Depositary Receipts ("**GDRs**") have been listed on the London Stock Exchange ("**LSE**"). In June 2008, 7 per cent. of shares were sold to the current and former employees of Croatia Telecom and Croatian Post, further reducing the ownership of Croatia to 3.6 per cent.

The privatisation of the Croatian Oil and Gas Company INA-INDUSTRIJA NAFTE d.d., ("**INA**"), is based on the Law on the Privatisation of INA (Official Gazette 32/02) passed by the Parliament on 19 March 2002. This provides for the privatisation of INA to be carried out in phases. Of these phases, four have already taken place, starting with the sale of 25 per cent. plus one share to the strategic investor MOL, a Hungarian Oil and Gas Public Limited Company ("**MOL**"), in 2003 and then the transfer, without compensation, of 7 per cent. of INA shares to Fond HB in 2005. The next phase was the sale of at least 15 per cent. of INA shares by way of a public offering to Croatian citizens, Croatian legal entities and foreign investors, which took place in November 2006. The ordinary shares of INA (16.2 per cent. of total number of shares) were listed and began trading on the official market of the ZSE and as GDRs on the LSE. The following privatisation phase, of selling a maximum of 7 per cent. of INA shares to present and former INA employees, was completed in November 2007 (6.28 per cent. of total shares).

The final phase of the INA privatisation envisages the sale or a swap of the remaining INA shares depending on market conditions. This would either be to a strategic investor or on the capital markets, pursuant to the Government's decision and subject to prior consent of the Parliament. The last phase would be the transfer of some of the remaining shares to former owners under the Law on Compensation for Property Expropriated during the Yugoslav Communist regime. None of these phases have been commenced or scheduled yet.

Croatia will retain direct ownership of 25 per cent. plus one share of INA, a stake which will be privatised once Croatia becomes a member of the EU.

MOL's voluntary takeover offer to all shareholders of INA, which was announced on 5 September 2008 and completed in October 2008, had a major effect on the shareholder structure. After the takeover offer MOL became INA's largest shareholder with a 47.16 per cent. share followed by the Government with a 44.84 per cent. share.

Economic Policy

One of the main objectives of Croatia's economic policy is to continue the process of narrowing the gap between its GDP per capita and the EU average. According to Eurostat estimates, as at 31 December 2009, Croatia's per capita income was approximately 64 per cent. of the GDP per capita of the EU27 countries in purchasing power standards.

The framework and objectives of the economic policy of the Republic of Croatia are defined in a series of strategic documents of the Government of the Republic of Croatia, namely: the Strategic Development Framework for 2006-2013, the Government Programmes Strategy 2010-2012, the Economic and Fiscal Policy Guidelines and the Pre-accession Economic Programme (PEP).

The main objective of the economic policy in the current macroeconomic environment is to preserve macroeconomic stability and create conditions for recovery and stable economic growth. This year's PEP reflects the set economic policy objective and describes in detail the macroeconomic developments and projections, further direction of the fiscal policy, as well as the key structural reforms in the 2010-2012 period.

In the circumstances of financial restrictions and a declining economic activity the emphasis is put on fiscal policy, which will, within the set framework, aim to achieve the set economic objectives. In this sense, the fiscal policy will be focused on fulfilling the twelve general objectives laid down in the Government Programmes Strategy:

- Macroeconomic and economic stability;
- Optimum environment for the development of a competitive economy;
- Strengthening of the state of law and the rule of law;

- Promoting knowledge, excellence and culture;
- Uniform regional development;
- Strengthening of social equality;
- Positioning of Croatia as one of the leading European tourist destinations;
- More competitive sector of agriculture, food industry and fisheries;
- Further strengthening of the international status of the Republic of Croatia;
- Improving the police and armed forces as the citizens' services;
- Health care, maintaining and improving health;
- Environmental protection and spatial development.

Supporting macroeconomic and fiscal policy, the implementation of key structural reforms will be continued in the medium-term in accordance with the priorities of the Government of the Republic of Croatia. With this view, further measures will be taken, aiming at improving the entrepreneurial climate, further improving the financial sector, completing reforms of the public administration, the judiciary reform and combating corruption, and at restructuring and privatisation of dependent sectors. In addition, further measures will be taken aimed at ensuring social fairness concurrently ensuring financial sustainability of the health and social security systems, environment protection, incentives to employment and further development of a knowledge-based society.

In September 2008, the World Bank's Board endorsed the Country Partnership Strategy ("**CPS**") for Croatia for 2009-2012. The goal of the CPS is to support the completion of Croatia's EU accession and the convergence of its income level with that of other EU member states in a fiscally, socially and environmentally sustainable fashion. In pursuing this goal, the CPS aims to:

- sustain macroeconomic stability;
- strengthen private sector-led growth and accelerate convergence with the EU;
- improve the quality and efficiency in the social sectors; and
- increase the sustainability of long-term development.

In the selection and structuring of projects to be supported, primary consideration is given to the potential contribution of the proposed projects to the Croatia's EU accession agenda. Projects that enhance Croatia's capacity to absorb EU funds, especially following the accession, have high priority. The CPS envisages an indicative aggregate base-case lending amount of approximately US$1.0 to 1.4 billion for investment operations over the four-year period. The CPS lending programme focuses on the areas of public expenditure reform, governance, investment climate and climate change.

In 2009, the World Bank's Board approved three loans exceeding US$240 million to fund the continuation of the Rijeka gateway, coastal city pollution control programs and the improvement of emergency medical services. At the request of the Government, the World Bank has agreed to provide a credit line of EUR100 million for exporters through the HBOR and commercial banks to help mitigate the impact of the global financial and economic crisis and to provide funding for the private sector. Other projects being developed cover such areas as judicial reforms, disaster risk management and mitigation, port development, irrigation and education. The CPS may be adjusted, if necessary, to help address the consequences of the global financial and economic crisis. As of 31 March 2010, the World Bank was financing 21 projects in Croatia in a wide range of sectors with loans remaining to be disbursed amounting to approximately US$1.03 billion. The International Finance Corporation's portfolio of investment in Croatia amounts to approximately US$340 million and the Multilateral Investment Guarantee Agency's guarantees relating to projects within Croatia slightly exceeded US$600 million as of June 2010.

Recent Economic Developments and Trends

The effects of the global financial and economic crisis were first felt in Croatia in the second half of 2008 and intensified towards the end of the year. The negative impact of the crisis intensified further in 2009 with the largest GDP decline in the first quarter of 2009. In particular, real GDP growth slowed down from 5.5 per cent. in 2007 to 2.4 per cent. in 2008, while GDP contracted by 5.8 per cent. in 2009. The negative trends continued in the first quarter of 2010, during which GDP recorded an annual decrease of 2.5 per cent. in real terms, according to the CBS estimates.

Domestic banks responded to these economic pressures by increasing their foreign financing and, commencing in January 2009, many domestic banks began drawing down their foreign assets, facilitated by regulatory changes such as the abolishment of the marginal reserve requirement in October 2008, the reduction in banks reserve requirement from 17 per cent. to 14 per cent. in December 2008 and further to 13 per cent. in February 2010, and the reduction of the minimum required ratio of banks' foreign currency claims to foreign currency liabilities from 32 per cent. to 20 per cent. in February 2009, as further described under "*Monetary Developments and International Reserves*" below.

In response to the global financial and economic crisis, the CNB tailored monetary policy to support macroeconomic and financial stability and maintain liquidity in the system. The CNB addressed emerging liquidity shortages through active use of regulatory requirements and repo auctions, while it maintained policy rates (the repo auction rate) that were generally stable at 6.0 per cent. In addition to monetary policy mechanisms, the CNB and the Government took the following actions:

- In October 2008, the Government increased the guarantee per account on bank deposits from HRK 100,000 (EUR 14,000) to HRK 400,000 (EUR 56,000), after banks experienced a large volume of household deposit withdrawals. In addition, Parliament authorized the Government to increase the guarantee limit further if necessary. Together with adequate support from the CNB and parent banks, this measure helped stop deposit withdrawals and encourage future deposits.
- In November 2008, the CNB simplified the rules for banks to access emergency liquidity assistance. As of 30 June 2010, no Croatian banks have accessed emergency liquidity assistance.
- In the last quarter of 2008 and beginning of 2009, the CNB abolished the marginal reserve requirement, reduced banks reserve requirements and the prescribed minimum foreign currency liquidity, and increased permitted open foreign currency position for banks. These measures were further supplemented by the CNB's selling of foreign currency through foreign exchange interventions and by more restrictive management of domestic currency liquidity through regular repo auctions. For additional discussion of measures taken by the CNB in response to the adverse effects of the global financial and economic crisis, see "*Monetary Developments and International Reserves — Monetary Policy and Instruments*".
- The Government obtained funds for HBOR from international institutions such as the World Bank and the European Investment Bank to support exporters and small-to-medium enterprises.
- The Government took steps to curtail public spending, for example by cutting public sector wages by 6.0 per cent. and freezing any public sector wage increases until GDP shows positive growth. As of the date hereof, this freeze was still in place.
- In January 2010, the Government adopted measures to stimulate economic recovery and development. In particular, the Government adopted two measures ('model A' and 'model B') to increase lending in the economy with the active participation of the Government, the CNB, the HBOR and commercial banks. Under 'model A', commercial banks are invited to issue loans, part of which are funded by the HBOR. Under 'model B', commercial banks are invited to issue loans, part of which are guaranteed by the Government. Approximately HRK 9.0 billion (up to HRK 5.0 billion in 'model A' and up to HRK 4.0 billion in 'model B') of new loans could be extended to the private sector in 2010 through these models. In line with this, in February 2010, the CNB reduced the reserve requirement rate from 14 to 13 per cent. releasing approximately HRK 2.9 billion of which was then allocated to the HBOR, which would provide loans jointly with commercial banks to the enterprises according to the criteria established by the Government ('model A').

These measures, together with intermittent intervention by the CNB that resulted in a total reserve loss between September 2008 and March 2009, as well as other factors, contributed to stabilising the Croatian market, strengthening consumer confidence and limiting the depreciation of the Kuna against the Euro. The depreciation pressures on the Kuna during the beginning of 2009 were followed by the appreciation of the Kuna in the second and fourth quarters of 2009. Overall in 2009, the HRK/EUR exchange rate appreciated slightly, strengthening from HRK 7.32/EUR at the end of 2008 to HRK 7.31/EUR at the end of 2009. In the first five months of 2010, mainly due to an environment of a balanced supply of, and demand for, foreign currency and high Kuna liquidity in the banking system, the HRK/EUR exchange rate largely remained stable.

Exports of goods and services, based on balance of payments data expressed in EUR, increased by 7.8 per cent. from EUR 17.0 billion in 2006 to EUR 18.3 billion in 2007. Exports of goods and services in 2008 increased by 8.7 per cent. to EUR 19.9 billion as compared to 2007. This increase in exports was largely due to the increase in exports of services, especially in the tourism sector. Exports of goods rose principally as a result of an increase in other transport equipment and natural and manufactured gas exports. However, excluding other transport equipment and gas exports, as well as oil and refined petroleum products, the rise in exports was negligible. In 2009, exports of goods and services decreased to EUR 16.1 billion, which represented a decrease of 18.9 per cent. as compared to 2008, primarily due to negative developments relating to trade in goods. In general, negative trade developments in 2009 were in line with the observed contraction in world trade as a result of the global economic crisis. More specifically, in 2009 the trade in goods deficit decreased by 31.5 per cent. compared to 2008 as a result of the decrease in imports outpacing the decrease in exports. This is mainly attributable to a decline in the negative trade balance in road vehicles and petroleum and petroleum products (in the case of the latter partially due to price effects) as well as from a surplus in trade in other transport equipment. The first quarter of 2010 saw a reversal of this trend, with a low but positive rate of change of exports of goods and services (3.8 per cent. compared to the same period of 2009).

Imports of goods and services, based on balance of payments data expressed in EUR, increased from EUR 21.5 billion in 2007 to EUR 23.7 billion in 2008. This increase was primarily due to a rise in the imports of goods, especially energy products (oil and gas) and other transport equipment, whereas imports of other goods increased at a slower rate due to a large extent to a decline in imports of road vehicles in the fourth quarter of 2008. In 2009, imports of goods and services decreased by 24.7 per cent. compared to 2008 and amounted to EUR 17.9 billion, primarily as a result of the contraction in domestic demand for imports as a consequence of the global financial and economic crisis. The decrease was principally attributable to the decline in imports of goods, which experienced decreases broadly distributed across all categories, in particular with respect to road vehicles, petroleum and petroleum products. The decrease in imports of goods and services continued, albeit at a much lower rate, in the first quarter of 2010, when imports of goods and services decreased by 7.7 per cent. compared to the same period in 2009.

The current account deficit widened from EUR 3.2 billion in 2007 to EUR 4.3 billion in 2008, which represented a decrease of 34.0 per cent. The current account deficit reached 9.2 per cent. of GDP in 2008, increasing by 1.6 per cent. of GDP compared to 2007. This increase was principally due to growing imbalances in foreign trade in goods, while strong performance in the services sector, primarily in tourism, helped to offset some of those negative effects. The current transfers account remained unchanged in 2008, while the negative balance in the factor income account further increased. In 2009, the current account deficit decreased by 43.6 per cent. to EUR 2.4 billion (5.4 per cent. of GDP), primarily due to developments relating to trade in goods. In particular, the trade in goods deficit decreased by EUR 3.4 billion, or 31.5 per cent. as compared to 2008, as a result of a decline in imports larger than in exports. The positive effect of the trade in goods deficit contraction on the current account balance was partially offset by decreased net exports of services, which declined by 18.4 per cent. in 2009 compared to 2008, mainly due to decreased tourism revenues. In the first quarter of 2010, the current account deficit continued to decline and amounted to EUR 1.4 billion, which represented a decrease of 23.9 per cent. from EUR 1.8 billion in the first quarter of 2009, primarily due to declining imports of goods, which, combined with a slight increase in exports, resulted in a further narrowing of the trade in goods gap.

In 2009, as a result of the global financial and economic crisis, all of the main Croatian high frequency macroeconomic indicators displayed negative trends. The available data from CBS for the beginning of 2010 point to a continuation of unfavourable trends but, mostly, at a slower pace.

In 2009, industrial production declined by 9.2 per cent., as compared to growth of 1.2 per cent. in 2008 and growth of 4.9 per cent. in 2007, according to the CBS data. In the first four months of 2010, industrial production contracted by 1.9 per cent. In 2009, real turnover in retail trade declined by 15.3 per cent. as compared to a decrease of 0.5 per cent. in 2008 and an increase of 5.3 per cent. in 2007. Real turnover in retail trade contracted by 6.8 per cent. in the first four months of 2010 compared to the same period in 2009. Construction work volume decreased by 6.5 per cent. in 2009, as compared to 2008, whereas in the first two months of 2010, it recorded an annual decline of 20.0 per cent.

Year-on-year growth of tourist arrivals in 2008 as compared to 2007 amounted to 0.9 per cent., while the number of nights spent in Croatia increased by 2.0 per cent., as compared to an increase of 5.6 per cent. in 2007. In 2009, total tourist arrivals declined by 2.9 per cent., while the recorded decrease in nights spent was 1.4 per cent. In the early 2009, a Tourism Action Plan was initiated by the Government in order to attract more tourists to Croatia. Among the measures implemented was the temporary lifting of visa requirements for Russian and Ukrainian citizens visiting Croatia during the summer of 2009. In the first four months of 2010, tourist arrivals and number of nights spent in Croatia decreased by 5.8 per cent. and 4.5 per cent., respectively, compared to the same period in 2009. However, it should be noted that tourist arrivals and number of nights spent in the first quarter of the year account on average for less than 5 per cent. and 3 per cent., respectively, of the annual total, as most tourists visit Croatia during the period from April-October. In addition, the data on tourist arrivals and number of nights spent as of January 2010 does not include those tourists in ports of nautical tourism. The growth rate in the first four months of 2010 has been calculated based on comparable data for 2009, in both cases excluding nautical tourism.

In 2009, the average inflation rate stood at 2.4 per cent. Downward pressures on inflation came from weakened domestic demand, alleviated imported inflation pressures and slower growth of unit labour costs. These downward pressures were to some extent offset by the growth of prices of the products with regulated pricing, such as gas, tobacco products, and medical and hospital services. (Prices of tobacco products went up due to a rise in excise taxes, while health care prices grew due to the introduction of participation fees for medical and hospital services.) These inflation trends continued at the beginning of 2010, bringing the average annual inflation rate down further to 0.8 per cent. in the first four months of 2010. Inflation is estimated to remain low in the remaining part of 2010, primarily due to downward pressures on prices from domestic demand.

The capital and financial account recorded larger net capital inflows in the last quarter of 2008 than in the same period in 2007 primarily due to increased direct investments, especially round-tripping transactions. Additional contribution to total capital inflows came from a decrease in international reserves, which resulted from a change in monetary policy (abolishing the marginal reserve requirement) aimed at improving commercial banks' foreign currency liquidity. Strong foreign borrowing by banks also contributed to the inflow of capital. In 2008, the capital and financial account had larger net capital inflows than in 2007 with the largest inflow of funds attributable to direct investments. The largest single inflow of foreign direct investment amounted to EUR 0.8 billion and was related to the acquisition of 22 per cent. of INA shares by MOL. (This does not take into account two round-tripping transactions, see "*Foreign Trade and International Balance of Payments — Capital and Financial Account*".) In addition, significant capital inflow was recorded through the debt instruments on the other investment account, while portfolio investment experienced outflows of funds through repayment of Government bonds and, at the end of 2008, through withdrawal of funds from Croatia and increased investments abroad.

Net inflows of capital on the capital and financial account in 2009 were significantly lower than in 2008 (by 27.1 per cent.), excluding the change in reserves which amounted to EUR 4.1 billion, almost one third less than in 2008. Specifically, both debt and equity related capital inflows decreased considerably (debt liabilities decreased by 30.1 per cent. and equity liabilities by 59.1 per cent.). Lower debt inflows mostly reflect a decrease in foreign borrowing by domestic companies due to declining economic activity and lower availability of foreign sources of funding during 2009. A significant decrease in direct equity investment reflected the reluctance of foreign investors to invest in developing countries and emerging markets and the overall uncertainty and risk aversion present in the global financial markets. In addition, the growth in foreign assets also weakened in 2009 as compared to 2008, primarily due to the decreased level of banks' foreign assets as a result of a reduction in minimum required amount of foreign currency claims. After a decline in 2008, gross international reserves increased by EUR 0.9 billion in 2009.

Capital inflows in the first quarter of 2010 were limited and amounted to EUR 0.1 billion, excluding the change in international reserves. During this period, domestic sectors decreased the level of their foreign assets by EUR 0.2 billion, which was offset by a similar decrease in their foreign liabilities. FDI in the first quarter totalled EUR 0.5 billion, approximately equal to that in the same period of 2009. Approximately half of this amount related to direct equity investments, mostly recapitalisations in the banking sector. The remainder comprised direct debt investments, which were significantly lower than in the first quarter of 2009. Unlike the first quarter of 2009, reinvested earnings were higher, reflecting improved business results of foreign owned companies and banks.

Increasing by EUR 5.9 billion in 2008, Croatia's gross external debt exceeded EUR 39.1 billion at the end of December 2008 (82.6 per cent. of GDP). The increase of debt levels from 2007 was mainly a consequence of strong corporate foreign borrowing, however, this slowed down noticeably in the last quarter of 2008. In 2009, external debt continued to rise, but at a much slower pace compared to 2008, increasing by EUR 3.6 billion, which represented less than two thirds of the increase recorded in 2008. In 2009, the composition of Government debt shifted when, after several years of declining external indebtedness, the Government significantly increased its foreign liabilities, while banks and enterprises recorded much slower debt growth.

After deleveraging in the first nine months of 2008, banks increased their foreign liabilities in the fourth quarter of 2008 by EUR 2.1 billion, leading to a total debt growth of EUR 1.2 billion in 2008. In 2009, banks' external debt, after a decrease in February 2009 prompted by the CNB's reduction of the minimum required amount of foreign currency claims, increased in the next three months and then, as is typical in the summer months, started to decrease which continued until December when a temporary increase of EUR 0.8 billion was recorded. Banks' external debt at the end of 2009 amounted to EUR 10.7 billion and was EUR 0.6 billion higher than at the end of 2008. As of 31 March 2010, banks' external debt stood at almost the same level as at the end of December 2009, with significant fluctuations recorded during the first quarter (a decrease in January by EUR 0.5 billion was followed by an equal increase in March).

The general government external debt largely remained flat during 2008, with the exception of a decrease in the general government external debt attributable to the reclassification of Croatian Motorways (Croatian Motorways were reclassified in the external debt statistics from the Government sector to the other sectors as of January 2008), which led to a one-off decrease in the debt of this sector (EUR 1.2 billion) in January 2008. In contrast to prior years, in 2009 the general government external debt increased significantly (by EUR 1.0 billion) and amounted to EUR 5.2 billion, mostly as a result of two bond issues on international markets, which was partially offset by the repayment of a maturing Eurobond and Samurai bond. In the first quarter of 2010, government external debt decreased by EUR 0.3 billion, primarily due to a decrease in government debt as a result of a repayment of a EUR 500 million Eurobond.

External debt of other sectors (mostly enterprises) was the main driver of the mounting external debt in recent years. At the end of 2008, in the midst of the global financial crisis, availability of foreign sources of finance significantly declined, resulting in an external debt stagnation during the last two months of 2008. In 2008, enterprises increased their external debt by EUR 4.6 billion (inclusive of direct debt investment in enterprises), while the reclassification of Croatian Motorways increased the level of other sectors debt by an additional EUR 1.2 billion. Weak economic activity and insecurity regarding any potential recovery of the economy continued to affect corporate demand for foreign funding during 2009. As a result, the growth of corporate foreign borrowing slowed down, and the increase in corporate debt amounted to EUR 1.8 billion in 2009 (inclusive of direct debt investment in enterprises), which represented only slightly over a half of the increase recorded in 2008. During the first quarter of 2010, enterprises continued to increase their liabilities abroad, both to foreign banks and to parent companies, albeit at a slower pace than in the same period of 2009. (The increase was by 0.5 per cent. during the first quarter of 2010, compared to an increase of 1.6 per cent. during the first quarter of 2009).

Gross Domestic Product

In the beginning of 2009, GDP data for the period from 1995 to the third quarter of 2008 was revised, under the recommendation of the CBS and CNB, in order to bring GDP calculations and estimates more in line with the European System of Accounts (ESA 1995) standard. The GDP calculation by production approach has been improved by including the non-observed economy, the new estimate of rent values for apartments rented and available for rent and the new estimate of Financial Intermediation Services Indirectly Measured ("**FISIM**"). Entrepreneurs comprise the largest part of the non-observed economy by generally under-reporting revenues and over-reporting costs in order to minimise tax obligations. This inaccuracy of reporting is believed to be most prevalent in the construction, retail trade and hotel and restaurant sectors. The expenditure side GDP components were revised in line with the production side of the GDP revision. The largest revisions were to household consumption, with an average increase of 22.7 per cent. compared to the old calculations, due to revisions to the estimate of rent values for apartments rented and available for rent, allocation of FISIM and the non-observed economy. The second largest correction was to the export of tourist services, which now takes into account non-observed economy and the allocation of FISIM.

The following table sets forth real and nominal GDP amounts, as well as HRK/EUR and HRK/U.S.$ exchange rates, for the periods indicated.

	Year ended 31 December				Three months ended 31 March	
	2006	2007	2008	2009	2009	2010
Nominal GDP (HRK millions)	286,341	314,223	342,159	333,063	77,867	76,504
Nominal GDP (EUR millions)	39,102	42,832	47,370	45,378	10,513	10,501
Nominal GDP per capita (EUR)	8,807	9,656	10,682	10,233	2,370	2,368
Real GDP growth (*per cent.*)	4.7	5.5	2.4	(5.8)	(6.7)	(2.5)
HRK/EUR exchange rate (average for the period)	7.32	7.34	7.22	7.34	7.41	7.29
HRK/U.S.$ exchange rate (average for the period)	5.84	5.37	4.93	5.28	5.68	5.26

Source: *Central Bureau of Statistics and Croatian National Bank*

The following table sets forth GDP real growth rates of various sectors of the economy for the periods indicated.

	Year ended 31 December			Three months ended 31 March	
	2007	**2008**	**2009**	**2009**	**2010**
			(per cent.)		
Households	6.2	0.8	(8.5)	(9.9)	(4.1)
Government	3.4	1.9	0.2	3.9	(1.1)
Gross fixed capital formation	6.5	8.2	(11.8)	(12.4)	(13.9)
Exports of goods and services	4.3	1.7	(16.2)	(14.2)	3.6
Imports of goods and services	6.5	3.6	(20.7)	(20.9)	(4.8)
Change in overall GDP for the period	**5.5**	**2.4**	**(5.8)**	**(6.7)**	**(2.5)**

Source: *Central Bureau of Statistics*

According to the latest estimates from the CBS, the real GDP recorded a year-on-year decrease of 2.5 per cent. in the first quarter of 2010.

In 2009, mainly as a continuation of the global financial crisis that commenced in the second half of 2008, GDP contracted by 5.8 per cent. in real terms, which represented a decrease of 8.2 per cent. in GDP compared to 2008, when GDP grew by 2.4 per cent. When observing the breakdown of GDP by expenditure in 2009, all categories except for government consumption recorded their largest year-on-year real declines so far since the currently used methodology was introduced in 2000. Imports of goods and services recorded the largest decrease in 2009 (20.7 per cent.) as a result of severe contraction in domestic demand. Due to a sharp decline in foreign demand for domestic goods and services, exports of goods and services declined by 16.2 per cent. in 2009. Shrinking domestic and foreign demand, a general deterioration of business climate, decreased capital availability and high financing costs were some of the key factors leading to the decrease of 11.8 per cent. in gross fixed capital formation in 2009. Personal consumption, which was the main driver of economic growth in most of the years preceding the global financial and economic crisis, recorded a decline of 8.5 per cent. in 2009. This decline was largely driven by a sharp fall in consumer confidence which was already noticeable in the second half of 2008 and was reflected mainly through postponement of purchases of more expensive durable consumer goods. Shrinking propensity to consume also closely correlates with unfavourable developments in the capital markets which led to a decrease in the value of households' financial assets. The other significant factors contributing to the decline in personal consumption in 2009 were the decreases in real net wage bill and in the real amount of granted consumer loans. In addition, increasing payment obligations on existing loans to households due to rising interest rates had a negative impact on the household consumption. The effect on weakening domestic demand of government consumption, the only component with a positive growth in 2009 (0.2 per cent.), was negligible.

In 2008, mainly due to the global financial and economic crisis, the GDP growth amounted to 2.4 per cent., decelerating by 3.1 percentage points compared to 2007. When observing the breakdown of GDP by expenditure categories, the highest GDP growth in 2008 was recorded by gross fixed capital formation, amounting to 8.2 per cent., primarily due to strong construction activity which, despite the crisis, had not slowed down significantly towards the end of 2008. Imports of goods and services recorded a real GDP growth of 3.6 per cent. in 2008, the lowest since 1999. Exports of goods and services rose by only 1.7 per cent. primarily because of the downward trend in foreign demand in the second half of 2008 and the decrease in revenue from exports. The main driver of economic slowdown in the second half of 2008 was the significant decrease in personal consumption, which recorded the lowest growth rate since 1999, amounting to only 0.8 per cent. The most important factors contributing to this were the decreasing consumer confidence, a decrease in real net wage bill growth and the slowdown in consumer credit growth. Government consumption, which recorded a real annual growth of 1.9 per cent., provided only a negligible contribution to the weakening domestic demand.

Gross Value Added

GVA in real terms declined by 4.0 per cent. in 2009, decelerating by 6.8 percentage points as compared to 2008 when it grew by 2.8 per cent. This decline was largely attributable to the real GVA decrease in the wholesale and retail trade sector and the mining, quarrying, manufacturing, electricity, gas and water supply sectors. The GVA dynamics and trends in 2009 are primarily due to the negative effects of the global financial and economic crisis. Negative GVA trends continued in the first quarter of 2010, during which period real GVA declined by 2.4 per cent. compared to the first quarter of 2009 (from HRK 68,902 as at 31 March 2009, as compared to HRK 67,272 as at 31 March 2010). This decrease was mainly due to real GVA decreases in the construction (18.7 per cent.), hotels and restaurants (5.5 per cent.) and transport, storage and communication (5.4 per cent.) sectors.

Growth of GVA in real prices decreased by 2.7 per cent. from a growth of 5.5 per cent. in 2007 to a growth of 2.8 per cent. in 2008. This decrease was principally due to decreases in the growth of GVA in the hotel and restaurant sector, wholesale and retail trade and the mining, quarrying, manufacturing, electricity, gas and water supply sector reflecting decreased consumption and a deceleration of tourism in large part to the global financial and economic crisis. These decreases were partially offset by increases in the construction sector as a result of private investment in non-residential buildings.

The following table sets forth nominal GVA in current prices of various sectors for the periods indicated:

	Year ended 31 December					Three months ended 31 March		
	2006	2007	2008	2009		2009	2010	
	(HRK millions)				(per cent. of total)	(HRK millions)		(per cent. of total)
Agriculture, hunting, forestry and fishing	15,578	16,400	19,011	19,512	6.7	4,373	4,391	6.5
Mining and quarrying, manufacturing, electricity, gas and water supply	50,683	55,271	59,753	55,549	19.1	13,745	14,214	21.1
Construction	19,044	20,907	24,659	23,189	8.0	6,156	4,919	7.3
Wholesale and retail trade, repair of motor vehicles, motorcycles and personal and household goods	31,156	34,431	36,122	31,691	10.9	7,465	7,145	10.6
Hotel and restaurants	10,510	11,802	12,791	12,849	4.4	1,501	1,445	2.2
Transport, storage and communications	22,466	24,479	25,480	24,216	8.3	5,068	4,838	7.2
Financial intermediation, real estate, renting and business activities	54,881	61,795	67,743	70,847	24.4	17,229	17,298	25.7
Other[(1)]	41,738	45,351	49,870	52,241	18.0	13,384	13,022	19.4
Total GVA	**246,056**	**270,436**	**295,430**	**290,093**	**100.0**	**68,920**	**67,272**	**100.0**

Source: *Central Bureau of Statistics*

(1) Includes public administration and defence, compulsory social security, education, health and social work, other community, social and personal services and activities of households.

The following table sets forth GVA in real prices for the periods indicated:

	Year ended 31 December					Three months ended 31 March		
	2006	2007	2008	2009		2009	2010	
	(HRK millions)				(per cent. of total)	(HRK millions)		(per cent. of total)
Agriculture, hunting, forestry and fishing	13,706	13,897	14,338	14,641	7.3	3,541	3,570	7.6
Mining and quarrying, manufacturing, electricity, gas and water supply	42,552	45,001	45,621	41,741	20.8	10,409	10,370	22.1
Construction	13,389	13,847	15,026	14,104	7.0	3,686	2,998	6.4
Wholesale and retail trade, repair of motor vehicles, motorcycles and personal and household goods	28,324	30,344	30,255	25,933	12.9	5,796	5,512	11.8
Hotel and restaurants	7,911	8,624	8,816	8,559	4.3	1,167	1,103	2.4
Transport, storage and communications	19,504	20,956	22,044	20,634	10.3	4,916	4,650	9.9
Financial intermediation, real estate, renting and business activities	34,267	36,891	38,143	38,681	19.3	9,463	9,453	20.2
Other[(1)]	32,276	32,811	33,530	33,894	16.9	8,516	8,496	18.1
Total GVA	**192,676**	**203,264**	**208,966**	**200,577**	**100.0**	**48,202**	**46,840**	**100.0**
Taxes minus subsidies on products	**38,356**	**40,409**	**40,456**	**34,349**	**—**	**7,371**	**7,319**	**—**
GDP	**231,032**	**243,673**	**249,422**	**234,925**	**—**	**55,573**	**54,159**	**—**

Source: *Central Bureau of Statistics*

(1) Includes public administration and defence, compulsory social security, education, health and social work, other community, social and personal services and activities of households.

The following table sets forth annual real growth rates of GVA by sector for the periods indicated:

	Year ended 31 December				Three months ended 31 March	
	2006	2007	2008	2009	2009	2010
			(per cent.)			
Agriculture, hunting, forestry and fishing	1.9	1.4	3.2	2.1	(0.6)	0.8
Mining and quarrying, manufacturing, electricity, gas and water supply	3.5	5.8	1.3	(8.5)	(10.3)	(0.4)
Construction	7.7	3.4	8.5	(6.1)	(1.7)	(18.7)
Wholesale and retail trade, repair of motor vehicles, motorcycles and personal and household goods	2.9	7.1	(0.3)	(14.3)	(15.0)	(4.9)
Hotel and restaurants	4.7	9.0	2.2	(2.9)	(4.4)	(5.5)
Transport, storage and communications	8.6	7.4	5.2	(6.4)	(5.2)	(5.4)
Financial intermediation, real estate, renting and business activities	8.2	7.7	3.4	1.4	1.4	(0.1)
Other[(1)]	1.1	1.7	2.2	1.1	1.8	(0.2)
Total GVA growth	**4.7**	**5.5**	**2.8**	**(4.0)**	**(4.0)**	**(2.8)**

Source: *Central Bureau of Statistics*

(1) Includes public administration and defence, compulsory social security, education, health and social work, other community, social and personal services and activities of households.

Agriculture, hunting, forestry and fishing

In the first quarter of 2010, GVA in the agriculture, hunting, forestry and fishing sector experienced real growth and, measured in current prices, increased by 0.4 per cent. from HRK 4.37 billion in the first quarter of 2009 to HRK 4.39 billion in the first quarter of 2010, mainly as result of the first quarter of 2009 being a relatively slow quarter for the sector. Real GVA in the agriculture, hunting, forestry and fishing sector increased by 0.8 per cent. in the first quarter 2010 as compared to the same period in 2009. The agriculture, hunting, forestry and fishing sector was the only sector that recorded real GVA growth in the first quarter of 2010. During the first quarter of 2010, the share in total GVA, measured in current prices, of the agriculture, hunting, forestry and fishing sector decreased slightly from 6.7 per cent. as at 31 December 2009 to 6.5 per cent as at 31 March 2010.

In 2009, GVA in the agriculture, hunting, forestry and fishing sector experienced real growth and measured in current prices, increased by 2.6 per cent., from HRK 19.0 billion in 2008 to HRK 19.5 billion in 2009, reflecting mainly an increase in volumes. The share of GVA in agriculture, hunting, forestry and fishing sector in the total GVA in 2009 grew slightly compared to 2008 and reached 6.7 per cent. In light of the 2.1 per cent. increase in 2009 as compared to 2008, the agriculture, hunting, forestry and fishing was the sector with the largest year-on-year real GVA growth in 2009.

In 2008, the GVA of the agriculture, hunting, forestry and fishing sectors, measured in current prices, increased by 15.9 per cent. to HRK 19.0 billion from HRK 16.4 billion in 2007. The increase was principally due to a rise in prices, as measured by the implicit deflator. The real GVA of the agriculture, hunting, forestry and fishing sectors increased by 3.2 per cent. in 2008 compared to 2007, mainly as a result of favourable weather conditions in 2008 that led to an increase in the volume of production of certain agricultural products. The economic activity in the sectors of agriculture, hunting, forestry and fishing was more pronounced in the second rather than the first half of 2008, mainly because the annual rate of change of GVA was higher during the period from July to December.

Mining and quarrying, manufacturing, electricity, gas and water supply

In the first quarter of 2010, GVA in the mining and quarrying, manufacturing, electricity, gas and water supply sector, measured in current prices, increased by 3.4 per cent. from HRK 13.7 billion in the first quarter of 2009 to HRK 14.2 billion in the first quarter of 2010. However, real GVA in the mining and quarrying, manufacturing, electricity, gas and water supply sector decreased by 0.4 per cent. in the first quarter 2010 as compared to the same period in 2009. As the mining and quarrying, manufacturing, electricity, gas and water supply sector is one of the main determinants of economy activity, weak domestic and foreign demand as a result of the global financial and economic crisis was the primary reason for this decrease. During the first quarter of 2010, the share in total GVA, measured in current prices, of the mining and quarrying, manufacturing, electricity, gas and water supply sector increased from 19.1 per cent. as at 31 December 2009 to 21.1 per cent as at 31 March 2010.

GVA in the mining and quarrying, manufacturing, electricity, gas and water supply sector, measured in current prices, decreased by 7.0 per cent., from HRK 59.8 billion in 2008 to HRK 55.5 billion in 2009. The share of GVA in the mining and quarrying, manufacturing, electricity, gas and water supply sector in total GVA decreased from 20.2 per cent. in 2008 to 19.1 per cent. in 2009. Real GVA in the mining and quarrying, manufacturing, electricity, gas and water supply sector declined by 8.5 per cent. in 2009 as compared to 2008. The reason for the decrease was the decline in demand as a result of the global economic crisis.

The GVA in current prices for the mining and quarrying, manufacturing, electricity, gas and water supply sectors increased by 8.1 per cent. from HRK 55.3 billion in 2007 to HRK 59.8 billion in 2008. To a large extent this was a result of the rise in prices. The real GVA of the mining and quarrying, manufacturing, electricity, gas and water supply increased by only 1.4 per cent. in 2008, as compared to 2008. Following a slight recovery of the real GVA dynamics early in the year, the second half of 2008 saw negative annual rates of change in these economic sectors, as a result of a noticeable weakening of both domestic and foreign demand.

Construction

In the first quarter of 2010, GVA in the construction sector, measured in current prices, decreased by 20.1 per cent. from HRK 6.2 billion in the first quarter of 2009 to HRK 4.9 billion in the first quarter of 2010. Real GVA in the construction sector decreased by 18.7 per cent. in the first quarter 2010 as compared to the same period in 2009. This decrease was due, in part, to the fact that the construction sector tends to be a lagging sector, as so it manifested the impact of the global economic crisis later than other sectors in the Croatian economy; it also reflects the slowdown in construction that resulted from a decrease in construction investment and the suspension of construction projects as a result of the ongoing global financial crisis. During the first quarter of 2010, the share in total GVA, measured in current prices, of the construction sector decreased from 8.0 per cent. as at 31 December in 2009 to 7.3 per cent as at 31 March 2010.

GVA in the construction sector, measured in current prices, decreased by 6.0 per cent. from HRK 24.7 billion in 2008 to HRK 23.2 billion in 2009. The share of GVA in the construction sector in total GVA decreased from 8.3 per cent. in 2008 to 8.0 per cent. in 2009.

After a strong year-on-year growth in 2008, real GVA in the construction sector decreased by 6.1 per cent. in 2009, the negative trend intensifying towards the end of the year. Unfavourable financial and economic conditions were the main contributing factors to these developments, as the sharp decrease in demand for both residential and commercial real estate as well as the excess supply in the real estate market, resulted in a decrease in private sector's investment in construction activity. In addition, deteriorating conditions in domestic and foreign financial markets limited the availability of financing for capital projects. The decline in the construction activity of public sector, in particular, largely reflects decreasing activity relating to the construction of road infrastructure.

GVA in current prices in construction increased by 17.9 per cent. from HRK 20.9 billion in 2007 to HRK 24.7 billion in 2008, principally due to the rise in prices and in volumes. Real GVA growth in construction accelerated strongly in 2008 compared to 2007 and reached 8.5 per cent. The increase in the construction activity was primarily attributable to the increase in construction activity in the private sector, as the public sector's construction activity, mainly related to the construction of road infrastructure, weakened slightly over the year. The private sector's activity in non-housing construction, such as the construction of tourist, sport and trading facilities, surged in 2008. Construction works on residential buildings also remained strong, but their contribution to the growth of the private sector construction activity was significantly smaller.

Wholesale and retail trade, repair of motor vehicles, motorcycles and personal and household goods

In the first quarter of 2010, GVA in the wholesale and retail trade, repair of motor vehicles, motorcycles and personal and household goods sector, measured in current prices, decreased by 4.3 per cent. from HRK 7.5 billion in the first quarter of 2009 to HRK 7.1 billion in the first quarter of 2010. Real GVA in this sector decreased by 4.9 per cent. in the first quarter 2010 as compared to the same period in 2009. The decrease was primarily due to a decline in employment rate, a decrease in disposable income levels, a decline in credit availability and lower consumer confidence. During the first quarter of 2010, the share in total GVA, measured in current prices, of the wholesale and retail trade, repair of motor vehicles, motorcycles and personal and household goods sector decreased from 10.9 per cent. as at 31 December 2009 to 10.6 per cent as at 31 March 2010.

EVA of wholesale and retail trade, repair of motor vehicles, motorcycles and personal and household goods measured in current prices, decreased by 12.3 per cent. from HRK 36.1 billion in 2008 to HRK 31.7 billion in 2009. The share of this sector's GVA in total GVA decreased from 12.2 per cent. in 2008 to 10.9 per cent. in 2009. As a result of the decline in both domestic household and tourists consumption, real GVA in the wholesale and retail trade sector decreased by 14.3 per cent. in 2009 compared to 2008, which was the largest year-on-year decrease in GVA by sector recorded in 2009.

The sector's GVA measured in current prices increased by 4.9 per cent. from HRK 34.4 billion in 2007 to HRK 36.1 billion in 2008. A noticeable slowdown in personal consumption growth and stagnation in average foreign tourist consumption in real prices during the peak tourist season had an adverse impact on the value added formation in both wholesale and retail trade in 2008. Real GVA of this sector declined by 0.3 per cent. in 2008 compared to 2007, with the negative trend intensifying gradually towards the end of the year. The difference between the real and nominal growth values reflects the rise in prices.

Hotel and restaurants

In the first quarter of 2010, GVA in the hotel and restaurants sector, measured in current prices, decreased by 3.7 per cent. from HRK 1.5 billion in the first quarter of 2009 to HRK 1.4 billion in the first quarter of 2010. Real GVA in the hotel and restaurants sector decreased by 5.5 per cent. in the first quarter 2010 as compared to the same period in 2009. The decrease was mainly due to a decrease in domestic consumption of the hotel and restaurants services as a result of a decline in employment rate, a decrease in disposable income levels, a decline in credit availability and lower consumer confidence, as well as a decline in foreign consumption of the hotel and restaurants services due to a decrease in foreign tourist nights spent. During the first quarter of 2010, the share in total GVA, measured in current prices, of the hotel and restaurants sector decreased from 4.4 per cent. as at 31 December 2009 to 2.2 per cent as at 31 March 2010.

In 2009, GVA in the hotels and restaurants sector, measured in current prices, rose by 0.5 per cent. and reached HRK 12.8 billion. The share of GVA in the hotels and restaurants sector in total GVA increased slightly from 4.3 per cent. in 2008 to 4.4 per cent. in 2009. Real GVA in this sector decreased by 2.9 per cent. in 2009 as compared to 2008, in line with the downward trends in volume indicators of demand for tourist services, such as tourist arrivals and overnight stays, and the decreased real consumption by foreign tourists as a result of the global financial and economic crisis.

In 2008, the GVA in current prices in hotels and restaurants sector rose only slightly to HRK 12.8 billion from HRK 11.8 billion in 2007. This increase was in line with the volume indicators of demand for tourist services, namely, a slight increase in tourist arrivals and a slightly stronger growth in tourist nights stayed in commercial accommodation facilities. Real GVA in hotels and restaurants in 2008 rose 2.2 per cent. compared to 2007.

Transport, storage and communications

In the first quarter of 2010, GVA in the transport, storage and communications sector, measured in current prices, decreased by 4.5 per cent. from HRK 5.1 billion in the first quarter of 2009 to HRK 4.8 billion in the first quarter of 2010. Real GVA in the transport, storage and communications sector decreased by 5.4 per cent. in the first quarter 2010 as compared to the same period in 2009. The decrease was mainly due to the effects of the global financial and economic crisis, including many of the same drivers of GVA underlying the decrease. During the first quarter of 2010, the share in total GVA, measured in current prices, in the transport, storage and communications sector decreased from 8.3 per cent. as at 31 December 2009 to 7.2 per cent as at 31 March 2010.

GVA in the transport, storage and communications sector, measured in current prices, recorded a decline of 5.0 per cent. from HRK 25.5 billion in 2008 to HRK 24.2 billion in 2009. The share of GVA in this sector in total GVA decreased from 8.6 per cent. in 2008 to 8.3 per cent. in 2009. The real year-on-year GVA decline in the transport, storage and communications sector in 2009 amounted to 6.4 per cent. with both goods transport and passenger transport (measured by the number of passengers carried and passenger-kilometres) declining at an annual level. With respect to telecommunications, the number of minutes spent in the fixed network recorded a decline, whereas the number of minutes spent in the mobile network continued to grow albeit at a somewhat slower pace than in 2008.

GVA in current prices for the transport, storage and communications sector increased from HRK 24.5 billion in 2007 to HRK 25.5 billion in 2008, fell by 1.0 per cent. in 2008 compared to 2007. Real growth of GVA in the transport, storage and communications sector in 2008 reached 5.2 per cent., which represents a slowdown in growth compared to 2007. This was mostly due to a slowdown in goods transport but also due to a deceleration in passenger transport (measured by the number of passengers carried and passenger-kilometres). With respect to the telecommunications sector, the downward trend in minutes spent in the fixed network ceased, whereas minutes spent in the mobile network continued to grow albeit at a somewhat slower pace than in 2007.

Financial intermediation, real estate, renting and business activities

In the first quarter of 2010, GVA in the financial intermediation, real estate, renting and business activities sector, measured in current prices, increased by 0.4 per cent. from HRK 17.2 billion in the first quarter of 2009 to HRK

17.3 billion in the first quarter of 2010. Real GVA in the financial intermediation, real estate, renting and business activities sector decreased by 0.1 per cent. in the first quarter 2010 as compared to the same period in 2009. As the sector is mainly composed of banks, the decrease reflects the decline in banking activity, in particular loan issuances, as a result of the global financial and economic crisis. During the first quarter of 2010, the share in total GVA, measured in current prices, of the financial intermediation, real estate, renting and business activities sector increased from 24.4 per cent. as at 31 December 2009 to 25.7 per cent as at 31 March 2010.

GVA in the financial intermediation, real estate, renting and business activities sector, measured in current prices, increased by 4.6 per cent. from HRK 67.7 billion in 2008 to HRK 70.8 billion in 2009. The share of GVA in this sector in total GVA increased from 22.9 per cent. in 2008 to 24.4 per cent. in 2009. Real GVA in the financial intermediation, real estate, renting and business activities sector grew by 1.4 per cent. in 2009 as compared to 2008.

GVA in current prices for the financial intermediation, real estate, renting and business activities sector increased by 9.6 per cent. from HRK 61.8 billion in 2007 to HRK 67.7 billion in 2008, reflecting an increase in prices and volume.

Other Sectors

In the first quarter of 2010, GVA in the other sectors, measured in current prices, decreased by 2.7 per cent. from HRK 13.4 billion in the first quarter of 2009 to HRK 13.0 billion in the first quarter of 2010. Real GVA in the other sectors decreased by 0.2 per cent. in the first quarter 2010 as compared to the same period in 2009. During the first quarter of 2010, the share in total GVA, measured in current prices, of other sectors increased from 18.0 per cent. as at 31 December 2009 to 19.4 per cent as at 31 March 2010.

GVA in current prices in the remaining sectors, which include public administration and defence, compulsory social security, education, health and social work, other community, social and personal services and activities of households, increased by 4.8 per cent. from HRK 49.9 billion in 2008 to HRK 52.2 billion in 2009. The share of GVA in these sectors in total GVA increased from 16.9 per cent. in 2008 to 18.0 per cent. in 2009 while the real GVA in these sectors grew by 1.1 per cent. in 2009.

GVA in current prices for these sectors increased by 10.0 per cent. from HRK 45.4 billion in 2007 to HRK 49.9 billion in 2008. Real GVA grew at an annual rate of 2.2 per cent. in 2008.

Inflation and Trends in Prices

Inflation in Croatia is measured by CPI and PPI. CPI is based on the price of a basket of approximately 740 goods and services weighted according to the Household Budget Survey and the retail sales data. PPI is based on a basket of approximately 400 industrial products. Unlike CPI, PPI does not take into account services. Standards for calculating CPI and PPI in Croatia are materially in line with the standards used for calculating CPI and PPI in the EU.

Price stability has consistently been the primary objective of the CNB's monetary policy. The CNB's main strategy for achieving price stability has been to attempt to maintain a relatively stable HRK/EUR exchange rate.

The following table sets forth the average annual rate of inflation, as measured in CPI and PPI, for the periods indicated.

	Year ended 31 December						Four months ended 30 April	
	2004	2005	2006	2007	2008	2009	2009	2010
				(per cent.)				
CPI	2.1	3.3	3.2	2.9	6.1	2.4	3.8	0.8
PPI	3.5	3.0	2.9	3.4	8.3	(0.4)	0.8	3.9

Source: Central Bureau of Statistics

The average annual rate of inflation as measured by CPI increased from 2.9 per cent. in 2007 to 6.1 per cent. in 2008. This was principally due to a relatively high carry-over effect from 2007, and to a sharp increase in prices of food and refined petroleum products in the first half of 2008. The carry-over effect on annual average inflation in 2008 was 3.3 per cent. Carry-over effects denote the annual average rate of growth that would result if the level of CPI reached in the last month of a given year (2007) remained constant throughout the following year (2008). This is equivalent to the percentage difference between the level of CPI in the last month of 2007 and the average level for that year. The calculation of carry-over effects is therefore based on CPI developments in 2007 only. When the level of CPI in the last month of 2007 is above its average level for that year, the carry-over effect on annual average growth in 2008 is positive. Conversely, the carry-over effect is negative when the level of CPI at the end of 2007 is below its average level for that year. Given that CPI growth in Croatia is most often positive, carry-over effects may be interpreted as the minimum annual average growth rate which will be observed in 2008 on the basis of developments in 2007. The actual annual average growth rate observed in 2008 will then be the combination of the carry-over effect and growth developments in the course of 2008.

The surge in CPI peaked in July 2008 when its annual rate of change reached 8.4 per cent. The annual rate of change of CPI subsequently decreased to 2.9 per cent. in December 2008. The annual increase in the inflation of consumer prices in 2008 was due to imported and domestic demand-side factors. One of the most significant domestic factors spurring inflation in the first seven months of 2008 was a strong acceleration of real aggregate demand in 2007. The real annual growth of personal consumption accelerated considerably in 2007 and the postponed impact of this was also observed in the first seven months of 2008. In addition, domestic inflationary pressures also arose from the growth of unit labour costs, caused by a slowdown in labour productivity and a continuing growth of the average nominal gross wage. The sizeable slowdown in inflation after July 2008 was primarily due to decreased personal consumption due in part to the global financial and economic crisis as well as declining imported inflationary pressures. Imported inflationary pressures in the first seven months of 2008 mainly stemmed from a large increase in world prices of raw materials, especially those of crude oil and food raw materials. Primary commodity prices recorded a large increase in 2008 compared to 2007. Having risen by an average of 10.6 per cent. (in U.S.$) in 2007, the global price of crude oil continued to grow at a much higher rate averaging 36.4 per cent. in 2008 (from U.S.$71.1 per barrel in 2007 to U.S.$97.0 per barrel in 2008). This growth amounted to 24.1 per cent. in HRK terms in the same period, due to the nominal appreciation of the HRK exchange rate against the U.S. dollar. Food prices also rose sharply in 2008 compared to 2007.

Domestic inflationary pressures in 2008 were further eased by a slight appreciation of the HRK against the Euro from an average of HRK/EUR 7.34 in 2007 to an average of HRK/EUR 7.22 in 2008. Such exchange rate developments tend to produce a positive effect on domestic inflation as they stabilise both inflationary expectations and the prices of goods imported from the eurozone.

Declines in inflation, which commenced in the second half of 2008, continued throughout 2009. The average annual inflation rate decreased from 6.1 per cent. in 2008 to 2.4 per cent. in 2009. Several factors contributed to downward pressures on prices, including weakened domestic demand for goods and services, reduced inflation pressures stemming from prices of imports and slower growth of unit labour costs. These downward pressures were to some extent offset by the growth in prices of subsidised products, such as gas, tobacco products, and medical and hospital services. The carry-over effect on annual inflation growth in 2009 was only 0.2 percentage points due to a decrease in consumer prices in the second half of 2008 following their strong growth in the first half of the year, spurred by a sharp increase in the prices of crude oil and other raw materials in the world market. In contrast, the carry-over effect on annual inflation growth in 2008 was much higher, standing at 3.3 percentage points. Carry-over effects denote the annual average rate of growth that would result if the level of CPI reached in the last month of a given year (e.g., 2008) remained constant throughout the following year (e.g., 2009). This is equivalent to the percentage difference between the level of CPI in the last month of 2008 and the average level for that year. Industrial producer prices followed a trend similar to general inflation, decreasing at an even faster pace as their average annual rate of change decreased from 8.3 per cent. in 2008 to (0.4) per cent. in 2009.

Similar CPI trends continued at the beginning of 2010, bringing the average annual inflation rate further down to 0.8 per cent. in the first four months of 2010. This was mostly due to a decrease in meat and processed food prices during that period and the base comparison effect associated with the already relatively strong increase in food and regulated prices at the beginning of 2009. An opposite effect resulting in upward pressures on inflation stemmed from an increase in energy prices (gas and refined petroleum product prices). PPI, trending upwards since October 2009, continued to grow through April 2010. Annual average producer price inflation increased in the first four months of 2010 to 3.9 per cent., primarily due to rising energy prices as a result of an increase in producer prices of refined petroleum products and gas, and to some extent due to a comparison base effect (low energy prices during the first four months of 2009).

Government Subsidies

The Government maintains a subsidy programme for some large industries such as agriculture, Croatia's shipyards and the Croatian railways. The following table sets out Government subsidies in real prices for the periods indicated:

Industry	Year ended 31 December				Three months ended 31 March	
	2007	2008	2009	Plan 2010[2]	2009	2010
			(HRK thousands)			
Croatian railways	1,655,700	1,727,348	1,649,900	1,524,580	397,282	408,826
Agriculture	3,063,343	3,228,520	3,513,902	2,889,854	857,560	1,162,597
Shipyards and shipbuilding	390,920	394,928	311,442	106,000	78,643	0,0
HBOR	300,000	146,000	260,000	250,000	44,000	56,000
Other industries[1]	1,082,047	1,362,717	974,788	1,164,673	165,420	252,975
Total subsidies	**6,492,010**	**6,859,512**	**6,710,033**	**5,935,107**	**1,542,906**	**1,880,398**

Source: *Ministry of Finance*

(1) "Other industries" includes subsidies to air transport, water transport, road transport and tourism.

(2) Based on the Budget for 2010.

The following table sets out Government subsidies as a percentage of nominal GDP for the periods indicated:

Industry	Year ended 31 December				Three months ended 31 March	
	2007	2008	2009	Plan 2010[2]	2009	2010
			(per cent.)			
Croatian railways	0.53	0.50	0.50	0.45	0.12	0.12
Agriculture	0.97	0.94	1.06	0.86	0.26	0.34
Shipyards and shipbuilding	0.12	0.12	0.09	0.03	0.02	0.00
HBOR	0.10	0.04	0.08	0.07	0.01	0.02
Other industries[1]	0.34	0.40	0.29	0.34	0.05	0.07
Total subsidies	**2.07**	**2.00**	**2.01**	**1.76**	**0.46**	**0.56**

Source: *Ministry of Finance*

(1) "Other industries" includes subsidies to air transport, water transport, road transport and tourism.

(2) Based on the Budget for 2010.

The subsidies to the Croatian railways comprise the amounts provided for the maintenance of the railways system and for the expansion of the railways network. The subsidies to the shipbuilding industry have been decreasing since 2004. The Government intends to reduce the amount of the shipbuilding industry subsidies in the long-term.

Croatian Bank for Reconstruction and Development

HBOR was originally established on 12 June 1992 by the Act on the Croatian Credit Bank for Reconstruction and is entirely owned by the State. HBOR provides support to small and medium size enterprises ("**SMEs**"), large economic entities and State-owned companies and enables them, through its loan programmes, export credit insurance, guarantees and advisory services, to be competitive in domestic and foreign markets. HBOR is a development and export bank which supports Croatian business entities pursuant to the guidelines for the strategic development of the Republic of Croatia.

The strategic goal of HBOR is to promote systematic, sustainable and economic and social development in accordance with the strategic objectives of the Republic of Croatia. Within the framework of its activities, aside from lending, HBOR performs foreign currency payment transactions, undertakes mandated activities for and on behalf of the Government. HBOR also manages certain funds on behalf, and for the account, of a number of Ministries, the Fund for Development and Employment, the Fund for Regional Development of Republic Croatia, the Environment and Energy Efficiency Fund, Vodovod i kanalizacija d.o.o., Split (utility company) and the Croatian Agency for Small Business ("**HAMAG**"). These assets are kept separate from HBOR's assets and HBOR does not have any other liabilities in respect of them.

While a high percentage of HBOR's loans are made to intermediary banks, HBOR also extends loans directly to both private and public sector customers. Loans may be granted in Kuna or in foreign currencies. HBOR may also carry out other banking operations if they correlate with the above-listed functions. In addition, the Government may, from time to time, authorise HBOR to perform other financial transactions if, in its opinion, such transactions are in the best interests of Croatia. HBOR does not, however, carry out any banking, credit or other financial operations or other operations which would distort competition between HBOR and other ordinary or specialised credit and financial or other institutions. HBOR has substantial influence on the development of the State. Its primary aim is not to maximise profit but to maintain the value of its capital. It aims to secure a return on loans made by it and to preserve the value of funds lent by it, to set interest rates so as to cover its operating expenses, to create reserves by increasing capital and providing for risk exposure and to pass on foreign exchange risk to counterparties through loan agreements.

In addition to its own capital and reserves, HBOR raises funds on the international capital and banking markets and also through borrowings from "special financial institutions" such as KfW, the European Bank for Reconstruction and Development ("**EBRD**"), the International Bank for Reconstruction and Development ("**IBRD**"), the CEB and the European Investment Bank ("**EIB**").

Infrastructure Development Projects

In the period between 2006 and 2009, the average share of capital investments on a consolidated government level accounted for approximately 5.0 per cent. of GDP. The Government's principal capital investment projects include: the construction and reconstruction of roads and motorways, the reconstruction of war damaged housing units and water supply systems, the modernisation and restructuring of the national railways, as well as construction and modernisation of ports, education and science systems, healthcare and the judiciary. The Government's 2010 Budget anticipates that capital investment projects will account for 4.1 per cent. of GDP, which represents an increase from the 2009, when capital investment projects accounted for 3.9 per cent. of GDP.

Between June and December 2008, approximately 41.5 kilometres of new motorways were opened, including the A1 Zagreb-Split-Ploce, Šestanovac-Zagvozd, Zagvozd-Ravca, A4 Zagreb-Gorican and A6 Zagreb-Rijeka sections of the motorway. In addition, the Government completed approximately 36.9 km of widening of existing roads. In June 2010, approximately 28 kilometres of the full profile of section Kanfanar-Pula of Istrian Epsilon was opened.

Employment

Unemployment in Croatia consistently decreased during the years 2005 through and including 2008. The average registered unemployment rate reached 13.2 per cent. of the population of working age citizens in 2008, down from 14.8 per cent. in 2007. This trend, however, reversed at the beginning of 2009, as the adverse effects of the global financial and economic crisis spilled over to the labour market. The average number of registered unemployed persons on the Croatian Employment Service ("**CES**") register in 2009 increased by 26,433 persons, or 11.2 per cent., as compared with 2008, as the number of persons registering with the CES increased and the number of persons coming off the register decreased. The average registered unemployment rate (the proportion of registered unemployed in the labour force) in 2009 amounted to 14.9 per cent., up from 13.2 per cent. in 2008.

The year-on-year increase in the number of registered unemployed persons (in relative terms), which commenced in February 2009 and accelerated throughout 2009, reached its peak in January 2010, when the number of registered unemployed persons stood at 21.7 per cent., and has been decreasing since. In May 2010, the number of registered unemployed persons amounted to 296,438, increasing by 40,169 persons or 15.7 per cent. compared with May 2009. In the first five months of 2010, the average number of registered unemployed persons increased on annual basis by 49,310 persons or 18.9 per cent. The average unemployment rate increased from 14.8 per cent. in the first four months of 2009 to 18.1 per cent. in the first four months of 2009.

The following table sets forth the unemployment rate calculated under the registered unemployment and ILO methodologies for the periods indicated.

	Year ended 31 December		Three months ended 31 March	
	2008	**2009**	**2009**	**2010**
	(average for the period, in per cent.)			
ILO unemployment rate	8.4	9.1	9.4	11.2
Registered unemployment rate	13.2	14.9	14.7	18.1

The key difference between the ILO unemployment methodology and the "registered unemployment" methodology is that while the latter uses official data on persons who have registered as unemployed with CES, the ILO methodology uses labour force surveys and does not count as unemployed persons who are actually employed (e.g., in seasonal or shadow-economy jobs) but have registered as unemployed.

The table below shows the state of the labour market in Croatia for the periods indicated:

	Year ended 31 December			Three months ended 31 March	
	2007	2008	2009	2009	2010[(3)]
	(average for the period)				
Total employed persons	1,516,909	1,554,805	1,498,784	1,512,975	1,419,440
Total unemployed	264,446	236,741	263,174	261,452	315,282
Rate of unemployment (per cent.)[(1)]	14.8	13.2	14.9	14.7	18.1
GDP per employee (HRK)[(2)]	207,147	220,065	222,222	51,466	53,897
GDP per employee (EUR)[(2)]	28,237	30,467	30,277	6,948	7,398

Source: Central Bureau of Statistics

(1) The registered unemployment rate is calculated as a ratio of unemployed persons to total active population (meaning the labour force which consists of persons whose activity status in the reference week is either employed or unemployed).

(2) Post-2006 GDP data is not harmonised with final annual GDP calculation.

(3) Preliminary data for the period since February 2010.

The data presented in this section does not reflect ESA95.

After increasing steadily for eight consecutive years, in February 2009 unemployment began to decrease. In 2009, the average number of employed persons was 1,498,784, a decrease of 56,021 or 3.6 per cent. when compared to 2008. Towards the end of 2009, the year-on-year decline in employment became more pronounced. Consequently, at the end of 2009, the number of employed persons was 1,450,039, which represents a decrease of 93,839 as compared to the end of 2008. As of 30 April 2010, the number of employed persons decreased to 1,416,459.

In 2009, due to the effects of the global financial and economic crisis, employment declined on a year-on-year basis in almost all activities (according to the National Classification of Economic Activities, "NCEA 2007"). The largest contributions to the average annual decrease in total employment in 2009 resulted from the following sectors: wholesale and retail trade, repair of motor vehicles and motorcycles (a decrease of 18,659 jobs or 8.4 per cent. on average), manufacturing (a decrease of 16,103 jobs or 6.5 per cent. on average), accommodation and food service activities (a decrease of 3,827 jobs or 7.6 per cent. on average) and construction (a decrease of 3,282 jobs or 3.0 per cent. on average). Due to the fact that negative developments in the real estate sector spilled over to the construction activity sector with a delay, unlike industry and trade, the increase in layoffs in the construction activity sector was more pronounced in the second half of 2009. On the other hand, employment in the public administration sector (including public administration and defence; compulsory social security, education, human health and social work activities) rose (43,111 jobs or 1.3 per cent.), partly offsetting the negative contribution of the private sector.

The table below shows the approximate average number of people employed in the public sector for the periods indicated:

	Year ended 31 December			Four months ended 30 April	
	2007	2008	2009	2009	2010
	(average for the period)				
Public administration and defence, compulsory social security[(1)]	104,803	106,542	105,797	106,018	104,795
Education	97,013	100,394	103,275	103,391	104,850
Human health and social work activities	76,431	79,139	80,595	80,503	80,081
Total	**278,247**	**286,075**	**289,667**	**289,912**	**289,726**

Source: Central Bureau of Statistics

(1) Includes military and police.

In 2010, approximately 290,000 people (approximately 20 per cent. of all employed persons) were employed in the public sector. This number is high in comparison with other countries in the region and efforts are being made to make the public sector more efficient.

Trade and labour unions are active in Croatia. On 4 December 2009, the Parliament adopted the new Labour Act ("**ZOR**") that provides, among other things, that, unless the collective bargaining agreement states otherwise, upon the expiration of a collective bargaining agreement, the provisions thereof that govern the labour relations that are subject to the agreement shall continue to apply until the execution of a new collective bargaining agreement. Collective bargaining agreements are normally entered between, and govern the rights and obligations of, employers, on the one hand, and trade or labour unions acting on behalf of their members, on the other hand, and typically contain provisions governing labour relations and related matters.

ZOR became effective on 1 January 2010; however, at the session held on 31 May 2010, the Government adopted the proposal to amend ZOR ("**ZOR Amendment Proposal**") that envisages that (i) a newly executed collective bargaining agreement may provide for the extended application of the provisions thereof after the expiration of the agreement and until the execution of a new collective bargaining agreement, however, such an extended application period may not exceed six months, (ii) after the ZOR Amendment comes into force, in cases when an existing collective bargaining agreement provides for the application of its provisions upon its expiration, such an extended application period may not exceed six months, and (iii) in the absence of a provision extending the application of the collective bargaining agreement after its termination, on the day the ZOR Amendment becomes effective, the provisions of the existing collective bargaining agreements shall cease to apply after the expiration of such agreements. The ZOR Amendment Proposal has not yet undergone parliamentary review process; however, the unions have opposed the proposal and collected a sufficient number of signatures to call for a national referendum on the ZOR Amendment Proposal. Such a referendum is likely be expensive, and, according to the Government, would require a budget revision. In addition, a referendum could delay the Government's economic recovery plan. At present, the Government has not formally announced the referendum and is considering the issue.

Wages and labour costs

The beginning of 2009 was marked by a high annual growth of wages, in line with favourable developments in previous years. However, annual growth of wages moderately slowed down in the second quarter of 2009 in most private sector activities as well as in the public sector as the decision reducing wages of civil servants and other government employees by 6 per cent. and reducing wages of government officials by 10 per cent. became effective . In addition to the negative effect on net wages of the unfavourable macroeconomic environment due to the global financial and economic crisis, the Act on the Special Tax on Salaries, Pensions and Other Income, which entered into force on 1 August 2009, imposed a special tax rate of 2 per cent. on monthly income between HRK 3,000.00 and HRK 6,000.00 and a special tax rate of 4 per cent. on monthly income exceeding HRK 6,000.00.

The deceleration in wages growth became more pronounced towards the end of 2009, and the year-on-year decline in nominal wages was recorded in November 2009. When considering the annual average, nominal gross wages grew by 2.2 per cent. in 2009 compared to 2008, which represents a 4.9 per cent. decrease in growth compared to 2008. Nominal net wages increased by 2.6 per cent. in 2009 compared to 2008, which represents a 4.4 per cent. decline in growth compared to 2008. However, taking into account the effect of the special tax on average monthly net wages, net wages started falling in July 2009. Nevertheless, as a result of the strong growth of wages in the first half of 2009, nominal net wages (after the effect of the special tax) rose by 1.1 per cent. in 2009 compared to 2008.

Taking into account the average annual inflation as measured by the growth of the consumer price index, real net wages increased by 0.2 per cent., while real gross wages declined by 0.2 per cent. in 2009. However, when accounting for the effect of the special tax on average monthly nominal net wage, real net wages in 2009 declined by approximately 1.2 per cent. compared to 2008.

Despite the aforementioned reduction, public sector wages increased at a higher rate in 2009 than the wages in private sector, due to their high levels at the beginning of the year. According to NCEA 2007, the highest year-on-year average real gross wages growth in 2009 was recorded in the following sectors: electricity, gas, steam and air conditioning supply (5.8 per cent.); public administration and defence and compulsory social security (1.9 per cent.). The largest decreases were recorded by administrative and support service activities (-2.8 per cent.); mining and quarrying (-2.8 per cent.); and agriculture, forestry and fishing (-2.4 per cent.). The average real gross wages in manufacturing and wholesale and retail trade; and repair of motor vehicles and motorcycles, which are the sectors that have the highest percentages of total employment, also recorded annual declines of 1.6 per cent. and 2.3 per cent., respectively.

In the first quarter of 2010, the decrease in wages due to the global financial and economic crisis was more pronounced. The average nominal gross wages decreased by 0.9 per cent., while nominal net wages declined by 0.8 per cent., compared to the same period in 2009. If the effect of the special tax is taken into account, the annual decrease in average nominal net wages in the first quarter of 2010 was even higher (3.6 per cent.).The average real gross wages, deflated by consumer price index, declined by 1.8 per cent., while the average real net wages decreased by 1.7 per cent. in the first quarter of 2010 compared to the same period in 2009.

In 2009, labour productivity in industry increased by 0.1 per cent. as compared to 2008. This negligible increase reflected strong declines in both the industrial production volume and the number of employed persons in industry.

In the first four months of 2010, labour productivity in industry increased by 7.0 per cent. as a result of the decrease in the number of employed persons outpacing the decrease in industrial production volume.

The following table shows average nominal wages in Croatia for the periods indicated:

	Year ended 31 December			Three months ended 31 March	
	2007	2008	2009	2009	2010
Average monthly gross wages and salaries in HRK	7,047	7,544	7,711	7,708	7,637
Average monthly net wages and salaries in HRK[(1)]	4,841	5,178	5,311	5,301	5,259
Net wages and salaries in EUR (average exchange rate)[(1)]	660	717	724	716	722

Source: Central Bureau of Statistics and Ministry of Finance

(1) Does not reflect the effect of the special tax.

Social Security System

Unemployment

The social security system in Croatia consists of the Health Care Fund, the Pension and Disability Fund and the Employment Fund. These funds collect their revenues through payroll contributions and from Government transfers. Although the funds are responsible for their own budgets, the Ministry of Finance is required to supervise their budget preparation and the performance of the funds and to provide reports on the funds to Parliament.

Historically, unemployed persons in Croatia may apply for unemployment benefits, but in order to be eligible they must actively look for work.

In 2008, the total expenditure on unemployment benefits was HRK 1.2 billion, according to the Croatian Employment Services 2008 Yearbook. Of this total, HRK 814.7 million (70.2 per cent. of total expenditure on unemployment benefits) was disbursed for the financial support and legal protection of unemployed persons. The majority of the funds spent on financial support and legal protection, HRK 813.6 million, was spent to fund unemployment benefits. The Government spent HRK 109.3 million on pension insurance contributions for unemployed persons, and HRK 1.0 million to cover reimbursement for expenses incurred in the course of training and compensation for relocation expenses. Approximately HRK 137.1 million, HRK 132.8 million and HRK 4.3 million was spent on active labour market policy measures established in the 2008 Annual Employment Incentive Plans, the National Employment Action Plan 2005-2008, and the Action Plan for the Decade of Roma Inclusion 2005-2015, respectively.

In 2008, the Government undertook a restructuring of the previous unemployment regime, with the aim of protecting the unemployed from poverty in the first year of unemployment by providing higher compensation and a increased educational incentives. The Act on Employment Mediation and Unemployment Rights, which came into force on 1 January 2009, (the "**Employment Act**") among other things provides a financial incentive to persons enrolled in unemployment benefits if they participate in job training or re-training aimed at increasing their competitiveness in the labour market by enhancing their competencies, employability and mobility. In 2009, a total of 1,365 people participated in 97 job-specific training programmes and various other education and training programmes, such as computer education and foreign languages, in a variety of industries (e.g., tourism, trade and business administration, construction, textile and leather, mechanical engineering, professional services and agriculture). The financial incentive provided by the Employment Act is in the form of an education scholarship. The obligations and responsibilities of the unemployed under the Employment Act have increased as well.

In response to the global financial and economic crisis and in order to preserve the fiscal sustainability of the unemployment regime, the Government amended the unemployment benefits scheme in July 2009 in order to align benefits with the minimum wage. According to the Government's 2010 Budget, 0.35 per cent. of GDP will be allocated for the payment of unemployment benefits and investment in adult education designed to assist in retraining and obtaining employment. Furthermore, in July 2009 the Government adopted the Act on Subsidies for Maintaining Employment, which permits employers to make agreements with unions to shorten the work week to 32 hours in order to save jobs, with the Government providing subsidies to cover workers' reduced net wages.

Healthcare

Healthcare reform is aimed at finding new sources of revenue while reducing unnecessary costs. One new source of revenue is the premium paid by holders of automobile insurance, which, as part of the healthcare reform effort, is being used to cover some of the expenses of the national health care system. In order to reduce costs, healthcare reform has targeted primary physicians, incentivising providers of basic care to perform diagnostic and therapeutic treatments for which, prior to healthcare reform, they would often have referred patients to a specialist.

Motherhood Protection

On 1 January 2009, the Mandatory Health Insurance Act came into force and has provided all employed mothers with right to exercise compulsory maternity leave, with full salary compensation until their child is six months old, in the amount of their average salary paid before the maternity leave. Under the amended legislation, the minimum financial compensation from sixth month until one year of child's age amounts from HRK 1,663 to HRK 2,500, and depends on the salary compensation the mother has received until the child is six months old. Also, one-off financial aid to cover the expenses relating to childbirth total HRK 2,328. The Act on Child Support (Official Gazette 94/01 138/06 107/07) establishes a minimum amount of monthly child support payments at HRK 199. Moreover, the Act on Child Support establishes an additional allowance for parents with up to four children.

In the period from 2007 to 2009, the average level of maternity allowances and child support allowances was 1.1 per cent. of GDP. According to the most recent budget, it is expected that these allowances will continue to account for 1.1 per cent. of GDP in 2010.

Pension System

The Pension Law, which is primarily focused on redesigning the primary level of pension cover for Croatian citizens (the so-called "first pillar" of the present day three pillar system), was adopted by Parliament in July 1998 and such pension system operated until the end of 2001. The funds held by the pension fund were not sufficient to meet the future pension obligations of current employees due to the ageing of the population, an extraordinary increase in the number of beneficiaries caused by the 1991 War and declining economic activity between 1991 and 1993.

As part of these changes, the retirement age was raised to 65 years for males and 60 years for females and many of the existing provisions were curtailed as a first step to reforming the overall system. Despite that, the ratio of work force to pensioners in Croatia is 1.3 to 1. The first pillar will continue to pay full benefits to those above the relevant cut-off age (which is set at 40 years of age), but with substantially lower benefits paid to those below the relevant cut-off age.

Since a new pension insurance system was introduced in 2002, the participants are, during their active life, allocating their funds into two additional pillars.

For every employee in Croatia, employers allocate 20 per cent. of gross salary to the pension fund. 15 per cent. of gross salary of any reform participant is allocated to the obligatory pension fund, or to the first pillar of a pension, and 5 per cent. to the mandatory pension fund at the choice of the insured person, or the so-called "second pillar". The second pillar is a fully funded system based on mandatory contributions from wages paid to individual accounts of employees below 40 years of age (people between the ages of 40 and 50 have the opportunity to elect whether they will be part of the first or second pillar).

The third pillar is a voluntary private system, fully funded by voluntary employee or employer contributions. Currently, there are six open and fifteen closed voluntary pension funds and four mandatory pension funds in Croatia.

The three pillars combined should provide higher social security and higher overall level of pensions. The insurance risks are divided in several levels and according to insurance providers. This, in accordance with the goals of the reform, should be more favourable for beneficiaries of pensions and for overall economic movements than the provision of pension insurance based on inter-generational solidarity only. The investments of pension funds will increase total investments, thus promoting the development of capital markets, economic growth and the rise in living standards in Croatia. Following the Act on the Croatian Agency for Supervision of Financial Services published on 28 November 2005 (Official Gazette No. 140/05) the former pension bodies and regulator, the Insurance Companies Supervisory Authority, the Croatian Securities Commission and the Agency for Supervision of Pension Funds and Insurance have all ceased as of 1 January 2006. As of the same date, the Croatian Agency for Supervision of Financial Services ("**CASFS**") commenced its work as their legal successor.

The table below shows the number of people receiving pension, unemployment and child allowances for the periods indicated:

	Total number of people receiving pension[1]		Average monthly pension amount before tax and surtax		Number of people receiving child allowance[2]		Unemployment benefit recipients	
	Number of users	Year on Year % change	HRK	Year on Year % change	Number of users	Year on Year % change	Number of users	Year on Year % change
2007	1,119,554	0.7	2,192	5.7	228,804	6.2	59,752	(7.9)
2008	1,145,438	2.3	2,343	6.9	227,111	(0.7)	64,712	(8.3)
2009	1,172,500	2.4	2,387	1.9	210,242	(7.1)	81,588	(26.1)
First quarter of 2009	1,152,947	0.7	2,340	(0.1)	211,819	(6.5)	71,863	(17.6)
First quarter of 2010	1,181,932	0.8	2,381	1.8	197,364	(6.8)	89.902	(25.1)

Source: Croatian Pension Insurance Institute, Croatian Employment Service

(1) Since January 2008, the total number of people receiving pension includes pension users as defined by the contract between the Republic and Bosnia and Herzegovina on the cooperation in the area of war-affected peoples' rights that were members of Croatian Defence Council and members of their families.

(2) Period average.

The following table sets forth the value of the net assets of the of the mandatory pension funds, open voluntary pension funds and closed voluntary pension funds at the end of the periods indicated:

	Year ended 31 December			Three months ended 31 March	
	2007	2008	2009	2009	2010
		(HRK thousands)		*(HRK thousands)*	
Mandatory fund[1]	21,001,886	22,590,933	29,264,636	23,565,531	31,344,699
Open voluntary funds[2]	692,810	799,665	1,144,809	876,878	1,274,447
Closed voluntary funds[3]	119,082	148,378	218,343	163,776	243,549
Total	**21,813,778**	**23,538,977**	**30,627,788**	**24,606,184**	**32,862,695**

Source: Croatian Financial Services Supervisory Agency

(1) Includes Raiffeisen, PBZ-Co, A-Z and Erste PLAVI.

(2) Includes AZ Benefit, AZ Profit, Croatia Osiguranje, Raiffeisen, Erste Plavi Expert and Erste Plavi Protect.

(3) Includes NOVINAR, T-Mobile, AZ VIP, Croatia Osiguranje, Hrvatski Lijecnicki Sindikat, Sindikat Pomoraca Hrvatske, AZ Dalekovod, Ericsson Nikola Tesla, AZ HKZP, HEP Grupa, THT Grupa, AZ Zagreb, Cestarski MF, HAC MF and Sindikat hrvatskih željeznicara.

The Government recently introduced several reforms to the government pension scheme, aimed at improving the material status of pension beneficiaries and raising the level of average pension share in the average salary. On 1 January 2008 Parliament enacted the Act on Amendments to the Pension Insurance Act (OG 79/2007), which permitted the Government to raise early retirement pensions through a change in the baseline factor for determining early retirement pensions.

On 28 March 2008, the Government enacted the Act on Amendments to the Pension Insurance Act (OG 35/2008) which provided equal rights to pension insurance for beneficiaries working part-time to obtained. Similarly, the Allowance on Pensions Earned Act of 2007, in connection with the Pension Insurance Act (OG 79/2007), provides for improvements to the material status of "new pensioners" by harmonising the amount of pension obtained for the same number of accumulated years for beneficiaries who have obtained pensions based on regulations in force prior to pension reforms.

The Government funds pensions principally from pension contributions. However, because pension contributions do not cover all pension expenditure requirements, the Government uses other general budgetary revenue sources to meet funding requirements. The Government anticipates that pension expenses will reach HRK 34.62 billion for 2010, while pension insurance contributions by beneficiaries are anticipated to reach HRK 19.87 billion for 2010, therefore 57.4 per cent. of pension expenditures will be funded by pension insurance contributions.

FOREIGN TRADE AND INTERNATIONAL BALANCE OF PAYMENTS

Current Account Deficit

The following table sets forth the current account deficit of Croatia for the periods indicated:

	Year ended 31 December					Three months ended 31 March
	2005	2006	2007	2008	2009	2010[(1)]
Current account deficit in EUR (millions)	1,975.6	2,717.1	3,236.1	4,337.8	2,447.8	1,404.6
Current account (as a percentage of nominal GDP)	(5.5)	(6.9)	(7.6)	(9.2)	(5.4)	—

Source: Croatian National Bank

(1) Preliminary figures

In 2008, Croatia's current account deficit reached EUR 4,337.8 million, or 9.2 per cent. of GDP, representing an increase of 34.0 per cent. in EUR terms, or 21.2 per cent. in GDP percentage terms, compared to 2007. The increase was principally due to the increase in the trade in goods deficit largely caused by the rise in oil prices and the deterioration in the factor income account, which was only partially offset by the services surplus. In 2009, the current account deficit decreased by 43.6 per cent. in EUR terms, or 3.8 percentage points in GDP percentage terms, compared to 2008, primarily due to the decrease in the trade in goods deficit as a result of the decline in imports outpacing the decline in exports. The decline in imports was mainly attributable to a decrease in domestic demand and in oil and energy prices. In the first quarter of 2010, the current account deficit decreased further by 23.9 per cent. as compared to the same period in 2009 principally as a result of developments relating to trade in goods. As domestic demand is increasing and oil and energy prices continue to rise, the growth of imports may outpace that of exports and, as a result, the current account and trade in goods deficits may start to increase again. See "*Risk Factors — The current account deficit may continue to rise*".

Goods Account and Recent Trade in Goods Developments

Trade in Goods Deficit

As in previous years, the foreign trade deficit made the biggest contribution to the widening of the current account deficit in 2008. Croatia has carried a foreign trade deficit since its independence in 1991. The trade deficit was EUR 8.3 billion, EUR 9.4 billion, EUR 10.8 billion and EUR 7.4 billion in 2006, 2007, 2008 and 2009, respectively. According to balance of payments data calculated in Euros, the trade in goods deficit increased by 14.4 per cent. in 2008, compared to an increase of 13.1 per cent. and 11.0 per cent. in 2007 and 2006, respectively. The increase in the trade in goods deficit in 2008 was principally due to the significant deterioration in the trade in oil and refined petroleum products as a result of the surge in global crude oil prices in the first half of 2008. In addition, the positive trade balance in other transport equipment declined substantially in 2008 compared to 2007, primarily due to the reporting methodology of ship finishing works on a gross basis. During the ship construction process, vessels exported abroad for finishing operations and imported back after such operations are completed, are reported in the foreign trade statistics on a gross basis. As a result, these movements distort the total value of exports and imports of other transport equipment.

In 2009, according to balance of payments data, the trade in goods deficit decreased by 31.5 per cent. compared to 2008 as a result of the decrease in imports outpacing the decrease in exports, mainly due to a decline in the negative trade balance in road vehicles and petroleum and petroleum products as well as from a surplus in trade in other transport equipment. During the first quarter of 2010, the trade in goods deficit contracted by approximately a third compared to the same period of 2009 as a result of a recovery in exports, which increased slightly, while imports continued to decline.

In May 2009, the Ministry of Economy, Labour and Entrepreneurship initiated a programme designed to incentivise and ultimately increase Croatian exports through six incentive measures. The measures aimed at individual entrepreneurs are designed to encourage participation of Croatian companies in foreign trade fairs, investments related to the development and introduction of new products on international markets and international business activities. The measures aimed at joint entrepreneurs are designed to stimulate joint participation of companies in foreign trade fairs, organisation of targeted economic missions on international markets and establishment and support of foreign sales offices in the target foreign markets. Public tenders for these incentives were announced in June 2009 and are still open.

Exports

The following table sets forth Croatia's exports of goods by sector for the periods indicated prepared in accordance with SITC methodology.

	Year ended 31 December			Four months ended April 30	
	2007	**2008**	**2009**	**2009**	**2010**
			(HRK millions)		
Food and live animals	5,437.1	5,250.6	5,427.5	1,855.9	1,594.2
Beverages and tobacco	1,195.2	1,212.3	1,200.8	349.8	361.9
Crude materials, except fuels	4,219.1	4,212.6	3,368.8	960.7	1,318.6
Mineral fuels and lubricants	8,546.6	8,826.0	7,088.0	2,271.4	2,076.3
Animal and vegetable oils and fats	116.5	174.9	131.8	35.9	42.9
Chemical products	6,229.4	6,821.2	5,333.6	1,722.1	1,928.3
Manufactured goods classified chiefly by material	10,184.6	10,589.3	8,318.9	2,737.8	2,634.9
Machinery and transport equipment	20,482.4	23,185.1	16,411.0	6,262.1	6,659.7
Miscellaneous manufactured articles	9,607.7	8,920.2	7,877.3	2,598.8	2,715.8
Commodities and transactions, n. e.	24.9	12.5	22.3	6.7	12.9
Total	**66,043.4**	**69,204.8**	**55,180.0**	**18,801.2**	**19,345.5**

Source: Central Bureau of Statistics

According to the data from the CBS, total exports of goods amounted to HRK 69.2 billion (20.2 per cent. of nominal GDP) in 2008, which represented an increase of 4.8 per cent. from 2007, as compared to an increase of 9.3 per cent. from 2006 to 2007. The strongest impact on export growth came from the exports of other transport equipment, which contributed to more than half of the increase in total exports. If this SITC division were excluded from total exports, their annual growth rate would be approximately halved to 2.6 per cent.

The decrease in the growth rate of exports in 2008 can principally be attributed to a substantial fall in exports of miscellaneous manufactured articles and cereals and cereal preparations. In addition, exports of apparel, sugar, sugar preparation and honey, as well as furniture and furniture components, decreased substantially, partially offset by the increase in exports of electrical machinery, apparatus and equipment as well as power generating machinery and equipment.

The decrease in total exports of goods in 2009 as compared to 2008, expressed in HRK terms, amounted to 20.3 per cent., and was primarily due to the decrease in exports of other transport equipment as well as oil and refined petroleum products, the latter mainly a result of a substantial decline in these products' prices. In addition, a significant decrease was recorded in exports of metal manufactures, fertilizers, machinery specialized for particular industries, metalliferous ores and metal scrap and plastics in primary forms. Export growth was recorded in a small number of SITC divisions among which the most significant were cereals and cereal preparations as well as medical and pharmaceutical products.

In the first four months of 2010, total exports increased by 2.9 per cent. compared to the same period in 2009, primarily due to growth in exports of other transport equipment as well as, to a lesser degree, exports of metalliferous ores and metal scrap and plastics in primary forms, which is partially attributable to base effects.

Imports

The following table sets forth Croatia's imports of goods by sector for the periods indicated prepared in accordance with SITC methodology.

	Year ended 31 December			Four months ended April 30	
	2007	2008	2009	2009	2010
			(HRK millions)		
Food and live animals	9,585.1	10,672.3	9,849.2	3,153.2	2,861.4
Beverages and tobacco	929.2	957.2	953.7	265.5	275.8
Crude materials, except fuels	2,387.1	3,087.6	1,800.2	688.9	574.6
Mineral fuels and lubricants	20,992.7	26,416.1	18,826.8	5,634.2	5,971.2
Animal and vegetable oils and fats	335.7	575.2	428.1	135.5	101.2
Chemical products	15,174.4	15,915.4	13,843.3	4,658.5	4,787.5
Manufactured goods classified chiefly by material	27,314.2	27,958.5	20,279.8	7,016.1	6,191.0
Machinery and transport equipment	44,962.9	48,699.0	31,842.3	10,954.3	8,657.8
Miscellaneous manufactured articles	16,384.2	16,021.6	13,794.3	4,864.3	3,957.7
Commodities and transactions, n. e	93.9	51.2	122.1	28.5	21.7
Total	**138,159.4**	**150,354.0**	**111,739.7**	**37,399.1**	**33,399.9**

Source: Central Bureau of Statistics

According to CBS data, total imports of goods stood at HRK 150.4 billion (43.9 per cent. of nominal GDP) in 2008 and the annual growth in total imports of goods decreased slightly from 10.3 per cent. in 2007 to 8.8 per cent. in 2008, principally due to fast-growing imports of energy products (oil, refined petroleum products, as well as natural and manufactured gas) and transport equipment. Gas imports were affected by the low base figure for 2007 as a result of the completion of gas pipes that connect rigs in the northern Adriatic sea with the Croatian coast. The increase in oil imports was principally due to the considerable growth in energy prices in the first half of 2008. Imports of transport equipment increased substantially as a result of increased imports of ships previously exported for finishing purposes abroad and the increase in imports of air transportation and similar equipment.

Excluding other transport equipment, natural and manufactured gas, and oil and refined petroleum products, the growth of total imports was somewhat slower in 2008 compared to 2007, standing at 4.4 per cent., which is approximately half of the rate recorded in 2007 (8.6 per cent). Among the SITC divisions which decreased most noticeably were imports of miscellaneous manufactured articles, non-ferrous metals, organic chemical products and road vehicles recorded in the last quarter of 2008. In contrast, imports of crude fertilisers, iron and steel as well as electrical current increased in 2008.

In 2009, total imports of goods expressed in HRK terms declined by 25.7 per cent. principally due to a decrease in domestic demand and energy prices, including oil. The decrease in imports resulted from a decline in the majority of SITC divisions, with the most significant decreases recorded in the imports of oil and refined petroleum products and road vehicles, the latter decreasing by approximately a half in comparison with 2008, as well as in the imports of other transport equipment.

According to CBS data, the trade deficit contracted by 30.3 per cent. in 2009 compared to 2008 and amounted to HRK 56.6 billion (HRK 81.1 billion in 2008) principally due to a more pronounced decline in imports than in exports, and is largely attributable to an improvement in the balance of trade in oil and road vehicles. These two sectors contributed to almost a half of the overall decrease in the total trade deficit.

In the first four months of 2010, total imports declined by 10.7 per cent. in comparison with the same period of 2009, mainly as a result of a significant decrease in the import of road vehicles, machinery specialized for particular industries and general industrial machinery and equipment. The trade in goods deficit in the same period contracted by 24.4 per cent. compared to the first four months of 2009.

Geographical Distribution of Croatia's Trade in Goods

The following table sets forth a geographical distribution of Croatia's exports, calculated from HRK values.

	Year ended 31 December			Four months ended April 30	
	2007	**2008**	**2009**	**2009**	**2010**
			(per cent.)		
Developed Countries	70.5	69.3	68.3	71.3	72.3
EU 27	60.3	60.9	60.5	62.1	62.5
Slovenia	8.3	7.8	7.4	7.4	7.7
Hungary	2.2	2.4	1.8	1.6	1.6
EU 15	43.7	44.2	43.9	44.4	47.2
Austria	6.1	5.8	5.4	5.4	5.3
Italy	19.2	19.2	19.1	19.1	23.4
Germany	10.0	10.7	11.0	12.2	10.2
EFTA(1)	1.2	1.2	1.7	1.7	1.2
Developing Countries	29.5	30.7	31.8	28.7	27.7
Bosnia and Herzegovina	14.4	15.3	12.8	12.1	10.6
Serbia, Montenegro	6.6	6.8	6.9	5.8	4.7
Russia	1.3	1.3	1.5	1.3	1.5
China	0.2	0.3	0.4	0.4	0.3

Source: Central Bureau of Statistics

(1) European Free Trade Association

The following table sets forth a geographical distribution of Croatia's imports, calculated from HRK values.

	Year ended 31 December			Four months ended April 30	
	2007	**2008**	**2009**	**2009**	**2010**
			(per cent.)		
Developed Countries	73.2	72.6	72.2	72.1	72.1
EU 27	64.8	64.1	62.7	62.6	60.2
Slovenia	5.9	5.6	5.7	5.7	5.6
Hungary	2.9	3.2	3.2	3.0	3.2
EU 15	48.8	48.5	47.0	47.3	45.7
Austria	5.3	4.9	5.0	5.2	4.6
Italy	16.1	17.1	15.4	14.2	15.3
Germany	14.4	13.4	13.5	14.4	12.7
EFTA(1)	1.9	1.7	2.6	2.8	2.0
Developing Countries	26.8	27.4	27.8	28.0	27.9
Bosnia and Herzegovina	2.8	2.7	2.7	2.6	2.8
Serbia, Montenegro	1.3	1.4	1.6	1.3	1.3
Russia	10.1	10.3	9.5	9.6	8.3
China	6.2	6.2	6.8	7.5	7.5

Source: Central Bureau of Statistics

(1) European Free Trade Association

Within the geographic break-down of Croatia's exports of goods, the share of more developed countries decreased slightly in 2008 compared to 2007, as exports to these countries grew more slowly than those to developing countries. With respect to exports to developed countries, exports to Old EU Member States grew more than twice as fast in 2008 as in 2007, most notably to Italy (primarily ships) and Germany (principally ships and vehicles on trails), while the growth rate of exports to new EU Member States in 2008 decreased to a third of that recorded in 2007. As for trade with developing countries, major contributors to export growth were exports to neighbouring countries, particularly Bosnia and Herzegovina (oil, refined petroleum products and electricity) and Serbia and Montenegro (non-metallic mineral manufactures and electrical machinery, apparatus and appliances), despite a noticeable deceleration in growth compared to 2007. In 2009, the share of developed countries decreased slightly as a result of a more pronounced decrease in exports to this country group than to developing countries, with the largest decreases recorded in exports to Italy, Germany and Slovenia. The decrease in exports to developing countries can be almost entirely attributed to the decline in exports to Bosnia and Herzegovina, mostly due to a decrease in the value of oil and petroleum product exported there.

The structure of Croatia's imports of goods was also marked by a slight decrease in the share of imports from developed countries, driven by the same factors affecting exports. Although still dominant, imports from developed countries grew at a slightly lower rate in 2008 than in 2007, mostly due to slower growth of imports from Germany (mostly iron and steel, and road vehicles). However, imports from certain other developed countries, particularly from Italy, accelerated significantly. The increase of imports from Italy was primarily a result of increased imports of ships and oil. Imports from developing countries were largely determined by increased imports from Russia, which comprised almost entirely of energy products. In 2009, the share of developed countries in Croatian imports continued to decline, albeit at a slightly lower rate than on the exports side. As in the case of exports, this was largely due to a stronger decrease in imports from the developed country group, with those from Italy recording the largest decline. Among developing countries, imports from Russia recorded the largest decrease, as the value of imported oil and petroleum products decreased compared to 2008, in line with the world market prices.

The following table sets forth major countries of destination of Croatian exports of goods as a percentage of total exports of goods in the first four months of 2010 and the changes in exports to these countries in the first four months of 2010 as compared to the first four months of 2009.

	Share	Change
	(per cent.)	
Austria	5.3	1.7
Bosnia and Herzegovina	10.6	(9.7)
Germany	10.2	(14.3)
Italy	23.4	26.3
Slovenia	7.7	6.6

Source: Central Bureau of Statistics

The following table sets forth major countries of origin of imports of goods in Croatia as a percentage of total imports of goods in the first four months of 2010 and the changes in imports of goods from these countries in the first four months of 2010 as compared to the first four months of 2009.

	Share	Change
	(per cent.)	
Austria	4.6	(21.9)
China	7.5	(11.0)
Russia	8.3	(23.3)
Germany	12.7	(21.2)
Italy	15.3	(3.9)
Slovenia	5.6	(13.0)

Source: Central Bureau of Statistics

Details of the International Balance of Payments

The balance of payments of Croatia represents a systematic overview of the value of economic transactions performed by Croatian residents with foreign countries within a particular period. It is compiled in accordance with the recommendations of the IMF Data sources, which include reports of the government institutions (CBS and Croatian Institute for Health Insurance), special reports of the CNB (International Transaction Reporting System, external debt relations, monetary statistics and reserve assets), and estimates and statistical research carried out by the CNB.

The balance of payments tabulates the credit and debit transactions of a country with foreign countries and international institutions for a specific period. Transactions are divided into three broad groups: current account, capital account and financial account. The current account is made up of: (1) trade in goods and (2) trade in services, income from profits and interest earned on overseas assets, net of those paid abroad, and net capital transfers to international institutions. The capital account primarily comprises net capital transfers from international institutions. The financial account is made up of items such as the inward and outward flow of money for direct investment, investment in debt and equity portfolios, international grants and loans and changes in the official reserves.

Balance of payments of Croatia data are reported in three currencies: in Euro, U.S. dollar and HRK. In all cases, the same data sources are used and the same principles regarding the scope of transactions and the procedures for compiling particular items are applied.

The last positive balance on the current account of international balance of payments was recorded in 1994.

The following table sets forth the balance of payments for the periods indicated:

	Year ended 31 December					Three months ended 31 March	
	2005	2006	2007	2008	2009	2009	2010[(1)]
				(EUR million)[(2)]			
CURRENT ACCOUNT	(1,975.6)	(2,717.1)	(3,236.1)	(4,337.8)	(2,447.8)	(1,844.7)	(1,404.6)
Goods, services, and income	(3,159.5)	(3,824.5)	(4,279.1)	(5,408.3)	(3,483.4)	(2,051.5)	(1,657.4)
Credit	15,990.2	17,883.1	19,600.2	21,256.5	16,927.9	2,916.7	2,892.8
Debit	(19,149.7)	(21,707.6)	(23,879.3)	(26,664.8)	(20,411.3)	(4,968.2)	(4,550.2)
Goods and services	(2,200.2)	(2,641.6)	(3,166.6)	(3,835.9)	(1,722.4)	(1,597.0)	(1,164.8)
Credit	15,272.9	16,990.4	18,307.2	19,904.6	16,144.4	2,701.9	2,805.0
Debit	(17,473.2)	(19,632.0)	(21,473.8)	(23,740.5)	(17,866.8)	(4,298.9)	(3,969.7)
Goods	(7,518.0)	(8,344.2)	(9,434.0)	(10,793.8)	(7,398.0)	(1,731.8)	(1,288.6)
Credit	7,220.3	8,463.6	9,192.5	9,814.0	7,690.5	1,928.5	2,017.1
Debit	(14,738.3)	(16,807.8)	(18,626.5)	(20,607.8)	(15,088.5)	(3,660.3)	(3,305.7)
Services	5,317.7	5,702.7	6,267.4	6,957.9	5,675.6	134.8	123.8
Credit	8,052.6	8,526.8	9,114.7	10,090.6	8,453.9	773.4	787.8
Debit	(2,734.9)	(2,824.2)	(2,847.3)	(3,132.7)	(2,778.3)	(638.6)	(664.1)
Transportation	376.1	474.2	542.1	508.5	255.0	51.2	37.3
Credit	880.3	1,037.5	1,165.4	1,209.4	752.0	173.9	145.8
Debit	(504.2)	(563.2)	(623.3)	(700.9)	(497.1)	(122.7)	(108.5)
Travel	5,394.9	5,708.7	6,035.2	6,694.0	5,655.8	171.9	188.1
Credit	5,998.9	6,293.3	6,752.6	7,459.4	6,379.7	300.7	324.7
Debit	504.0	388.4	389.2	386.4	255.7	40.0	39.0
Other services	(453.3)	(480.3)	(310.0)	(244.6)	(235.1)	(88.4)	(101.6)
Credit	1,173.4	1,196.0	1,196.8	1,421.8	1,322.2	298.8	317.4
Debit	(1,626.6)	(1,676.3)	(1,506.7)	(1,666.4)	(1,557.3)	(387.1)	(419.0)
Income	(959.2)	(1,182.9)	(1,112.5)	(1,572.4)	(1,761.0)	(454.5)	(492.6)
Credit	717.3	892.7	1,293.0	1,351.9	783.5	214.8	87.9
Debit	(1,676.5)	(2,075.6)	(2,405.5)	(2,924.3)	(2,544.5)	(669.3)	(580.4)
Current transfers	1,183.8	1,107.4	1,043.0	1,070.5	1,035.6	206.8	252.7
Credit	1,628.4	1,639.5	1,576.1	1,684.4	1,607.1	348.7	394.6
Debit	(444.6)	(532.1)	(533.1)	(613.9)	(571.5)	(141.9)	(141.9)
CAPITAL AND FINANCIAL ACCOUNT	3,008.7	3,695.1	4,084.3	5,909.9	3,173.0	2,312.5	640.7
Capital account	53.8	(134.0)	28.5	14.9	40.5	(3.4)	12.6
Financial account, excl. reserves	3,776.8	5,241.3	4,777.4	5,564.6	4,028.9	1,905.2	110.5
Direct investment	1,276.1	2,556.6	3,411.7	3,206.6	1,177.3	408.5	472.7
Abroad	(191.8)	(208.2)	(266.9)	(988.8)	(918.7)	(28.7)	38.5
In Croatia	1,467.9	2,764.8	3,678.6	4,195.4	2,096.0	437.2	434.2
Portfolio investment	(1,187.9)	(529.6)	6.1	(633.9)	155.7	(415.7)	(640.2)
Assets	(581.3)	(459.8)	(404.7)	(280.0)	(797.4)	155.9	(102.6)
Liabilities	(606.6)	(69.8)	410.8	(353.9)	953.1	(571.6)	(537.5)
Financial derivatives	(88.4)	0.0	0.0	0.0	0.0	0.0	(61.1)
Other investment	3,777.0	3,214.3	1,359.7	2,991.9	2,695.9	1,912.4	339.1
Assets	982.2	(692.3)	(1,653.3)	(1,620.9)	682.6	1,940.7	426.0
Liabilities	2,794.7	3,906.6	3,012.9	4,612.8	2,013.3	(28.4)	(86.9)
Reserve assets	(821.8)	(1,412.2)	(721.6)	330.4	(896.4)	410.7	517.5
NET ERRORS AND OMISSIONS[(3)]	(1,033.1)	(977.9)	(848.2)	(1,572.1)	(725.2)	(467.8)	763.9

Source: Croatian National Bank

(1) Preliminary data.

(2) Exchange rate: as at the end of the relevant period.

(3) The item "net errors and omissions" also comprises the counter entry of a portion of revenues from travel services which relates to such revenues not stated in the banks' records.

Services Account

The positive balance recorded on the services account improved in 2008 relative to 2007 by 11.0 per cent., principally due to tourism revenues rising by 10.5 per cent. in 2008 compared to 2007. The growth in tourism revenues resulted mostly from an increase in average consumption, as foreign tourist arrivals and nights spent (according to the CBS data, which covers only commercial accommodation facilities) rose only slightly (1.2 per cent. and 2.1 per cent., respectively). The break-down of tourist nights by country of residence shows an increase in number of nights spent by guests from new EU Member States, especially Poland and Slovenia, while the number of nights spent by guests from Old EU Member States showed no significant change compared to 2007. With respect to trade in other services, a modest worsening was recorded in the trade balance of transportation services, notably freight transport. However, the negative trade balance in other services fell by 21.1 per cent. year-on-year, with the largest improvement seen in the trade of miscellaneous business services such as architecture, research and development and construction services. On the other hand, a deterioration was seen in the balance of trade in operational leasing services and agricultural services.

Net revenues from international trade in services in 2009 decreased by 18.4 per cent. compared to 2008 mainly due to decreased revenues from tourism, which declined by 14.5 per cent. or EUR 1.1 billion. The decrease in tourism revenues can primarily be attributed to lower average consumption, as the number of foreign tourist arrivals and nights spent decreased insignificantly (0.9 per cent. and 0.3 per cent., respectively). According to a break-down of tourist nights spent by country of residence, the number of nights spent by guests from new EU Member States, especially Hungary and Slovenia, decreased relative to 2008, while the number of nights spent by guests visiting from old EU Member States increased. In relative terms, less positive results than in tourism were seen in transportation services. The positive trade balance in these services decreased by approximately a half compared to 2008, with the largest decrease recorded in sea fright and air passenger transport. In contrast, the negative balance in trade of other services improved slightly, as expenditures declined more than revenues. On the revenues side of these services, the largest decline was seen in miscellaneous business services (especially those related to architecture and research and development) and telecommunication services. On the other hand, revenues from agricultural and mining, as well as informational and construction services, increased. The drop on the expenditures side mostly came from business and telecommunication services.

In the first quarter of 2010, the positive balance on the services account decreased slightly, mainly as a result of decreased net revenues from transportation and deteriorating balance of trade in other services, while net revenues from tourism increased slightly. Decreased net revenues from transportation services mostly were due to lower volumes of international trade in goods but also due to lower number of tourists traveling. These adverse conditions primarily affected the air transport and freight transport in general. Regarding other services, the deterioration of the balance mostly related to miscellaneous business services. Revenues from tourism grew by 8.0 per cent. in the first quarter of 2010 compared to the same period of 2009 as a result of the increased number of arrivals and the average consumption. According to the CBS data, which covers only commercial accommodation facilities, in the first quarter of 2010 arrivals increased by 2.5 per cent., while the number of nights spent rose by 5.7 per cent., as compared to the same period of 2009.

Factor Income Account

The factor income account balance deteriorated in 2008 by 41.3 per cent. compared to 2007, principally due to a significant increase in expenditures (21.6 per cent.), accompanied by weak revenue growth (4.6 per cent.). On the revenue side, compensation to employees recorded low rates of growth, while revenues related to resident investments abroad decreased slightly compared to 2007. The significant increase in expenditures was primarily due to interest paid on foreign borrowing, as well as to expenditures related to direct investments.

The deficit in the factor income account increased by 12.0 per cent. in 2009 compared to 2008 primarily due to the decrease in revenues outpacing the decrease in expenditures. A decrease in total revenues on the factor income account in 2009 amounted to 42.0 per cent. compared to 2008, primarily due to the decline in revenues related to resident investments abroad as a result of weak business performance of domestically owned companies abroad. In addition, the CNB's and commercial banks' revenues from the investment of foreign assets also declined considerably in 2009 compared to 2008, with the exception of revenues attributable to compensation to employees, which grew by 4.1 per cent. On the expenditure side, the largest decline was observed in expenditures related to direct investment (dividends and reinvested earnings of foreign owned companies and banks). Additionally, interest payments on external debt also decreased as a result of relatively low interest rates on the international markets during 2009.

Further deterioration of the factor income balance during the first quarter of 2010 was primarily attributable to the deterioration in the direct equity investment account, while net expenditures related to interest payments decreased.

Deterioration of the equity investments account mostly reflected the fact that resident owners of companies abroad incurred losses during the first quarter of 2010, while foreign owned companies and banks on the domestic market made profits. Lower interest payments, mostly made by companies and commercial banks, were predominantly be attributable to relatively low interest rates.

Current Transfers

A minor positive change was recorded in the current transfers account balance in 2008, with stronger revenue growth compensating for a somewhat weaker increase in expenditures. The growth of total revenues was mostly related to general government revenues from intergovernmental grants, including EU pre-accession funds. Revenues earned by other domestic sectors also grew to some extent. On the expenditures side, the largest increase also came from the government sector, specifically as a result of expenditures on pensions, taxes and one-time payment resulting from the settlement of a legal dispute.

The change in the current transfers account balance in 2009 was also insignificant, although both expenditures and revenues declined. The decrease in expenditures was most pronounced in the government sector, which resulted in an improvement in the overall balance of the current transfers account. On the other hand, as revenues declined more than expenditures, especially those related to workers' remittances from abroad, the balance of other sectors deteriorated slightly.

Net revenues in the current transfers account in the first quarter of 2010 increased by almost a quarter relative to the same period of 2009, almost entirely as a consequence of a positive change in revenues, while expenditures remained at the level recorded in the first quarter of 2009. The growth in revenues in the first quarter of 2010 can be attributed primarily to increased revenues earned by the private sector, mostly comprising gifts, donations and workers' remittances from abroad, while the government sector experienced somewhat lower growth in revenues as compared to the private sector.

Capital and Financial Account

In 2008, the capital and financial account had somewhat larger net capital inflows than in 2007 and, excluding the change in reserves, stood at EUR 5.6 billion. The largest inflow of funds was attributable to direct investments, principally through the increase in equity capital. In addition, significant capital inflow was recorded on the account of other investment where liabilities saw a high growth rate (53.1 per cent.) while assets decreased slightly (2.0 per cent.). The account of portfolio investment experienced outflows of funds through repayment of Government bonds and, at the end of 2008, through withdrawal of funds invested by non-residents in Croatian assets, including bonds and equity holdings and increased investment in foreign debt instruments by domestic banks and other sectors. After continuous growth during the last several years, gross international reserves in 2008 declined by EUR 0.3 billion mainly due to the change in monetary policy instruments.

Net inflows of capital through other investment such as trade credits, loans, currency and deposits more than doubled in 2008 compared to 2007 due to very high growth of foreign liabilities (120.1 per cent.), principally those of other domestic sectors and banks, which increased by EUR 3.5 billion and EUR 1.0 billion, respectively. This contributed to a further increase in the stock of external debt that at the end of 2008 reached 82.6 per cent. of GDP. However, strong inflow of capital was offset by significant outflows as a result of a rise in foreign assets (EUR 1.6 billion), mainly as a consequence of rumours in October about possible financial problems of foreign parent banks. As a result, households withdrew a significant amount of deposits from local banks, which in turn led to an increase in households' foreign currency holdings.

Net inflows of capital in the capital and financial account in 2009 were significantly lower than in 2008 (excluding the change in reserves, net inflows stood at EUR 4.1 billion, a decline of almost one third compared to 2008). Both debt and equity related capital inflows dropped considerably. In addition, the growth in foreign assets weakened compared to 2008. After a decline in 2008, gross international reserves increased by EUR 0.9 billion in 2009 (excluding SDR allocation). The much lower current account deficit (-43.6 per cent.) in 2009 resulted in significantly lower financing needs, so that despite the drop in inflows of capital (-27.1 per cent.), international reserves increased in the same period.

The increase in foreign liabilities of domestic sectors in 2009 (by EUR 5.2 billion) mostly reflects the growth of debt liabilities (by EUR 4.2 billion), particularly those of private companies. Nevertheless, compared with 2008, the intensity of foreign borrowing of domestic companies weakened considerably due to declining economic activity and reduced availability of foreign sources of finance during 2009. Banks also recorded lower debt growth than in 2009, while the Government stepped up external borrowing and increased its foreign liabilities by EUR 1 billion. Consequently, total foreign debt increased in 2009 by EUR 3.6 billion (excluding round-tripping), which is approximately 40 per cent. less than the increase in 2008. Despite slower growth, ratio of debt to GDP deteriorated due to a decrease in nominal GDP. The external debt to GDP ratio reached 94.9 per cent. at the end of 2009. The growth in foreign assets in 2009 mostly reflects resident direct investments abroad, which amounted to EUR 1.2 billion in 2009, most of which relates to round trip investment. Additionally, investment funds, after withdrawing from international capital markets during 2008, started investing again in 2009, mostly in debt securities. With respect to foreign assets of commercial banks, the decreased level can mostly be attributed to the reduction in the minimum required amount of foreign currency claims.

Two round-tripping transactions were recorded in Croatia, one in the last quarter of 2008 (EUR 0.8 billion) and one in the third quarter of 2009 (EUR 0.7 billion). These transactions involve Croatian equity investment abroad to companies which then lend back to the investing company in Croatia. Although these round-tripping transactions had no effect on the amount of net FDI inflows in Croatia, and thus no effect on the total financial account of the balance of payments, they had the effect of overstating the amount of direct investment in Croatia (through debt instruments) and Croatia's direct equity investment abroad during the period in which these transactions were performed. Also, this contributed to a significant increase in gross external debt (by a total of EUR 1.5 billion, as compared to the balance that excludes these transactions).

Excluding the change in foreign reserves, during the first quarter of 2010, only minor capital inflows were recorded. During that period, domestic sectors decreased their foreign assets by EUR 0.2 billion, which was offset by a similar decrease in their foreign liabilities. Regarding foreign assets, the decrease can be attributed to the decrease in foreign assets of domestic banks, while other domestic sectors, especially investment funds, increased the level of their assets mostly by investing in stocks and equity shares in foreign markets. The drop on the liabilities side almost entirely reflects the reduction in debt liabilities, i.e. the stock of external debt, while equity liabilities increased during the same period. Among specific sectors, the Government decreased its foreign debt the most, mainly by repaying its EUR 500 million Eurobond in February. Banks decreased their liabilities only slightly, while companies, in contrast, continued to increase the level of their foreign debt during the first quarter of 2010, although at a very slow pace.

Foreign Direct Investment (FDI)

The following table sets forth FDI in Croatia for the periods indicated.

	Year ended 31 December					Three months ended 31 March	
	2005	**2006**	**2007**	**2008**	**2009**	**2009**	**2010[(1)]**
			(EUR millions)				
FDI into Croatia	1,276.1	2,556.6	3,411.7	3,206.6	1,177.3	437.2	434.2
FDI from Croatia abroad	(191.8)	(208.2)	(266.9)	(988.8)	(918.7)	(28.7)	(38.5)
FDI (net)	**1,276.1**	**2,556.6**	**3,411.7**	**3,206.6**	**1,177.3**	**408.5**	**395.7**

Source: Croatian National Bank, Foreign Direct Investments Statistics (as of May 2010)

(1) Preliminary figures.

FDI includes equity capital, reinvested earnings and debt relations between ownership-related residents and non-residents.

Net FDI in 2008 totalled EUR 3.2 billion, decreasing by EUR 0.2 billion or 6.0 per cent. compared to 2007, mainly due to lower inward investments (excluding round-tripping transactions). FDI into Croatia in 2008 totalled EUR 4.2 billion, increasing by EUR 0.5 billion or 14.0 per cent. compared to 2007, primarily due to round-tripping related investments, which totalled EUR 0.8 billion. Excluding round-tripping, inward investments totalled EUR 3.4 billion and were EUR 0.3 billion or 8.4 per cent. lower than in 2007. Equity investment dominated the structure of inward investments in Croatia, making up 64.5 per cent. of total inward FDI (excluding round-tripping transactions) in 2008 (as compared to 59.5 per cent. in 2007). Debt investment (i.e. domestic sectors' liabilities to their affiliated companies abroad), which accounted for 20.4 per cent. of total inward FDI (excluding round-tripping transactions) in 2008, decreased by nearly one third in 2008 after growing strongly in 2007. However, foreign owners of domestic banks and enterprises saw only a minor increase in their retained earnings compared to 2007.

In 2008, inward FDI (excluding round-tripping) break-down by sector was as follows: 34 per cent. —financial intermediation (except insurance and pension funds), 27 per cent. — the manufacture of coke and refined petroleum products, 9 per cent. — manufacture of other non-metallic mineral products, 6 per cent. — retail trade (except motor vehicles), 4 per cent. — the extraction of crude petroleum and natural gas, 4 per cent. — hotels and restaurants, 6 per cent. — wholesale trade and commission trade. When reviewing the FDI in monetary intermediation, recapitalisation of domestic banks by their foreign owners amounted to EUR 0.4 billion, which is significantly less than in 2007 (EUR 1.2 billion). Nevertheless, including substantial retained earnings, total FDI in this sector reached EUR 1.1 billion. In addition, significant inflows of equity investments were recorded in the manufacture of coke and refined petroleum products, which relates to the acquisition of 22 per cent. of INA shares by MOL, which was the largest individual inflow in 2008. In terms of a geographical break-down, Austrian investors (mostly bank owners) comprise the largest share of total FDI, followed by Hungarian investors (INA).

Net FDI in 2009 amounted to EUR 1.2 billion, which represented a 63.3 per cent. decrease compared to 2008, primarily due to significantly decreased inward FDI, while resident investments abroad decreased only slightly. FDI into Croatia in 2009 totalled EUR 2.1 billion, decreasing by approximately a half compared to 2008. The structure of FDI into Croatia reveals the dominance of direct debt investment (i.e. domestic sectors' liabilities to their affiliated companies abroad) amounting to EUR 1.1 billion, more than half of which relates to round-tripping investments. Direct equity investments totalled EUR 0.7 billion, one third of the amount recorded in 2008. A significant decrease in direct equity investment reflects the reluctance of foreign investors to invest in developing countries and emerging markets and the overall uncertainty and risk aversion dominating the global financial markets. The amount of reinvested earnings halved in 2009, as foreign owned companies and banks made less profits in 2009 than in 2008. The breakdown of inward FDI (excluding round-tripping) by sector in 2009 was as follows: 46 per cent. — financial intermediation (except insurance and pension funds), 22 per cent. — other business activities, 9 per cent. —the extraction of crude petroleum and natural gas, 8 per cent. — retail trade and commission trade, 8 per cent. — manufacture of coke and refined petroleum product, and 8 per cent. — real estate investments.

The first quarter of 2010 witnessed a slightly decreased net FDI compared to the same period of 2009, with inward FDI largely remaining stable, while outward FDI slightly increased. Approximately half of this amount relates to direct equity investment, mostly recapitalisations in the financial sector. In addition, direct debt investments amounted to EUR 0.1 billion, which is significantly less than in the same period of 2009 (EUR 0.4 billion). Unlike in the first quarter of 2009, reinvested earnings were positive in the first quarter of 2010, indicating better business results of foreign owned companies and banks.

In order to encourage private and foreign investment, the Investment Incentive Act provides for various incentives for investors, including:

- tax benefits,
- customs benefits (available until the day of Croatia's accession to the EU): when importing equipment which is an integral part of the investment, customs duties are not charged for certain categories of goods,
- Government contribution when new workplaces are created,
- Government contribution towards expenses arising in connection with training of employees,
- Government contribution towards development of technological and innovation centres,
- Government contribution of strategic business support activities, and
- Government contribution in the amount equalling 5 per cent. of construction costs of a new factory (up to a maximum of EUR 1.0 million), costs relating to purchases of new machines (up to a maximum of EUR 1.0 million) and infrastructure construction costs (up to a maximum of EUR 0.5 million) for large investment projects where the investment amount is at least EUR 15 million and it is intended that the project will create at least 100 new jobs.

These incentives are available to both foreign and domestic investors investing at least EUR 300 thousand. Croatia has signed agreements on mutual incentives and protection of investments with 53 countries. The most represented foreign investments in Croatia are investment in financial mediation sector, telecommunications, pharmaceuticals, extracting crude oil and gas and related services, trade, hotels and restaurants. The Investment Incentive Act is in compliance with the *acquis communautaire* in the area of State grants.

Exchange Rates

Croatia adheres to the exchange rate regime of managed floating, where the exchange rate of the Kuna is not fixed against another foreign currency or a basket of currencies but is rather freely determined by the foreign exchange market. The exchange rate therefore floats depending on the foreign exchange supply and demand on the foreign exchange market. The CNB does not predetermine the floor or the ceiling level of the exchange rate that it attempts to maintain or at which it will necessarily intervene. However, the CNB attempts to prevent excessive exchange rate volatility by occasional market interventions or by other monetary policy instruments that influence foreign exchange market or money market conditions such as open market operations and reserve requirements, among others. The CNB aims to maintain the stability of the HRK/EUR exchange rate in order to meet its primary objective of maintaining stability of prices in Croatia. In particular, in economies where the role and circulation of the Euro are substantial and that have significant capital inflows such as Croatia's, prices are very sensitive to exchange rate fluctuations. As a result, exchange rate movements materially impact household inflationary expectations. The effect of this is augmented by the population's sensitivity to inflation as a result of experiencing hyperinflation in the early 1990's.

In 2008, there was a very slight nominal appreciation of the Kuna against the Euro, with the Euro declining from HRK 7.325 at the end of 2007 to HRK 7.324 at the end of 2008. Notwithstanding slightly more pronounced appreciation pressures at the beginning of 2008, the HRK/EUR exchange rate was relatively stable in the first seven months of 2008. Mild appreciation pressures during that period were to a large extent the result of the inflow of foreign currency tourism receipts and to a lesser degree an outcome of corporate foreign borrowing. The appreciation pressures on the HRK/EUR exchange rate were also stimulated by the inflow of foreign exchange necessary for the purchase of INA shares. The Kuna appreciated slightly in July and August 2008 principally due to increased demand at the peak of the tourism season. In the last quarter of 2008, the HRK/EUR exchange rate was mainly exposed to depreciation pressures brought on by the increase in demand for foreign exchange.

In 2008, the CNB intervened twice in the foreign exchange market. The CNB held the first auction on 31 January, after the intensification of appreciation pressures caused by the decline in Kuna liquidity, and bought EUR 189.1 million creating an additional Kuna liquidity of HRK 1.4 billion. The second auction was held on 27 October 2008, when the increase in demand for foreign exchange led to stronger depreciation pressures, and the CNB sold EUR 270.6 million, withdrawing HRK 2.0 billion from the system. Both interventions were spot transactions. In addition to these two interventions, in 2008 the CNB conducted one outright purchase of EUR 70 million with one bank in November and arranged foreign exchange swap transactions in the aggregate amount of EUR 150 million, with a two-week duration each, from the end of November to December. Through all foreign transactions with the banks in 2008, the CNB sold EUR 11.5 million net, withdrawing HRK 90.6 million from the system. In respect of transactions with the Government, the amount of foreign exchange was higher and these transactions had a stronger net effect on the Kuna liquidity in the monetary system. In foreign exchange transactions with the Ministry of Finance in 2008, the CNB purchased a net aggregate of EUR 185.9 million, releasing HRK 1.3 billion in the system.

The HRK/EUR exchange rate appreciated by 0.2 per cent. from the end of 2008 to the end of 2009, strengthening from HRK 7.32/EUR to HRK 7.31/EUR. As outlined below, the appreciation was primarily due to the developments in the last quarter of 2009, whereas the beginning of 2009 was marked by depreciation pressures stemming from the reduction in foreign capital inflows combined with strong Government and corporate demand for foreign exchange required for the payment of maturing foreign liabilities. Depreciation pressures declined in the second quarter of 2009, among other things due to the Government Eurobond issue and the expectations of significant capital inflows following announced borrowings by certain public companies. Customary seasonal appreciation pressures did not materialise in the summer months of 2009, partly due to a decrease in foreign exchange inflows from tourism compared to previous years, resulting in a stable Kuna/Euro exchange rate. Exchange rate developments in the last quarter were marked by the appreciation of the Kuna against the Euro primarily due to an increase in the supply of foreign exchange in the domestic market as a result of borrowing abroad by some public enterprises and other companies as well as the Government bond issue in the US market. In addition, the Kuna also strengthened due to the continued narrowing of the trade deficit.

The CNB intervened seven times in the foreign exchange market in 2009. Two interventions (one in late January and one in mid-February) involved selling foreign exchange in response to mounting depreciation pressures, while the other five interventions were aimed at moderating the pace of the appreciation of the Kuna through foreign exchange purchases. At the auctions, the CNB purchased foreign exchange in the net amount of EUR 324.8 million. The volume of foreign exchange transactions between the Ministry of Finance and the CNB was also high in 2009. The CNB purchased EUR 570.4 million net from the Government, which represented a significant increase from EUR 185.9 million in 2008. The CNB's purchase from the Government in 2009 was attributable to a large extent to the purchase of foreign exchange raised by the Government through a Eurobond issue in May, and to a smaller extent to the purchase of foreign exchange from the Government bond issue on the US market in November 2009.

The HRK/EUR exchange rate largely remained stable in the first five months of 2010, due to an environment of a balanced supply of, and demand for, foreign exchange and high Kuna liquidity in the system. The HRK/EUR exchange rate appreciated by 0.6 per cent. in the first quarter of 2010 and remained largely stable during April-May 2010. The HRK/EUR exchange rate appreciated from HRK 7.31/EUR at 31 December 2009 to HRK 7.26/EUR at 31 May 2010. The CNB did not hold foreign exchange auctions in 2010 to date but conducted foreign exchange transactions with the Government. The CNB sold EUR 206.5 million net to the Ministry of Finance in 2010 as at 31 May 2010, withdrawing HRK 1.5 billion from the system.

In line with the movements in the HRK/EUR exchange rate and the U.S.$/EUR exchange rate, the HRK/U.S.$ exchange rate depreciated by 3.4 per cent. in 2008, from HRK 4.99/U.S.$ at the end of 2007 to HRK 5.16/U.S.$ at the end of 2008. In 2009, HRK/U.S.$ exchange rate, affected by the developments on the global foreign exchange markets, appreciated by 1.3 per cent., from HRK 5.16/U.S.$ at 31 December 2008 to HRK 5.09/U.S.$ at 31 December 2009. In the first five months of 2010, the HRK/U.S.$ exchange rate depreciated significantly (15.0 per cent.) to HRK 5.85/U.S.$ at the end of May, mainly due to strengthening of the U.S.$/EUR rate on the global foreign exchange markets as a result of the Euro weakness following the developments relating to the fiscal stability of Greece and certain other Member States.

Export price competitiveness deteriorated in 2008 compared to 2007. The index of the real effective Kuna exchange rate deflated by producer prices appreciated in the reference period by 4.3 per cent., while the same index deflated by consumer prices appreciated by 5.5 per cent., principally due to faster growth in consumer and producer prices in Croatia than in foreign countries in the reference period and due to appreciation of the nominal effective exchange rate of the Kuna. In the same period, the average monthly index of the nominal effective Kuna exchange rate appreciated by 3.0 per cent.

Evaluated in CPI terms, the real effective exchange rate of the Kuna depreciated by 2.7 per cent. in 2009. Evaluated in PPI terms, however, the real effective exchange rate of the Kuna appreciated by 2.8 per cent. in 2009, mainly as the result of domestic producer prices decreasing at a faster rate than decreases in foreign producer prices, which led to a deterioration in export price competitiveness in 2009.

The available data for the first quarter of 2010 shows a 1.1 per cent. depreciation of the real effective Kuna exchange rate deflated by consumer prices and a 1.4 per cent. depreciation of the real effective Kuna exchange rate deflated by producer prices, as compared to the average respective measures for the last quarter of 2009. The depreciation in both measures was primarily due to the nominal depreciation of the Kuna against the currency basket, in particular against the U.S.$. Domestic prices in Croatia grew more than abroad resulting in weaker real depreciation compared to the nominal effective depreciation (1.6 per cent.).

The following table sets forth the end-of-month HRK/EUR exchange rate from January 2004 to June 2010:

	Year ended 31 December						
	2004	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
January	7.670249	7.551070	7.359333	7.373400	7.249864	7.373294	7.313102
February	7.607293	7.507513	7.307577	7.345292	7.277476	7.403887	7.270536
March	7.395440	7.441756	7.323554	7.382466	7.256652	7.457249	7.259334
April	7.533576	7.364438	7.291280	7.372840	7.263753	7.425124	7.246875
May	7.369765	7.307220	7.264151	7.308634	7.250440	7.326488	7.263120
June	7.365831	7.310503	7.256979	7.303218	7.246264	7.292035	7.193455
July	7.406563	7.296747	7.258119	7.297330	7.221125	7.333135	—
August	7.391677	7.378355	7.314609	7.319403	7.161648	7.326773	—
September	7.547840	7.438696	7.381777	7.281634	7.107741	7.288341	—
October	7.490452	7.381207	7.369343	7.350060	7.185881	7.225837	—
November	7.600835	7.400190	7.333542	7.313666	7.128034	7.317610	—
December	7.671234	7.375626	7.345081	7.325131	7.324425	7.306199	—

Source: Croatian National Bank

MONETARY DEVELOPMENTS AND INTERNATIONAL RESERVES

Monetary Policy and Instruments

Throughout 2008 and 2009 and during the first half of 2010 the CNB successfully maintained the stability of the HRK/EUR exchange rate, a key aspect of achieving domestic price stability as well as the stability of the financial sector as a whole.

During the fourth quarter of 2008 and the first quarter of 2009, monetary policy was executed in an environment that was characterised by the strong spill-over effects of the global financial and economic crisis on domestic real activity. Given the slower economic growth and decreased foreign capital net inflows, the CNB, in addition to maintaining domestic currency stability, focused on ensuring sufficient foreign currency liquidity. After reducing domestic currency liquidity creation in the first half of 2008 in order to alleviate inflationary pressures, in the second half of 2008 and in early 2009 the CNB tightly managed domestic currency liquidity to prevent exchange rate depreciation. In order to preserve exchange rate stability, during this period, the CNB took the following steps:

- *October 2008:* the CNB abolished marginal reserve requirement (as a result EUR 532 million were released in the system);
- *December 2008:* the banks reserve requirement rate was reduced from 17 per cent. to 14 per cent. (HRK 8.4 billion released, of which HRK 5.9 billion in Kuna component and HRK 2.5 billion or around EUR 345m in foreign exchange component);
- *January 2009:* the CNB increased the calculated foreign exchange component of reserve requirement that is allocated in Kuna from 50 to 75 per cent. (result was an increase of Kuna reserve component, i.e. a decrease in foreign exchange component by HRK 5.9 billion or around EUR 810 million);
- *February 2009:* the minimum required amount of foreign currency assets was reduced from 28.5 to 20.0 per cent. of banks total foreign liabilities (resulted in freeing of EUR 2.1 billion that were previously set aside as part of banks liquid foreign assets).
- *February 2009:* the CNB increased the limit on banks' open foreign exchange position from 20 per cent. to 30 per cent. The expected resulting increase in bank liquidity was intended to stabilise the foreign exchange market, to improve domestic credit conditions and to facilitate a EUR 750 million syndicated loan of six domestic banks to the Government.

The above mentioned changes of monetary policy instruments substantially improved the foreign currency liquidity of the banking system. Besides these changes, the CNB also intervened in the foreign exchange market at the beginning of 2009 by selling EUR 328.3 million on 23 January and EUR 184.7 million on 18 February, while on 27 February the CNB purchased EUR 331.2 million from banks.

In line with a policy of more restrictive management of the money supply and due to a major increase in Government borrowing from banks, the CNB has tightened regulations concerning the amount of collateral which automatically puts additional Kuna liquidity at banks' disposal. Also, the nominal value of intraday and Lombard loans was reduced from 90 per cent. of collateral (T-bills) down to only 50 per cent. In addition, the scope of securities eligible as collateral was reduced to include only those with an original maturity of up to one year.

After the end of the first quarter of 2009, the monetary environment improved markedly and the remaining part of 2009 and the first half of 2010 were characterized by substantially more stable conditions, which necessitated no further changes in monetary policy instruments. Appreciation pressures on the Kuna re-emerged, which were to a large extent generated by foreign capital inflows related to the issuance of government bonds on the international financial markets. The central bank prevented the excessive strengthening of the Kuna by intervening in the foreign exchange market, as well as by converting significant amounts of the foreign exchange receipts of the government. Owing to the impact of these monetary policy actions, the Kuna/euro exchange rate remained stable, standing at 7.31 Kuna per euro at year-end 2009, which was almost the same level as at year-end 2008. In the first five months of 2010, the Kuna appreciated only slightly (by 0.6 per cent.), reaching 7.26 Kuna per euro at 31 May 2010.

Despite the gradual improvement of financial conditions, monetary developments in 2009 and the first part of 2010 were mainly influenced by the negative effects of the downturn in real economic activity, suppressed domestic and external demand, pressures on the credit market coming from large funding needs of the central government as well as the stagnation of lending to the private sector. In such circumstances, the Croatian National Bank was primarily focused on providing sufficient primary liquidity to the banking system with the aim to foster the recovery of lending to the private sector while also maintaining the stability of the nominal Kuna/euro exchange rate.

In an environment of high levels of Kuna liquidity, the need for creating reserve money by means of regular reverse repo operations was significantly reduced. Thus, the turnover at the regular repo auctions (held at a fixed rate of 6.0 per cent. since December 2008) gradually decreased throughout 2009 and since mid-October 2009 no auctions have been held. Favourable Kuna liquidity was also reflected in low levels of money market interest rates in late 2009 and early 2010, as well as in banks' increased use of overnight deposits with the CNB. The banks used the overnight deposit facility on a daily basis, even at the very beginning of the reserve maintenance period, which was previously uncommon. The average daily balance of overnight deposits with the CNB in the first five months of 2010 was HRK 4.9 billion, compared to only HRK 0.6 billion in 2009. The highest amount of overnight deposits (as high as HRK 9.8 billion) was registered in mid-February, i.e., close to the end of the reserve maintenance period.

Pursuant to the Law on the Croatian National Bank and the Decision on Reserve Requirements (Official Gazette Nos. 203/2003, 145/2004, 34/2005, 64/2005, 136/2005, 146/2005, 112/2008, 137/2008, 139/2008, 3/2009 and 18/2010) (the "**Reserve Requirement Decision**"), credit institutions are required to maintain with the CNB certain reserves in the settlement account, or in a separate account with the CNB. Reserve requirements apply to banks founded in Croatia and branches of foreign banks in Croatia and does not apply to special purpose banks when regulated by a special law and to HBOR. The reserve requirement comprises two parts, Kuna and foreign exchange. The Kuna base for calculating reserve requirements consists of the Kuna sources of funds which include received Kuna deposits and loans, issued Kuna-denominated debt securities, Kuna-denominated hybrid and subordinated instruments and other Kuna-denominated financial liabilities. The Kuna sources of funds excluded from the reserve requirement calculation include funds received from the CNB and HBOR, funds received from financial institutions which calculate reserve requirements pursuant to the Reserve Requirement Decision and relief funds received in connection with natural disasters including emergency funds for recovery of war damage. The foreign exchange base for calculating reserve requirements consists of the foreign exchange sources of funds, including received foreign exchange deposits and loans, obligations arising from the issued securities in foreign currency (excluding banks' equity securities), hybrid and subordinated instruments in foreign currency and other financial liabilities in foreign currency. The foreign exchange sources of funds excluded from the reserve requirement calculation include foreign exchange funds received from financial institutions which calculate reserve requirements pursuant to the Reserve Requirement Decision, blocked household foreign exchange savings converted into public debt of Croatia, foreign exchange loans refinanced by Croatia, foreign exchange funds received from HBOR and relief funds received in connection with natural disasters including emergency funds for recovery of war damage. A bank's reserve requirements are deemed satisfied if, during each one-month maintenance period, the average amount of the daily balances of the reserve accounts is not lower than the reserve requirement.

The level of reserve capital in the banking sector is set according to the risk sensitivity of a bank's balance sheet. Reserves are formed for provisions and impairment on banks' assets (especially loans) in a manner prescribed by the Credit Institutions Act. In addition, the CNB has the authority to prescribe in detail how such reserves are formed pursuant to a 'Decision on the Classification of Placement and Off — Balance Sheet Liabilities of Credit Institutions' (a "**Classification Decision**"). Generally, according to a Classification Decision, assets are classified according to the degree of risk in risk categories depending on the likelihood of collection, i.e. on the expected future cash flows. Placements are classified into three broad categories (regardless of whether exposures are individually significant or they belong to a portfolio of small loans), as follows:

- placements for which no evidence of impairment is identified on an individual basis (risk category A);
- placements for which evidence of partial impairment is identified, i.e. partly recoverable placements (risk categories B-1/B-2/B-3); or
- placements for which evidence of impairment is identified, equal to their carrying amount, i.e. fully irrecoverable placements (risk category C).

Additionally placements in risk categories according to the general classification criteria stated in a Classification Decision shall, in the entire period of contractual relationship, assess placement quality and shall classify placements into the appropriate risk categories on the basis of the following criteria: debtors' creditworthiness; debtors' timeliness in meeting their obligations towards a credit institution and other creditors; and quality of instruments of collateral for a credit institution's receivables.

Monetary Developments

Monetary developments in 2008 were characterised by an increase in net domestic assets and a moderate decline in net foreign assets which led to slower growth in total liquid assets ("**M4**"). These trends were largely the result of changes in the last quarter. The ratio of nominal GDP to M4 has shown a slightly downward trend over the last

5 years, whilst being broadly stable as shown by the table below. By contrast in 2000 the ratio was approximately 2.4, the current trend would therefore suggest that the remonetisation process is complete.

	Year ended 31 December				
	2005	**2006**	**2007**	**2008**	**2009**
Ratio of Nominal GDP/M4	1.7	1.6	1.5	1.5	1.5

Sources: *Croatian Bureau of Statistics and Croatian National Bank*

The following table sets forth the Republic of Croatia's money supply at the end of the periods indicated:

	Year ended 31 December			Four months ended 30 April	
	2007	**2008**	**2009**	**2009**	**2010**
			(HRK millions)		
Reserve money	51,923.9	49,743.0	56,141.9	59,075.1	54,076.0
Money (Ml)(1)	57,878.3	55,222.3	47,181.7	46,419.2	48,982.2
Broad money (M4)(2)	215,822.1	225,018.5	223,094.6	218,797.6	222,055.0
Net domestic assets(3)	166,375.5	183,279.1	178,083.2	192,003.3	184,328.8
Domestic credit(4)	210,828.4	232,982.1	231,661.9	234,342.1	234,764.5

Source: *Croatian National Bank*

(1) Money (Ml) comprises currency outside banks, deposits with the CNB by other banking institutions and other domestic sectors and banks' demand deposits.

(2) Broad money (M4) comprises money (M1), savings and time deposits and foreign currency deposits, as well as bonds and money market instruments.

(3) Net domestic assets are defined as a difference between total liquid assets and foreign assets (net).

(4) Domestic credit comprises banks' claims on other non-government non-financial domestic sectors, other banking institutions and other financial institutions.

Until late in the third quarter of 2008 net domestic assets grew moderately due to more stringent financing terms by commercial banks, the overall economic slowdown and CNB measures to curb credit growth. The growth of bank placements to the non-banking sector on the aggregate level did not exceed the CNB recommended rate. In the first nine months of 2008, placements rose by only 6.5 per cent., or 2.5 percentage points below the CNB ceiling. In addition to the moderate growth of placements to the private sector, central government borrowing from domestic banks was negligible, which together led to slower growth in net domestic assets. At the same time, banks' net foreign assets increased as banks used domestic deposit inflows to decrease their foreign liabilities. Deposit inflows were particularly strong due to adverse capital market developments and the successful tourist season.

However, with the effects of the global financial and economic crisis spilling over on Croatia, at the beginning of the fourth quarter of 2008 monetary developments took a different path. At the beginning of October 2008 banks were faced with a major outflow of household deposits triggered by the lack of confidence resulting from the financial crisis. The prompt reaction of commercial banks including the support of the parent banks, the CNB and the Government halted the deposit outflow.

To increase foreign exchange liquidity, monetary policy was adjusted in response to the new conditions in the domestic and global financial markets. The CNB decreased the reserve requirement rate and abolished the marginal reserve requirement, thus freeing foreign exchange funds allocated over a long period of time. The Government increased the guaranteed amount of savings deposits from HRK 100,000 to HRK 400,000, which strengthened public confidence in the banking system.

In the last quarter of 2008 lending activities of banks to the private sector lost momentum. Bank loans grew by less than 1.0 per cent. in total (excluding exchange rate effects) as a result of a sharp fall in demand for loans caused by more stringent financing terms as well as the preference on the part of banks to preserve their liquidity and lend to the private sector more moderately in view of the crisis in the global and domestic financial markets. Bank activities in the last quarter of 2008 thus mostly focused on ensuring sufficient funds from abroad and on central government financing. Bank claims on the central government grew more than 45 per cent. in that period, mostly on account of the increase in loans granted and T-bills subscribed.

The annual movements of monetary and credit aggregates in 2008 were largely affected by the financial crisis and slowdown of economic growth. The nominal growth of bank placements to the non-banking sector was 10.5 per cent. Excluding the exchange rate effect, the annual growth rate of placements was approximately 8.5 per cent., almost 8 percentage points less than the growth rate in 2007. The slowdown in bank lending was particularly pronounced in household loans. Their annual growth rate decreased from 18.0 per cent. in 2007 to 12.1 per cent. in

2008. In contrast to slower household loan growth, the annual growth rate of corporate loans increased to 11.4 per cent. in 2008. This suggests that, in an environment of weaker household demand for loans, banks focused more on corporate financing. Furthermore, as the global financial and economic crisis impeded their access to foreign capital, domestic enterprises increasingly turned to domestic banks for loans. Banks' net claims on the central government increased by 41.6 per cent. in 2008 and were mostly determined by the change in the last quarter. The annual growth rate of M4 fell to 4.3 per cent. in 2008 and money ("**M1**") growth became negative at the year-end. M1 thus fell by 4.6 per cent. in 2008.

The decelerating trend in lending to the private sector continued throughout 2009. Bank loans to the private sector fell by 0.6 per cent., with household loans falling by 2.9 per cent. (mostly due to contraction of consumer loans including loans for car purchase) and corporate loans growing by only 2.1 per cent. This was influenced by negative trends on both the supply side (rise in interest rates, increased risk aversion of the banks) and the demand side (fall in economic activity and personal consumption accompanied by a negative economic outlook). The year-on-year growth rate of net claims on the central government at end-2009 was relatively low (1.3 per cent.) because at the very end of the year the government used part of the funds received from the issuance of a dollar bond to repay domestic short-term loans. The CNB supported financing needs of the domestic sectors, especially the Government, by further decreasing the minimal required foreign currency coverage from 28.5 to 25 per cent. on 6 February 2009 and further to 20 per cent. on 20 February 2009 and thus releasing EUR 2.1 billion. In addition, in November 2009 the CNB abolished the Decision on the purchase of compulsory CNB bills, which had successfully limited the excessive growth of bank loans in the past three years. However, based on a considerable slowdown of credit growth and the fact that banks now exercise greater caution as regards credit and associated risks, it was decided that formal restrictions of credit growth were no longer necessary.

The stagnation of bank lending and the worsening liquidity conditions in the real sector of the economy strongly influenced developments of narrow money (M1), which recorded the most pronounced fall among all monetary aggregates during 2009 (14.6 per cent.). This was largely a result of the fall in demand deposits with banks, especially deposits by the corporate sector. The decline of the broadest money aggregate — total liquid assets (M4) — was less pronounced (-0.9 per cent.), owing to a robust growth of foreign currency deposits (15.5 per cent.). In contrast, banks' foreign liabilities continued to grow throughout 2009 (by 6.7 per cent. year-on-year), except during the tourist season, when banks usually use seasonal deposit inflows generated by the tourism industry to decrease their foreign currency denominated debt. As the majority of non-resident deposits and loans came from foreign account holders, parent bank funding proved to be a stable and significant source of financing of the domestic banking sector, especially given the adverse conditions in international markets and the slowdown of inflows from domestic financing sources.

Reserve money ("**M0**") increased in 2009 (12.9 per cent. year-on-year) standing at HRK 56.1 billion at year-end. The rise in demand for reserve money was due to the increase in Kuna reserve requirement for banks. Namely, the reduction in the reserve requirement from 17 to 14 per cent. in December 2008 was offset in January 2009 with an increase in the percentage of the reserve requirement for foreign currency-denominated deposits that is covered by Kuna-denominated assets from 50 per cent. to 75 per cent.

In the first four months of 2010, developments in monetary and credit aggregates were generally in line with trends observed in 2009. Money ("**M1**") showed signs of moderate recovery (growing by 3.8 per. cent in the first four months of 2010), in line with the slight increase of short-term loans to private sector, but also reflecting the running down of Kuna deposits balances. However, despite this moderate increase of the M1 monetary aggregate, total liquid assets (M4) declined further (by 0.5 per cent.), with continued substitution of Kuna savings for foreign currency savings, which increased the share of foreign currency deposits in total deposits to over 80 per cent. by the end of April 2010. On the asset side, government demand for financing remained strong and net lending to the central government grew by 27.1 per cent. On the other hand, after falling during 2009, bank loans to the private sector recovered slightly (growing by 1.3 per cent. in the period January — April 2010). This was the result of an increase in corporate loans, reflecting the positive impact of a moderate decline in interest rates and high level of liquidity in the banking system. However, low credit demand stemming from adverse conditions in the real sector still suppresses the pace of the recovery in bank lending.

Reserve money (M0) fell by 3.7 per cent. in the first four months of 2010, amounting to HRK 54.1 billion at 30 April. This was mainly the result of a reduction of the reserve requirement rate from 14 to 13 per cent. in February, which resulted in release of approximately HRK 2.9 billion (out of which 2.4 billion was the Kuna component of the reserve requirement). The majority of these funds (HRK 2 billion) were then allocated to the Croatian Bank for Reconstruction and Development, which is tasked with providing credit to enterprises (in cooperation with commercial banks) as a part of the Government's measures to boost economic recovery.

International Reserves Management

In managing the international reserves of Croatia, the CNB is governed by the principles of liquidity and safety of investment. In that context, it aims to maintain high liquidity of reserves and adequate risk exposure and, attempts to achieve favourable rates of return on its investments while adhering to these principles. Similar principles are normally used by other central banks in their international reserves management.

The CNB manages international reserves in two ways: (1) reserves formed through the outright purchase of foreign currency from the banks and the Ministry of Finance are actively managed in accordance with the pre-defined benchmark portfolios, and (2) reserves accumulated pursuant to the foreign currency reserve requirements and deposits of the Ministry of Finance are passively managed according to the foreign currency liabilities assumed (investments in this part of the portfolio are made in such a way that CNB is protected against currency or interest rate risk, i.e. they are made in the same currency and with the same maturity as the assumed liabilities).

Set out below is the balance sheet of the CNB at the end of the periods indicated.

	Year ended 31 December					Four months ended 30 April	
	2005	2006	2007	2008	2009	2009	2010
	(HRK millions)						
ASSETS							
Foreign assets	54,862.5	64,088.2	68,177.8	66,805.5	75,807.8	65,972.7	72,577.2
Gold	—	—	—	—	—	—	—
Holdings of SDRs	6.3	5.3	5.6	5.3	2,423.7	5.1	2,512.7
Reserve position in the IMF	1.4	1.3	1.3	1.3	1.3	1.3	1.3
Currency and demand deposits with foreign banks	7.7	7.2	7.2	1,472.7	1,763.8	1,577.7	1,748.3
Time deposits with foreign banks	28,274.1	33,243.0	33,204.4	13,189.3	17,534.5	15,381.8	17,992.3
Securities in foreign currency	26,573.0	30,831.2	34,959.3	52,136.9	54,084.5	49,006.7	50,322.6
Non-convertible foreign exchange	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Claims on central government and funds	1.4	0.9	1.0(1)	2.2	2.9	1.4	0.1
Claims in Kuna	1.4	0.9	1.0(1)	2.2	2.9	1.4	0.1
Bridging loans	—	—	—	—	—	—	—
Loans under separate decrees	—	—	—	—	—	—	—
Overdue claims	1.4	0.9	1.0	2.2	2.9	1.4	0.1
Claims in foreign currency	—	—	—	—	—	—	—
Claims on other domestic sectors	73.4	64.0	67.9	64.2	4.2	4.4	4.0
Claims on banks	4,215.6	3,911.5	4,178.3	13.9	13.5	1,614.7	13.2
Credits to banks	4,215.6	3,911.5	4,178.3	13.9	13.5	1,614.7	13.2
Refinancing of banks	—	—	—	—	—	—	—
Short-term credits against securities portfolio	—	—	—	—	—	—	—
Lombard credits	—	—	1,349.1	—	—	—	—
Short-term liquidity credits	—	—	—	—	—	—	—
Other credits	14.5	14.5	14.7	13.9	13.5	13.9	13.2
Reverse repo transactions	4,201.1	3,897.0	2,814.5	—	—	1,600.8	—
Overdue claims	—	—	—	—	—	—	—
Claims on other banking institutions	—	—	—	—	—	—	—
Total	**59,153.0**	**68,064.6**	**72,425.1**	**66,885.8**	**75,828.3**	**67,593.1**	**72,594.5**

	Year ended 31 December					Four months ended 30 April	
	2005	2006	2007	2008	2009	2009	2010
				(HRK millions)			
LIABILITIES							
Reserve money	40,390.8	46,331.2	51,923.9	49,743.0	56,141.9	53,075.1	54,076.0
Currency outside banks	12,163.8	14,609.3	16,007.5	17,051.0	15,282.1	16,302.6	15,139.0
Banks' cash in vaults	2,210.7	2,698.0	3,305.8	3,428.3	3,659.6	3,113.9	3,429.3
Banks' deposits	26,016.3	29,023.9	32,610.6	29,263.7	37,200.1	33,658.6	35,507.7
Settlement accounts	8,411.1	8,535.7	7,553.9	9,520.3	12,024.6	9,864.1	9,837.4
Statutory reserves	17,605.2	20,478.2	22,275.6	19,222.7	23,600.6	23,601.4	21,876.8
CNB bills on obligatory basis	—	—	1,991.1	460.6	—	193.1	—
Overnight deposits	—	10.0	790.0	60.0	1,575.0	—	3,793.5
Deposits of other banking institutions	—	—	—	—	—	—	—
Deposits of other domestic sectors	—	—	—	—	—	—	—
Restricted and blocked deposits	13,551.8	16,633.5	14,286.0	8,064.1	5,091.6	4,723.1	4,781.7
Statutory reserve in foreign currency	13,495.9	16,576.7	14,257.5	8,008.3	5,041.7	4,666.9	4,723.3
Restricted deposits	55.9	56.9	28.6	55.8	49.9	56.2	58.4
Escrow deposits	—	—	—	—	—	—	—
Foreign liabilities	18.9	18.9	17.2	16.6	8.1	14.8	8.6
Use of IMF credit	—	—	—	—	—	—	—
Liabilities to international organisations	18.9	18.9	17.2	16.6	8.1	14.8	8.6
Liabilities to foreign banks	—	—	—	—	—	0.0	—
Central government and funds deposits	332.2	188.0	199.1	206.9	4,171.4	260.3	2,879.2
Demand deposits	319.0	174.5	125.8	171.1	1,839.2	192.0	2,870.4
Central government demand deposits	246.3	138.6	100.3	43.0	1,772.9	116.3	860.4
Central government funds demand deposits	72.7	35.9	25.4	128.2	66.2	75.7	2,010.0
Central government foreign currency deposits	13.2	13.5	73.3	35.8	2,332.2	68.3	8.8
CNB bills	—	—	—	—	—	—	—
CNB bills	—	—	—	—	—	—	—
CNB bills in Kuna	—	—	—	—	—	—	—
CNB bills in foreign currency	—	—	—	—	—	—	—
Capital accounts	5,357.4	5,408.8	6,664.5	9,562.4	11,151.3	10,229.7	11,585.3
Other items (net)	(498.2)	(515.8)	(665.6)	(707.1)	(735.9)	(709.9)	(736.2)
Total	**59,153.0**	**68,064.6**	**72,425.1**	**66,885.8**	**75,828.3**	**67,593.1**	**72,594.5**

Source: *Croatian National Bank*

Net international reserves comprise an active portfolio managed by the CNB and foreign cash. Net international reserves of the CNB rose by EUR 1,012.27 million in 2009 (12.6 per cent.) compared with 2008. At the end of 2009, net international reserves of the CNB stood at EUR 9.03 billion. Net international reserves as at 30 April 2010 remained largely unchanged and stood at EUR 9.02 billion. The EUR 10 million decrease between the end of 2009 and 30 April 2010 was mainly due to the fact that at the end of 2009 net international reserves included some temporary government foreign currency deposits that were subsequently withdrawn.

The main factors leading to changes in the level of total international reserves in 2009 on the inflow side were: EUR 1,125.75 million in foreign exchange interventions involving purchases of foreign currency from the banks; EUR 118.9 million in income from international reserves investment; EUR 669.8 million in foreign currency purchases from the Ministry of Finance; and EUR 11.1 million in cross-currency changes.

The main factors leading to changes in the level of total international reserves in 2009 on the outflow side were: a fall of EUR 402.9 million in foreign currency reserve requirements; EUR 99.3 million in foreign currency sales to the Ministry of Finance; and EUR 801.0 million in foreign exchange interventions involving sales of foreign currency to the banks.

After 3 years of continuous growth (from EUR 6.4 billion at the end of 2004 to EUR 9.3 billion at the end of 2007), CNB's gross international reserves declined in the third quarter of 2008 and the first two months of 2009 by 12.8 per cent. as a result of changes in the monetary policy instruments to improve foreign currency liquidity of the banking system and alleviate the adverse shocks created by the international financial markets (the marginal reserve requirement was abolished in October 2008 and foreign currency reserve requirement was reduced in December 2008). After a decrease in January and February 2009, gross international reserves started to increase and were up 13.76 per cent. at year-end 2009 compared with year-end 2008. On 31 May 2010, gross international reserves stood at EUR 10.2 billion.

At the end of May 2010, net international reserves of the CNB stood at EUR 9.1 billion, which represents an increase of 1.2 per cent. as compared to 31 December 2009. The impact of changes in the monetary instruments in the last quarter of 2008 and the first quarter of 2009 mostly affected gross reserves, while the net usable reserves continued to grow, reaching the annual growth rate of 12.6 per cent. at the end of 2009.

In August 2009, the Ministry of Finance accepted SDR 270.7 million of general SDR allocation. An additional SDR 32.5 million of special one-time allocation was received in early September 2009, totalling approximately U.S.$470 million which has further strengthened the international reserves.

As investors fled into safer assets during the global financial and economic crisis, prices of the U.S.$ and Euro denominated Government bonds grew strongly, which reflected positively on the return on the CNB's foreign currency portfolios. In response to the global financial and economic crisis, credit risk management guidelines tightened in 2008 and as a result the CNB's investment portfolio was restructured. Investments in non-collateralized bank deposits were almost completely withdrawn and re-invested in safer assets such as Government bonds, Bank for International Settlement deposits and deposits with the central banks.

According to the degree of credit risk exposure, net international reserves have been divided into funds invested in Government bonds, covered bonds, banks, international financial institutions and central banks. In terms of the structure of net international reserves, the share of investments in Government bonds grew from 80.9 per cent. at 31 December 2008 to 85.6 per cent. at 31 December 2009. The share of net international reserves invested in non-collateralised instruments with the banks slightly increased from 1.3 per cent. at the end of 2008 to 1.6 per cent. at the end of 2009. During the same period, investments in international financial institutions and central banks also decreased, accounting for 10.5 per cent. of net international reserves. As at 31 May 2010, the share of investments in Government bonds decreased to 80.6 per cent., from 85.6 per cent. at 31 December 2009; the share of investments with central banks and international financial institutions increased to 17 per. cent of net international reserves, from 10.5 per. cent. at 31 December 2009; and the share of net international reserves invested in non-collateralised instruments slightly increased to 1.8 per cent., from 1.6 per. cent at the end of 2009.

The following table sets out the composition of net international reserves for the periods indicated:

	2008	**2009**	**Five months ended 31 May 2010**
		(per cent.)	
Government bonds	80.9	85.6	80.6
Financial instruments of central banks	17.8	10.5	17.0
Con-collateralized instruments	1.3	1.6	1.8
Bank/covered bonds	0.0	2.3	0.6
Total	100.0	100.0	100.0

Source: Croatian National Bank

In terms of credit rating, 74.7 per cent. of the total reserves in 2009 were invested in securities of countries and banks with the highest Aaa rating according to Moody's. Banks rated Aa1 and Aa2 accounted for more than 10.5 per cent. of international reserves investment, banks rated Aa3 4.4 per cent., while the remaining share (10.4 per cent.) of total international reserves was invested in the International Monetary Fund and the Bank for International Settlements. This allocation of the total reserves has mostly remained the same in 2010.

As at 31 December 2009, the share of reserves in Euro in net international reserves was 81.2 per cent. and the share of reserves in U.S. dollars was 18.8 per cent. This ratio has generally not changed in 2010. In 2009, the net yield on the CNB Euro portfolio was 1.73 per cent. (according to the Global Investment Performance Standards methodology) and the net yield on the CNB U.S.$ portfolio during the same period was 0.50 per cent. The yields have been somewhat lower during the first quarter of 2010 due to interest rate movements in the global markets, along with the above mentioned tightening of the investment guidelines. The average size of the CNB Euro portfolio that was actively managed by the CNB in 2009 was EUR 6.7 billion and the average size of the U.S.$ portfolio was

U.S.$1.5 billion. Income realised from reserves investment in 2009 was EUR 111.0 million and U.S.$11.5 million. In the first quarter of 2010, such income was EUR 33 million and U.S$6.5 million.

CNB measures to incentivise local currency lending

The regulations relating to capital adequacy calculations were changed in 2006 to take into account currency-induced credit risk: new risk weightings of 75 per cent. and 125 per cent. were introduced into the calculation of credit risk-weighted assets (in addition to the existing risk weightings of 0, 20, 50 and 100 per cent.). A 75 per cent. risk weighting is assigned to foreign currency loans and loans with a currency clause which are completely insured by mortgages, specifically loans approved to debtors who do not have adjusted foreign exchange positions. A 125 per cent. risk weighting is assigned to foreign currency claims and claims with a currency clause which are not covered by the bank's deposits or mortgaged property, specifically claims from debtors who do not have adjusted foreign exchange positions.

Furthermore, as of the beginning of 2008 the capital adequacy calculation regulations were strengthened further: instead of risk weightings of 75 per cent. for collateralised and 125 per cent. for uncollateralized foreign currency and foreign currency indexed claims on clients with an unmatched currency position, new weights of 100 per cent. and 150 per cent., respectively, are applied.

The new Decision on the capital adequacy of credit institutions, which is harmonized with the EU regulations for calculating capital adequacy, entered into force on 31 March 2010. In addition, the minimum capital adequacy ratio was raised from 10 per cent. to 12 per cent. as of 31 March 2010. According to the new methodology prescribed in CNB subordinated legislation, at 31 March 2010 the capital adequacy ratio in the banking system amounted to 18.95 per cent., which represents an increase by 2.52 percentage points over the end of 2009. The main reason for the rise in the capital adequacy ratio is the new methodology used for its calculation. The new methodology prescribes more detailed rules for applying risk weights. Although the prescribed risk weights are generally lower for all types of loans (including Kuna loans), due to the large share of currency-induced credit risk positions in total risk weighted assets, the capital adequacy increase was mostly triggered by lower risk weights on these positions.

Measures to control the increase of the un-hedged Euro-denominated asset base

In the past few years, the CNB has initiated several measures to indirectly stimulate the growth of banks' capital and domestic currency deposits, as opposed to foreign currency sources. These measures have focussed on amendments to the marginal reserve requirement in order to discourage banks from foreign borrowing, and to encourage the banks to start to finance their lending activities by increasing their capital. In additional, amendments to the minimum liquidity requirement of foreign exchange liabilities has stimulated the banks to attract domestic currency deposits instead of foreign exchange deposits or deposits indexed to a foreign currency. Thus, in order to match the currency structure of their assets with the currency structure of their sources of funding, commercial banks have been motivated to lend more in domestic currency and to offer more attractive interest rates on Kuna loans.

Banking System

The CNB is responsible for the supervision of banks, savings banks, housing savings banks and credit unions. The supervisory tasks of the CNB also include the issuance and withdrawal of authorizations for these institutions and other authorizations and approvals in accordance with the relevant acts, the adoption of relevant subordinate legislation and the supervision of operations of these institutions. Legal compliance and safety and soundness of bank operations and risk management are assessed through on-site supervision, specialized on-site supervision and off-site supervision. On-site supervision is performed according to the CNB's methodology and in line with the annual supervisory plan adopted at the end of each calendar year for the following year. On-site examinations are performed at the banks' premises using original documentation and internal reports. In large banks, targeted on-site examinations are performed, while in medium-sized and small banks full-scope examinations are performed in tandem with targeted examinations. The off-site supervision department makes assessments of banks' risk profiles based on information provided in compulsory, extensive reports that banks submit to the CNB. If violations or irregularities are established, the on-site and off-site departments work together and issue regulatory orders that require banks to implement remedial measures.

Pursuant to the Credit Institutions Act, where a credit institution is either in breach of a law or regulation or its financial position makes its continued operation uncertain, the CNB may withdraw authorisation to provide particular financial services, appoint a special administrator, withdraw the credit institution's authorisation, initiate the compulsory winding-up of the credit institution or submit a request to initiate bankruptcy proceedings. The CNB shall appoint a special administrator if:

- a credit institution was ordered to and has failed to implement supervisory measures, owing to which its liquidity or solvency could be jeopardised;
- a credit institution fails to meet the minimum capital adequacy ratio of 12 per cent. despite the supervisory measures imposed;
- a credit institution has a capital adequacy ratio of equal to or less than 6 per cent.; or
- a credit institution's continued operation would, or could, jeopardise its solvency or liquidity and it is necessary to protect the interests of the credit institution's creditors.

However, the CNB has the discretion to postpone the application of the above provisions where the CNB is of the view that facts exist indicating a high probability of improvement of the credit institution's position. If the credit institution has a capital adequacy ratio of between 9 and 12 per cent., the CNB may impose, in addition to the above measures, other restrictions such as prohibition on profit distribution, ordering a reduction of expenses, limiting asset increases, prohibition of acquisition of shares or holdings in other legal persons, prohibition of increasing exposures to a single person, or ordering the management board to propose a recapitalisation of the credit institution. If the credit institution has a capital adequacy ratio of between 6 and 9 per cent., the CNB may also impose any of the following measures: requiring that the credit institution stops or alters the performance of certain more risky activities, requiring the suspension of certain persons with special rights and responsibilities, requiring that interest rates on received deposits do not exceed comparable market interest rates, the restriction of salaries and other income for persons with special rights and responsibilities, ordering shareholders to sell their shares in the credit institution, or ordering the credit institution to sell the shares it holds in another legal person or to wind-up such entity.

Structure of the Banking Industry

Croatia has a two-tier banking system in which the CNB acts as a central bank but does not engage in commercial banking.

At the end of June 2009 the Croatian banking system comprised 34 banks (2 of which being savings banks), 5 housing savings banks and HBOR. During the first half of 2009, one savings bank entered the market and one large and one middle-sized bank merged. Six foreign banks have offices in Croatia. The decrease in the number of banks after 1998 has resulted from consolidation/mergers, take-overs and the bankruptcy of some banks.

The proportion of the assets of banks within Croatia held in foreign ownership rose sharply between 1996 and 2002 as shown by the table below:

	1996	1999	2002
		(per cent.)	
State owned	78.4	45.6	4.0
Domestically owned	20.7	14.5	5.8
Foreign owned	1.0	39.9	90.2

Source: *Croatian National Bank*

The following table sets out the share ownership of the total assets of banks in Croatia (as a percentage) at the end of the periods indicated:

	Year ended 31 December					Three months ended 31 March	
	2005	2006	2007	2008	2009	2009	2010
State ownership[(1)]	3.4	4.2	4.9	4.5	4.2	4.5	4.3
Private domestic ownership	5.3	5.0	4.7	4.9	4.9	4.8	5.1
Foreign bank ownership	91.3	90.8	90.4	90.6	90.9	90.7	90.6
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: *Croatian National Bank*

(1) State owned and private with a significant public stake of at least 50 per cent. owned by the State.

The banking system in Croatia is highly concentrated with the two largest banks holding 41.3 per cent. of the market as at 31 March 2010. The majority of the banks' assets are controlled by foreign shareholders. As at 31 March 2010, 15 entities were majority owned by foreign shareholders, 17 by private domestic shareholders and 2 by the State.

The table below provides a breakdown of the ownership of banks in Croatia as at 31 March 2010.

	Voting shares				
	In private domestic ownership	**In government (domestic) ownership**	**Foreign (private) ownership**	**Share of market**	**Share in shareholders equity**
			(per cent.)		
Zagrebacka banka d.d	3.1	0.5	96.5	24.6	26.9
Privredna banka Zagreb d.d	22.5	0.9	76.6	16.7	18.6
Erste&Steiermärkische Bank d.d. Rijeka	3.7	0.2	96.2	12.8	10.6
Raiffeisenbank Austria d.d	2.1	0.0	97.9	10.5	10.4
HYPO Alpe-Adria-Bank d.d.	0.0	0.0	100.0	10.5	12.1
Société Générale-Splitska banka d.d	0.0	0.0	100.0	7.4	6.0
HPB d.d	1.1	98.9	0.0	3.8	1.3
OTP banka d.d.	0.0	0.0	100.0	3.3	3.0
Volksbank d.d	0.0	0.0	100.0	2.0	3.3
Medimurska banka d.d	2.5	0.0	97.5	0.8	0.7
Podravska banka d.d	11.2	1.8	87.0	0.7	0.7
Jadranska banka d.d	87.3	12.3	0.4	0.6	0.7
Istarska kreditna banka Umag d.d	76.6	3.5	19.9	0.6	0.4
Banco Popolare Croatia d.d	1.1	0.0	98.9	0.6	0.5
Karlovacka banka d.d.	87.0	7.0	6.0	0.6	0.4
Croatia banka d.d.	0.0	100.0	0.0	0.5	0.3
Kreditna banka Zagreb d.d	99.6	0.4	0.0	0.4	0.5
Centar banka d.d	90.3	0.0	9.7	0.4	0.4
Credo banka d.d	100.0	0.0	0.0	0.4	0.3
Imex banka d.d	100.0	0.0	0.0	0.4	0.2
Vaba d.d. banka Varazdin	80.9	2.3	16.9	0.4	0.3
Partner banka d.d	100.0	0.0	0.0	0.3	0.3
Banka Kovanica d.d	1.0	0.0	99.0	0.3	0.2
Štedbanka d.d	100.0	0.0	0.0	0.3	0.6
Veneto banka d.d	0.0	0.0	100.0	0.3	0.5
Slatinska banka d.d	89.0	8.8	2.2	0.3	0.3
BKS Bank d.d	0.0	0.0	100.0	0.2	0.1
Banka Brod d.d	100.0	0.0	0.0	0.1	0.1
Samoborska banka d.d	99.8	0.2	0.0	0.1	0.2
Nava banka d.d	98.6	0.0	1.4	0.1	0.1
Banka splitsko-dalmatinska d.d	89.9	0.0	10.1	0.1	0.1
Primorska banka d.d	14.3	0.0	85.7	0.0	0.1
Aggregate weighted by market share	10.0	4.7	85.3		
Aggregate weighted by share in shareholders equity	10.2	2.0	87.8		

Source: *Croatian National Bank*

Large banks are categorised as having a market share (in the total banking sector according to assets) of more than 5 per cent. and middle-sized banks are categorised as having a market share of between 1 per cent. and 5 per cent. According to these criteria there were 9 large or medium-sized banks in Croatia as at 31 March 2010. Only one of these banks, HPB, is majority owned by the government (or government agencies).

The following table sets forth the structure of bank peer group assets as at 31 March 2010:

	Money assets and deposits with the CNB	**Deposits**	**Securities**	**Loans**	**Other**
			(per cent.)		
Large banks	12.3	7.2	8.8	69.1	2.7
Medium-sized banks	12.6	9.4	11.1	63.2	3.8
Small banks	12.5	10.6	10.9	61.5	4.4
Total banks	12.4	7.7	9.2	67.9	2.9

Source: *Croatian National Bank*

The following table sets forth the structure of bank peer group liabilities as at 31 March 2010:

	Capital	Deposits	Securities	Loans	Other
			(per cent.)		
Large banks	14.8	67.0	0.9	14.3	3.1
Medium-sized banks	11.9	70.6	2.2	9.4	5.9
Small banks	13.2	73.2	1.0	9.6	3.0
Total banks	14.4	67.8	1.0	13.4	3.4

Source: *Croatian National Bank*

Changes in banks' balance sheets in 2008 were influenced by the monetary and prudential measures of the CNB, while the effects of the implementation of those measures were seen at the end of 2008 in slower assets growth, substitution of a part of foreign sources of financing with additional capital and currency restructuring of the entire balance sheet. Continued implementation of the same monetary and prudential measures, combined with a spill over of the effects of the global financial and economic crisis into domestic markets, led to slower growth in banks' assets. As market participants (including banks) remained risk averse, slow growth of bank balance sheets continued in 2009 (2.2 per cent. compared with year-end 2008). In the first quarter of 2010, bank balance sheets recorded a decrease of 1.1 per cent. compared with year-end 2009.

Balance sheet currency restructuring, involving growth of the Kuna component of banks' assets and liabilities, began at the end of 2006 and continued throughout 2007. In 2008, this growth trend reversed and started declining, a decline which continued in 2009 and the first quarter of 2010. At the end of 2009, bank assets consisted of 34.5 per cent. Kuna assets, 40.1 per cent. foreign currency indexed assets and 25.4 per cent. foreign currency assets. On the liabilities and capital side, the Kuna component accounted for 41.4 per cent., foreign currency indexed component accounted for 4.2 per cent. and foreign currency accounted for 54.5 per cent. of the total. During the first half of 2009, despite growth in interest rates on Kuna deposits, Kuna liabilities continued to stagnate, reflecting the traditional tendency of households to favour foreign currency savings, especially in times of economic uncertainty. Thus, bank holdings by households compensated the decrease of corporate bank deposits. As of 31 March 2010 liabilities and capital consisted of 41.0 per cent. Kuna liabilities and capital, 54.9 per cent. foreign currency and 4.1 per cent. were indexed to foreign currency. The significant decrease in Kuna loans (especially to the corporate sector) was partially offset by the liquidation of part of foreign liquid assets (by reducing holdings of foreign debt securities and the level of deposits held abroad), allowing banks to keep their currency positions relatively stable which lead to the Kuna component keeping its share of total assets basically unchanged compared with year-end 2009. At 31 March 2010, bank assets consisted of 34.5 per cent. Kuna assets, 41.2 per cent. foreign currency indexed assets and 24.3 per cent. foreign currency assets.

Capitalisation

At the end of 2009 the total capital of Croatian banks was HRK 52.5 billion, an increase of 5.3 per cent. from the end of 2008 and 21.7 per cent. from the end of 2007. The major contributors to this were share capital, retained earnings and statutory and other reserves which increased 14.2 per cent., 84.4 per cent. and 36.4 per cent., respectively, from 2007 to 2009. During the first quarter of 2010, banks' capital increased by 2.2 per cent. reaching 14.4 per cent. of total assets. Mainly driven by value adjustments costs, banks' current year pre-tax profit decreased by 9.6 per cent. in the first quarter of 2010.

The growth of assets of financial intermediaries in Croatia was 17.6 per cent. in 2007, 2.1 per cent. in 2008, and 3.7 per cent. in 2009, and this represented a compounded annual growth rate of 1.9 per cent. for the three years 2007 to 2009.

Risk-Based Capital Requirements and Solvency Ratios

The capital adequacy ratio is regulated by Title V of the Credit Institutions Act. In addition, capital adequacy is regulated by the 'Decision On The Capital Adequacy Of Credit Institutions', the 'Decision On Own Funds Of Credit Institutions', the 'Decision On Reports On Own Funds and Capital Requirements Of Credit Institutions', and the 'Decision On The Classification Of Placements and Off Balance Sheet Liabilities Of Credit Institutions'.

Regulatory capital (own funds) refers to the sum of capital requirements to cover the following items of risk as defined in Art. 131 of the Credit Institutions Act. 1) credit risk; 2) counterparty risk; 3) position risk and settlement risk; 4) exceeding permitted exposure limits; 5) foreign-exchange risk and commodities risk; and 6) operational risk. In comparison, minimum statutory capital (referred to as 'initial capital'), is defined in Art.29 of the Credit Institutions Act and is currently HRK 40m for banks, HRK 8m for savings banks, and HRK 20m for housing savings banks.

At the end of 2009 the regulatory capital of Croatian banks totalled HRK 52.6 billion, an increase of 7.4 per cent. compared with the end of 2008 and 24.5 per cent. compared with the end of 2007. During the first quarter of 2010, banks' regulatory capital increased by 1.4 per cent.

After declining from 14.6 per cent. in 2005 to 14.0 per cent. in 2006, the CNB capital adequacy ratio rose to 16.4 per cent. in 2007, declined to 15.2 per cent. in 2008 and rose again to 16.4 per cent. in 2009. The reason for the decline in capital adequacy (in 2006 and 2008) was the faster growth of risk-weighted assets over regulatory capital, which was mostly a result of changes in prudential measures aimed at increasing the capital required for currency induced credit risk. During 2009, risk weighted assets, as well as total bank exposures to risks, declined by approximately 1 per cent. indicating a decreased risk appetite on the part of banks during the financial crisis (a slowdown in banks' activities and the increased share of loans to government which have a zero per cent. risk-weighting). In the first quarter of 2010 bank regulatory capital increased by 1.4 per cent., but more importantly, the total risk exposures declined significantly because of the new methodology (in line with Basel 2 standards) used for its calculation. Consequently, the capital adequacy ratio increased to 19.0 per cent. as of 31 March 2010.

Total bank assets as at 31 December 2009 amounted to HRK 378.2 billion, an increase of HRK 8.3 billion, (2.2 per cent.) as compared with the end of 2008. The annual growth rate of bank assets was lower in 2009 than in 2008 (when it was 7.2 per cent.) and 2007 (13.3 per cent.). The observed slowdown in 2008 may to a large extent be attributed to the measure on the compulsory purchase of CNB bills aiming to slow down the credit growth, which was introduced in 2006. In connection with the escalation of the financial crisis and further deterioration in market conditions, market participants became more risk averse, resulting in a significant decrease of credit growth. The compulsory purchase of CNB bills, introduced with the goal of slowing down credit growth, was therefore no longer needed and was nullified. In the first six months of 2008, due to asset restructuring, credit growth was at 5.5 per cent. while bank assets grew at a rate of less than 1.0 per cent. However, in the second half of 2008 CNB measures were redesigned in the context of the global financial crisis and total bank assets increased by 6.5 per cent., while credit growth was at 8.1 per cent. Finally, total bank assets growth was 7.2 per cent. in 2008 and 2.2 per cent. in 2009. As of 31 March 2010 compared with the end of 2009 the grown rate of bank asset was negative (-1.1 per cent.), while credit growth amounted only to 0.6 per cent.

The following table sets out an overview of the assets of the Croatian banks as at 31 December for the years 2006 to 2009 (in million HRK):

	Year ended 31 December				Three months ended 31 March
	2006	**2007**	**2008**	**2009**	**2010**
			(HRK millions)		
Total assets	304,605	345,081	369,955	378,216	373,980
Total placements and contingent liabilities	349,630	396,421	422,478	426,624	401,819

Source: Croatian National Bank

According to audited data, in 2009 commercial banks in Croatia realised HRK 4.2 billion profit before tax, a decrease of 26.2 per cent. in comparison with 2008. Eight banks realized losses in 2009 and their assets represent 6.0 per cent. of the total assets of all banks in Croatia. The total loss amounted to HRK 624.5 million which amounted to 0.2 per cent of all bank assets in Croatia. During the first quarter of 2010 banks' pre-tax profits totalled HRK 1.2 billion, representing a decrease of 9.6 per cent. compared with the first quarter of 2009. Seven banks reported losses totalling HRK 48.5 million. The reduction in total bank profits compared to the first quarter of 2009 was primarily due to an increase in provisioning costs while bank operating profits remained relatively unchanged.

Loan Exposure

Total (net) loans of banks in 2009 amounted to HRK 252.3 billion (an increase of 2.4 per cent. as compared to 2008) and 46.7 per cent. of the loans were retail loans, while 37.5 per cent. were corporate loans. As of 31 March 2010 the total (net) amount of loans was HRK 253.9 billion, representing an increase of 0.6 per cent. compared with the end of 2009. Loans to corporate increased by 2.2 per cent., and the proportion of total loans represented by loans to enterprises increased to 38.1 per cent. The total amount of loans to households reduced by 0.2 per cent. compared to the position as at the end of 2009, and the proportion of total loans represented by loans to households reduced to 46.3 per cent. Along with loans to corporates, loans to non-residents and government entities also increased during the first three months of 2010 relative to the end of 2009 around 2 per cent. each. Loans to government entities thereby continued the upward trend which began in 2008 following the participation of the banks in external and domestic public debt refinancings.

During 2009 the percentage of non-performing loans started to increase for the first time since the late 1990's. The average overall percentage of non-performing loans increased from below 5 per cent. during 2008 to 7.8 per cent. at the end of 2009. The level of non-performing loans as of 31 March 2010 stands at approximately 9.0 per cent.

The table below shows the percentage of loans that were non-performing for the periods indicated:

	Year ended 31 December						Three months ended 31 March
	2000	2002	2004	2006	2008	2009	2010
				(per cent.)			
Non-performing loans	17.3	10.2	7.4	5.2	4.9	7.8	9.0

Source: Croatian National Bank

While non-performing loans increased across all sectors 2009, including in the household sector which historically has demonstrated lower levels of non-performing loans, the increase in non-performing loans in the corporate sector was the greatest.

The trend towards an increase in non-performing loans was spread through all sectors, however, the contribution of the corporate sector was greatest. Historically, the household sector has demonstrated lower levels of non-performing loans, due to the fact that household loans are generally collateralized and often guaranteed by third parties. By comparison, corporate loans do not benefit from such security and carry higher risk; hence, non-performing loans in the corporate sector have therefore increased as a result of the general decline in economic activity.

Real estate prices started to decline in 2008 and the trend continued in 2009, as a result of an increase in the interest rates on real estate loans; a sharp decline in the volume of newly approved loans; and a decline in real household income. This decline (measured in terms of average market price) was 3.2 per cent. in 2009 compared to the peak in real estate prices reached in 2008. This decline is not expected to have a significant impact on the quality of banks' collateral as banks were somewhat conservative in granting the loans and in addition, housing loans were predominantly granted to persons purchasing property for use as their domestic residence rather than as a speculative investment. As a result, a small, and relatively stable, portion of housing loans (approximately 2.7 per cent. as at 31 March 2010) are currently non-performing.

Total annualised expenses on loss provisions rose from HRK 3,514.6 million at the end of 2009 (which represented a 220.8 per cent. increase compared with 2008) to HRK 3,679.2 million at the end of March 2010 due to a rise in expenses on value adjustments and provisions for identified losses on an individual basis, which was linked to the decline in quality of total placements and contingent liabilities (so called bad loans).

Loans (net) to households reached HRK 117.8 billion at the end of 2009, a decrease of HRK 4.8 billion (3.9 per cent.) compared to the end of 2008. Home loans were the only loans to households that recorded an increase in 2009 (by 1.2 per cent.) which resulted in the increase of their share in total net loans extended to households and in total net loans to 44.5 and 20.8 per cent. respectively. All other loans extended to households decreased in 2009 (car purchase loans by 19.5 per cent. and credit card loans by 10.1 per cent.). Net loans to households reached HRK 117.6 billion at 31 March 2010, a decrease of HRK 0.2 billion (0.2 per cent.) compared to the end of 2009. In contrast to previous years during which bank credit activity was oriented towards the household sector, the growth of loans to households slowed down significantly in 2009 and the first quarter of 2010 reflecting turbulence in the macroeconomic environment and weaker demand. As of 31 March 2010 all types of loans to households except home loans had reduced relative to the end of 2009. Home loans increased by 1.2 per cent., while their share of the total net loans to households and the total net loans slightly increased to 45.2 per cent. and 20.9 per cent., respectively. Unlike in 2009 when most of the decrease in household loans came from general purpose loans, around two thirds of the reduction in loans to households in the first quarter of 2010 was a result of a decline in car purchase loans and credit card loans.

In comparison with an annual growth rate of 6.3 per cent. in 2008, in 2009 bank deposits grew by 3.6 per cent. This reduction in the rate of growth of deposits was mainly the result of an 8.8 per cent. decrease in the amount of deposits by enterprises in 2009. In the first three months of 2010, bank deposits decreased by 1.2 per cent. relative to the end of 2009, as explained below. The share of deposits to total bank liabilities has remained relatively stable since 2007 and stood at 67.8 per cent. as at 31 March 2010.

As of 31 March 2010, total deposits amounted to HRK 253.6 billion, with significant decrease in time deposits of corporate and non-residents of HRK 5.5 billion (8.2 per cent.) compared with the end of 2009. Giro account and current account deposits as well as savings deposits remained basically unchanged in the first quarter of 2010. Total non-resident deposits decreased by HRK 2.3 billion (5 per cent.), as a result of decrease in foreign shareholders' deposits (8.1 per cent.) which was compensated with deposits by other foreign financial institutions (8.8 per cent.) in the same period. Households deposits grew by 1.1 per cent. compared to the end of 2009. Kuna deposits decreased by HRK 3.7 billion (4.4 per cent.), mainly as a result of a decrease in Kuna time deposits. Foreign exchange deposits increased by HRK 1.2 billion (0.7 per cent.) while currency linked deposits decreased by HRK 0.6 billion (10.8 per cent.).

As of 31 March 2010, 66.9 per cent. of total deposits were denominated in a foreign currency, 31.2 per cent. in Kuna, and only 1.9 per cent. were currency-linked deposits. Total deposits consisted of 56.2 per cent. household deposits, 17.3 per cent. corporate deposits, with 17.2 per cent. belonging to non-residents and 9.2 per cent. to State, financial and non-profit institutions.

The 0.6 per cent. increase in total bank loans in the first three months of 2010 was mostly due to an increase in loans to corporates, which rose by approximately HRK 2.1 billion.

The receivables of banks from the central government amount to HRK 47.9 billion at 31 March 2010, which is an increase of 8.4 per cent. compared to the end of 2009 and 17.1 per cent. compared to the end of 2008. This amount consists of HRK 30.2 billion credits and HRK 17.7 billion Ministry of Finance treasury bills and Government securities. The deposits of central government with commercial banks slightly increased from HRK 1.38 billion at the end of 2009, to HRK 1.44 billion at the end of March 2010.

The Croatian Registry of Loan Obligations (Hrvatski registar obveza po kreditima d.o.o., "**HROK**"), a company for business services that are customary in countries with developed financial markets, started its operations at the beginning of May 2007. HROK was formed to maintain a complete registry of loans made in Croatia. It was established by 20 banks in Croatia representing over 97 per cent. of the credit market in Croatia, and the accession of other banks is also expected. The complete registry of loans is a system for collection, processing and exchange of information on all loan obligations of customers and due fulfilment of these obligations. The exclusive users of HROK's services are banks and savings banks. There is also a plan to include credit card companies and leasing companies into HROK, since they can give a more complete insight into the debt of consumers.

Impact of recent events in the financial markets

In 2009, a period characterized by unfavourable macroeconomic conditions during which domestic deposits stagnated, banks were able to increase their foreign financing and foreign liquid assets. In the first quarter of 2010, there was no potential for credit growth and banks' foreign liabilities were reduced. More specifically, banks returned a portion of deposits and loans to their owners by liquidating a portion of their foreign liquid assets or partially replacing owners with other non-residents as financing source. In addition to keeping operational costs down and maintaining interest rates at relatively high levels, banks managed to support their operating profits by increasing the share of (more expensive) short-term loans. Thus, banks managed to offset rising interest costs and keep operating profits relatively stable. However, banks earnings are calculated after value adjustment costs, which rose around 200 per cent. in 2009 and caused banks profit and profitability indicators to decrease. In the aggregate, Croatian banks have remained profitable and have increased their capital which has made the banking sector more resilient to shocks. However, eight banks reported negative pre-tax earnings at year-end 2009 and at the end of the first quarter of 2010.

Although Croatian banks are not directly exposed to the global financial and economic crisis, they are partially dependent on funding from foreign parent banks that are themselves exposed to such risks. The global economic turmoil did not cause a deceleration in the inflow of capital from parent banks to the domestic banking system. Moreover, parent banks proved to be a stable source of financing through the crisis. In 2008 loans and deposits from parent banks increased by 30.9 per cent. to HRK 52.0 billion, with additional increase of 15.1 per cent. in 2009 to HRK 59.8 billion. In the first quarter of 2010 financing from foreign owners was reduced by 8.2 per cent to HRK 54.9 billion. The decrease in parent bank financing in the first quarter of 2010 was driven by the reduced need for support from foreign parent banks.

Foreign Currency Liquidity

In an economy such as Croatia which has a high volume of euros in circulation, the issue of foreign currency liquidity of both banks and the entire economy is particularly sensitive. The foreign currency liquidity management of banks is regulated by determining the minimum amount of foreign currency assets required to be held. Banks meet this requirement by using transactions with non-residents, which implies that slower or interrupted capital inflows from abroad would cause difficulties in maintaining the foreign currency liquidity of Croatian banks. Foreign currency liquidity indicators have deteriorated from the previously very high levels as a consequence of the turbulences in financial markets which began in 2008. The ratio of foreign liquid assets to foreign short-term liabilities fell from 81.3 per cent. at the end of 2007 to 64.6 per cent. at the end of 2008, to 53.6 per cent. at the end 2009, and to 48.6 at the end of March of 2010, while the ratio of foreign liquid assets to total foreign assets declined from 73.7 per cent. at the end of 2007 to 69.6 per cent. at the end of 2008, to 64.3 per cent. at the end of 2009, and to 62.8 at the end of March of 2010. This was partly the result of a change in regulation which allowed banks to decrease their net foreign assets (see further "Monetary Policy and Instruments" above), as well as due to a sharp rise in liabilities (more precisely in non-resident deposits and loans during the last quarter of 2008 and beginning of 2009) primarily directed from parent banks to their Croatian subsidiaries in order to maintain their liquidity (which was under pressure due to some deposit withdrawals in early October 2008).

Banking sector liquidity, measured as the ratio of total liquid assets to total assets, decreased from 12.7 per cent. in 2007 to 11.7 per cent. in 2009, and further decreased to 11.5 per cent. at the end of March of 2010. This was partly due to a change in regulation that allowed banks to sell a part of foreign assets. The ratio of total liquid assets to total short-term liabilities decreased from its 2007 level of 17.0 and amounted 15.8 per cent. at the end of 2008 and 2009. As of 31 March 2010 the ratio was 15.5 per cent.

Considering its major implications for the entire economy, the CNB policy of maintaining adequate international reserves, with international reserves currently running at a satisfactory level also ensures external liquidity in the economy. Also, macro-prudential measures of the CNB in the years of strong economic and credit growth (2006-07) enhanced the resilience of the banking sector to foreign currency liquidity risk. Marginal reserve requirements made foreign debt more expensive for banks and higher risk weights for foreign currency induced credit risk required recapitalization of banks. Together, these measures triggered the substitution of foreign borrowing by new equity.

Due to current market conditions and the global financial and economic crisis, the restrictions on the marginal reserve requirement were removed as of 10 October 2008 (by a decision of the Council of the CNB). By this measure, the CNB released to commercial banks for their disposal approximately EUR 355 million and U.S.$ 129 million in order to help provide additional foreign exchange liquidity and increase banks' ability to fulfil their obligations towards all clients. Furthermore, decreasing the minimum required amount of foreign currency assets from 28.5 per cent. to 20.0 per cent. of total foreign liabilities, which took place in February 2010, resulted in additional foreign exchange liquidity for Croatian banks. (See also "*Monetary Policy and Instruments' above for details of further liquidity measures*")

Bank Regulation and Prudential Standards

The Credit Institutions Act entered into force on 1 January 2009. It introduces the term "credit institution", which is defined as a legal person whose core activity is to receive deposits and other repayable funds from the public and to grant credits for its own account or to issue means of payment in the form of electronic money. A credit institution may be established as a bank, savings bank, housing savings bank or an electronic money institution. A bank must follow the principles of liquidity and solvency, and as of 31 March 2010 the minimum rate of capital adequacy must be at least 12 per cent. Regulatory capital (own funds) refers to the sum of capital requirements to cover the following items of risk as defined in Art. 131 of the Credit Institutions Act: (i) credit risk; (ii) counterparty risk; (iii) position risk and settlement risk; (iv) exceeding permitted exposure limits; (v) foreign-exchange risk and commodities risk; and (vi) operational risk.

According to Croatian law both direct and indirect acquisition of a bank's shares or an increase in the holding of a bank's shares must be approved by the CNB beforehand. The thresholds set by the law are: 10 per cent. or more (a qualifying holding), 20 per cent. or more, 30 per cent. or more and 50 per cent. or more shares acquired. These thresholds are based on: recommendations and practise form other countries, historic experience of CNB and EU Directives. The motive for choosing a number of thresholds is to monitor more closely the ownership structure changes in a bank. That way, before giving the approval for crossing each threshold, CNB monitors not only the legal position of a potential acquirer, but also the acquirer's financial health and other relevant factors.

Foreign banks can offer banking and other financial services in the territory of Croatia only through branches established on the basis of a licence from the CNB. As a condition to the granting of a licence, the CNB may also require that the foreign bank deposits a certain amount of money in Croatia or provide some other corresponding security for the settlement of liabilities arising from business operations in Croatia.

The Credit Institutions Act contains certain provisions that will become effective as of the date when Croatia becomes a member of the EU and which are linked to the single passport regulations within the provision and supervision of financial services in the EU.

Deposit Insurance

The State Agency for Deposit Insurance and Bank Rehabilitation has been established as a specialised financial institution for deposit insurance of banks and saving banks and for implementation of bank rehabilitation procedures in insolvency. The Government founded the Agency, which guarantees the commitments and liabilities of the Agency. The assets for the operation of the Agency comprise insurance premiums paid to the Agency by banks and saving banks for the purpose of savings deposit insurance and revenues earned by the Agency through its operation. Deposits (in HRK or foreign currency) are insured up to HRK 400,000. Prior to obtaining authorization to provide services, credit institutions must join the deposit insurance scheme run by the State Agency for Deposit Insurance and Bank Rehabilitation. Banks are required to pay a levy of 0.3 per cent. of their initial capital at the start, and are required to pay quarterly premiums of 0.125 per cent. of their insured deposit base at the end of each financial quarter in which they conduct business.

Rehabilitation Programme and Privatisation of Banks

The legislative structure for the rehabilitation programme was previously set out in the Act on Bank Rehabilitation and Restructuring which came into force on 11 June 1994 and was revoked in 2000 after the Government privatised most of the restructured banks. The rehabilitation of insolvent banks was implemented by the transfer of bad bank credits to a special agency, recapitalisation, replacing shareholders and replacing bank management.

In order to revitalise the banking sector and to support economic growth, the Government has rehabilitated six banks: Slavonska banka, Privredna banka Zagreb Rijecka banka, Dubrovacka banka, Splitska Banka and Croatia banka.

Two banks remain state-owned — Hrvatska poštanska banka (Croatian Postal Bank) and Croatia banka.

Money Market

The last quarter of 2008 and first quarter of 2009 were characterised by instability in the money and foreign exchange markets. A decrease in foreign capital inflows in the last quarter of 2008 resulted in strong depreciation pressures on the domestic currency. In addition, withdrawal of deposits from banks in the first half of October 2008 prompted banks to convert assets into more liquid forms which boosted demand for foreign exchange. To address the increased demand for liquidity, the CNB abolished the marginal reserve requirement which previously was 55 per cent., thus releasing approximately EUR 355 million and U.S.$ 129 million into the banking system. Continuing downward pressures on the Kuna in late October prompted the CNB to undertake a foreign exchange intervention in which HRK 2.0 billion was purchased from the banks. However, Kuna liquidity was created cautiously by way of reverse repo auctions. Although the largest ever amounts of the funds demanded and funds placed by repo auctions and Lombard loans were recorded in 2008. This policy helped maintain a stable exchange rate but resulted in increased tension on the money market. Reduction of the reserve requirement rate in early December from 17 per cent. to 14 per cent. temporarily eased the pressures on the money market and sharply reduced money market interest rates. The weighted average interest rates for overnight loans in direct interbank trading fell from 16.10 per cent. in November to 5.77 per cent. in December of 2008. The year 2009 was generally marked by large fluctuations in interest rates on the money market, with monthly averages ranging between 19.0 per cent. in February and 1.0 per cent. in November. Observed over the five-year period leading up to 2009, interest rates on money market deposits were at their highest average monthly level during the first quarter of 2009 and at their lowest average monthly level in the fourth quarter of 2009. The rate was 1.20 per cent. in December 2009 and stands at 0.84 per cent. as at 31 May 2010.

Depreciation pressures on the Kuna resumed in January 2009, prompting the CNB to increase the calculated foreign currency component of reserve requirements that is set aside in Kuna from 50 per cent. to 75 per cent. and intervene in the foreign exchange market on two occasions (23 January and 18 February) in order to stabilise the exchange rate withdrawing a total of HRK 3.8 billion. This also contributed to a rapid rise in money market interest rates and an increase in their volatility from mid-January 2009. In addition to these measures, during February 2009 the CNB also conducted a two-step decrease of the minimum required amount of foreign currency claims of a bank's total foreign liabilities from 28.5 per cent. to 25.0 per cent. and then further to 20.0 per cent. which released EUR 2.1 billion that were previously set aside as part of banks' liquid foreign assets. The policy actions conducted from October 2008 improved foreign currency liquidity in the banking system, releasing funds worth EUR 3.8 billion.

Depreciation pressures on the Kuna started to subside in February and in a subsequent intervention on 27 February 2009, the CNB purchased Euros, creating HRK 2.46 billion and easing money market pressures. As a result, money market rates decreased considerably and liquidity in the system remained sufficient. The increase in the level and volatility of money market interest rates that began in the last quarter of 2008 decelerated in March 2009. The weighted interest rate on overnight loans in direct interbank trading in reserve money decreased from a record high of 18.97 per cent. in February to an average of 13.67 per cent. in March. On a quarterly basis interest rates decreased from an average of 13.86 per cent. in the first quarter of 2009 to 5.87 per cent. in the second quarter. As the tourist season intensified and the share of domestic currency held outside banks increased, interest rates rose to 7.41 per cent. in July. As the CNB created additional Kuna liquidity by increasing placements though repo auction and Lombard loans, money market rates decreased to 6.47 per cent. in August. The liquidity of the domestic banking system was exceptionally good throughout the last quarter of 2009, cutting interest rates on the money market to approximately 1.0 per cent. Owing to good banking system liquidity, towards the end of 2009, the average weighted interest rate on overnight loans in direct interbank trading fell to 1.20 per cent. in December 2009.

The first quarter of 2010 was marked by high liquidity in the domestic banking system and a stable EUR/HRK exchange rate. High liquidity was supported by decreasing the reserve requirement rate in February 2010 (from 14 per cent. to 13 per cent.) in order to release liquidity for Government measures aimed at stimulating economic activity. Subsequently, in this period, interest rates on overnight loans in direct interbank trading reached their lowest level in the past five years. These rates amounted to 0.77 per cent. in March 2010 and remained below 1.0 according to the latest available data, standing at 0.84 per cent. in May 2010.

Money market turnover increased in 2009 compared to 2008 as a result of restrictive money creation, especially in the first quarter. Banks met their primary liquidity needs on the money market in the average daily amount of HRK 2.6 billion, compared to HRK 2.5 billion in 2008. In 2009, total turnover amounted to HRK 660.8 billion, compared to HRK 637.8 billion in 2009. In the first three months of 2010, the average daily turnover was 1.3 billion and total turnover amounted to 83.3 billion, compared with 3.3 billion and 207.0 billion, respectively, in the same period of 2009.

In 2009, the largest share of total loans placed on the money market was, as in the past, attributable to loans in demand deposit trading (HRK 560.8 billion or 87.9 per cent.), and banks additionally raised HRK 76.7 billion by purchasing repo agreements. The remaining HRK 0.3 billion was raised through the sale of securities. Within the structure of demand deposit trading, the share of interbank trading, traditionally the largest category, declined to 35.9 per cent. in 2009 from 41.6 per cent. in 2008, and decreased to 28.9 per cent. in the first quarter of 2010. Share of demand deposit trading with other legal persons increased to 43.0 percent in 2009 from 33.7 per cent. in 2008, and increased to 43.7 per cent. in the first quarter of 2010. Conversely, the share of demand deposit trading with non-banking financial institutions decreased to 21.1 per cent. in 2009 from 24.7 per cent. in 2008, but subsequently increased again to 27.4 per cent. in the first quarter of 2010.

Within interbank trading in demand deposits, direct interbank trading remained dominant, totalling HRK 184.2 billion in 2009, while bank trading with Zagreb Money Market ("**ZMM**") intermediation was HRK 20.8 billion. Overnight loans continued to be the most liquid instrument in direct interbank trading in reserve money, accounting for HRK 100.4 billion in 2009. The average daily turnover in overnight loans was HRK 0.4 million in the same period. The average daily turnover in loans intermediated by the ZMM was HRK 0.1 million in 2009.

The Government raised substantial short-term domestic funding in order to cover the consolidated government deficit and to refinance maturing T-bills. In the first five months of 2010, the Ministry of Finance raised at 11 T-bill auctions a total of HRK 6.3 billion in Kuna denominated T-bills and HRK 2.1 billion in EUR-linked T-bills. EUR-linked T-bills are denominated in EUR but settled in Kuna at the official CNB rate. The weighted interest rate on one-year Kuna T-bills hit a record high of 7.95 per cent. in December 2008. It was 6.06 per cent. in December 2009 and has decreased since then to 3.95 per cent. in May 2010. The weighted interest rates on 91-day T-bills and 182-day T-bills denominated in Kuna in May 2010 were 2.5 per cent. and 3.25 per cent., respectively. EUR-linked T-bills were issued only with one-year maturity and weighted interest rates on these bills fell from 7.95 per cent. in December 2008 to 4.72 per cent. in December 2009. and fell further to 3.65 per cent. in May 2010. This decrease in interest rates was a result of a stable monetary environment characterised by sufficient available liquidity.

Total stock of subscribed T-bills grew in the first five months of 2010, increasing from HRK 12.1 billion at the end of 2009 to HRK 13.8 billion at the end of May 2010. The stock of Euro denominated T-bills increased from EUR 1.36 billion to EUR 1.39 billion in the same period.

The main factors which boosted bank interest rate growth in the first half of 2009 were more expensive sources of bank financing, the worsening of the quality of credit portfolios of banks and large government demand for bank loans. At the same time, the growth in interest rates was mitigated by a reduction in the costs of regulatory compliance for banks (e.g., reductions in required foreign liabilities coverage and general reserve requirements) and the improvements in system liquidity under the influence of CNB measures. Starting in the second half of the year and as a result of the easing of liquidity pressures and the first signs of recovery in neighbouring countries, investor risk aversion began to decline, leading to a decrease in Croatia's sovereign risk premium. This in turn facilitated access to foreign sources of financing and led to a decline in interest rates on corporate loans. Bank interest rates on deposits remained relatively stable throughout the first half of 2009, owing to developments in interest rates on foreign currency deposits, while weighted interest rates on Kuna time deposits without a currency clause rose considerably. In the second half of 2009, deposit interest rates generally moved in line with developments in lending interest rates of banks, keeping interest rate spreads relatively stable.

In general, lending interest rates of banks, particularly on short-term corporate loans, fell in the fourth quarter of 2009 and in early 2010. Such developments in interest rates were an indication of improved banking system liquidity. In the first three months of 2010, interest rates on loans, in particular on corporate and household loans, trended down compared to 2009. Interest rates on both short-term Kuna-denominated loans and long-term loans with a currency clause mostly decreased. Between December 2009 and March 2010, weighted interest rates on Kuna denominated short-term corporate loans decreased from 9.29 per cent. to 7.24 per cent., while weighted interest rates on long-term corporate loans with a currency clause slightly rose from 7.31 per cent. to 7.67 per cent. In the same period, weighted interest rates on short-term Kuna denominated household loans fell from 12.68 per cent. to 12.60 per cent. and weighted interest rates on long-term household loans with a currency clause decreased from 9.02 per cent. to 8.82 per cent.

In the fourth quarter of 2009 and first quarter of 2010, interest rates on time deposits mirrored declining interest rates on loans, thus stabilising interest rate spreads. The increase in liquidity also affected interest rates on time deposits, reducing them to multi-year lows in late 2009 and in early 2010. Weighted interest rates on time deposits fell from 5.65 per cent. in December 2008 to 2.52 per cent. in December 2009 and stand at 2.07 per cent. as of March 2010. Weighted interest rates on foreign currency time deposits declined from 4.14 per cent. to 3.58 per cent. from December 2008 to December 2009 and stand at 3.17 as of March 2010. Interest rates on corporate giro-accounts denominated in Kuna were relatively stable, decreasing only marginally from 0.62 per cent. in December 2008 to 0.60 per cent. in December 2009, and 0.58 per cent. in March 2010.

Between December 2008 and December 2009, the spread between the weighted interest rate on total loans and the weighted interest rate on total deposits rose from 6.42 per cent. to 7.03 per cent., while in March 2010 it declined to 6.96 per cent. The spread between the weighted interest rate on Kuna loans without a currency clause and the weighted interest rate on Kuna deposits without a currency clause increased from 7.79 per cent. in December 2008 to 8.90 per cent. in December 2009, but this trend reversed as well and in March 2010 the spread was 8.40 per cent. The spread between the weighted interest rate on Kuna loans with a currency clause and the weighted interest rate on foreign currency deposits increased from 3.76 per cent. in December 2008 to 4.30 per cent. in December 2009 and 4.88 per cent. in March 2010.

Capital Markets

In 2007 the Varazdin Stock Exchange merged with the Zagreb Stock Exchange ("**ZSE**"), and the ZSE is currently the only stock exchange in Croatia. There are two types of participants envisaged in the ZSE system: brokers and specialists. The system for specialists has not yet been implemented although some preparations have started. Once implemented the role of specialists will be to maintain market liquidity of specific shares within boundaries set by the ZSE defining the maximum spread and minimum quoted volume. There are currently 41 brokerages with 187 licensed brokers whose role is to execute client orders. Equity trading on the ZSE is organized into three market segments: the prime market, the official market and the regular market. The ZSE also operates a multilateral trade platform.

The following table sets forth the break-down of total trading volume for the periods indicated:

	First half of 2008	Second half of 2008	First half of 2009	Second half of 2009	Variation of second half of 2009 from first half of 2009	Variation of second half of 2009 from second half of 2008
Regular volume	116,994,886	273,111,381	69,239,406	103,969,337	50.2	(61.9)
of which Stocks	16,317,483	18,045,468	17,821,350	15,570,993	(12.6)	(13.7)
of which Bonds	84,093,954	237,764,460	28,734,342	85,227,764	196.6	(64.2)
of which Rights	16,583,449	193,453	16,829,994	1,473,100	(91.2)	661.5
of which Commercial Paper	NA	17,108,000	5,853,720	1,697,480	(71.0)	(90.1)
Block volume[(1)]	849,437	845,306	0	0	(100.0)	
Reported volume[(2)]	257,127,500	197,512,800	79,000,000	80,861,339	2.4	(59.1)
Institutional volume[(3)]	3,852,275,488	2,203,313,523	891,667,071	842,618,645	(5.5)	(61.8)
Total number of trades	383,845	374,319	278,677	208,575	(25.2)	(44.3)
Number of securities traded	336	295	289	310	7.3	5.1
Number of trading days	123	126	120	128	6.7	1.6
Daily average volume	34,367,864	21,228,437	8,665,887	8,336,112	(3.8)	(60.7)

Source: Zagreb Stock Exchange

(1) Block trades are negotiated deals that are done outside regular order book and daily price limits.
(2) Reported trades are trades with bonds in amount greater that HRK 3.0 million.
(3) Institutional trades are trades reported by institutional investors.

There was only one stock issue in 2009, which was a recapitalization of an already listed company and there were no new corporate or bond listings on ZSE. At the end of 2008 there were 21 commercial paper issues by 17 issuers, at the end of December 2009, there were 39 commercial paper issues listed at the ZSE by 20 issuers. At the end of April 2010, there were 38 commercial paper issues listed at the ZSE by 21 issuers.

Developments on the domestic capital markets in 2009 closely followed those in more mature capital markets worldwide. The beginning of the year was marked by the spillover effects of the world financial crisis on the real economy and high risk aversion of global investors. The first two months of 2009 saw a worsening of the declines witnessed in 2008, followed by the first signs of recovery in March. The initial recovery of the domestic stock price index, CROBEX, was less pronounced than in more mature markets. However, in May 2009 year-to-date growth significantly outpaced that in more mature markets, which was followed by a relatively strong decline that lasted until early July and was more pronounced than in other European emerging markets. Positive trends from the world markets encouraged the recovery of the domestic capital market which continued till the last quarter of 2009, when investors' concern about the sustainability of the economic recovery of the largest economies and the worsening domestic macroeconomic indicators negatively influenced the movements on the domestic capital market. The year 2010 started optimistically with developments on domestic capital markets broadly following European markets in the first weeks of January. This continued until mid-February, despite declines in stock prices on developed markets driven by worries about global recovery. Between mid-February and the end of April, the CROBEX traded in a narrow range, with prices virtually unchanged. At the end of April 2010, due to intensification of Greek crisis, the CROBEX, in line with the major European indices, declined to the levels seen at the end of 2009.

Market liquidity in 2009 was low, despite the fact that the CROBEX index rose 16.4 per cent. After a positive start of 2010, over the first five months CROBEX slightly decreased (1.0 per cent.), which was the result primarily of negative domestic and international macroeconomic movements in the second quarter of 2010. The total market capitalization of shares listed on the ZSE decreased from HRK 142.1 billion (41.5 per cent. of GDP) at the end of 2008 to HRK 135.4 billion (40.6 per cent. of GDP) at the end of 2009 and to HRK 133.4 billion at the end of May 2010.

In 2009, the domestic bond market faced challenges related to increased risk aversion by domestic and international investors, low liquidity, and concerns about the state of the economy. In 2009, the ZSE bond index, CROBIS, increased by 5.8 per cent. In the first five months of 2010, CROBIS increased further by 1.5 per cent. Total bond turnover on the ZSE in 2009 was HRK 3.4 billion, 74.5 per cent. lower compared to 2008, marking the lowest turnover since the year 2001. The total market capitalisation of bonds listed on the ZSE increased from HRK 33.4 billion at the end of 2008 to HRK 36.0 billion at the end of 2009 and represented 10.7 per cent. of GDP, compared to 10.2 per cent. at the end of 2008. The issuance of two new government bonds and one corporate bond since the end of 2009 led to an increase in total bond market capitalisation to HRK 42.7 billion at the end of May 2010 (an 18.6 per cent. increase).

Thirty-five bonds were listed on the domestic capital market at the end of 2008, and 33 were listed at the end of 2009. Eight were Government bonds, one was a State agency (HBOR) bond, eight were municipal bonds and 16 were corporate bonds. In the first five months of 2010, there were two new Government ten-year issues (a HRK 3.5. billion 6.75 per cent. bond and a EUR 350 billion foreign currency-indexed 6.50 per cent. bond) which were partially used to repay the domestic bond that matured in March 2010 (HRK 3.0 billion). In the same period there was one corporate issue. Therefore, at the end of May of 2010, there were 35 bonds listed on the domestic capital market: nine Government bonds, one State agency (HBOR) bond, eight municipal bonds and 17 corporate bonds.

The average monthly yield spread between Croatian Eurobonds and benchmark bonds as measured by the JPMorgan EMBI Index decreased from 445 basis points at the end of December 2008 to 235 basis points at the end of December 2009, and decreased further to 206 basis points at the end of April 2010, while in May it rose to 285 basis points due to unstable condition in the global bond markets. The trend of the fluctuations in the spread on Croatian Eurobonds broadly followed other European emerging markets Eurobonds, reflecting a decline in global risk aversion in the second half of 2009 and the beginning of 2010 and a relative increase in risk aversion since then. The stabilisation of the market environment allowed the issuance in June 2009 of a EUR 750 million 6.5 per cent. Eurobond due January 2015 and the issuance in November 2009 of U.S.$ 1.5 billion 6.75 per cent. notes due 2019.

Five Croatian bonds were listed on foreign markets as at the end of May 2010, three of which were denominated in Euro and two in U.S. dollars. In the first five months of 2010, one bond listed on foreign markets matured (EUR 500 million). The total outstanding nominal value of Croatian bonds listed on foreign markets was approximately EUR 3.9 billion at the end of May 2010.

Regulation of the Non-Banking Sector

The Croatian Financial Supervisory Authority Act (Official Gazette No. 140/2005) envisaged the establishment of a single body responsible for the supervision of the non-banking financial sector. The Act combined the existing supervisory authorities in the non-banking financial sector into a single supervisory authority responsible for the non-banking financial sector, the Croatian Agency for Supervision of Financial Services ("**CASFS**"). CASFS became operative as of 1 January 2006 and its responsibilities include supervision of:

- stock exchanges and regulated public markets, authorised companies and securities issuers;
- investment, privatisation investment and pension fund management companies, investment funds, privatisation investment funds, pension funds, the Fund of the Croatian Homeland War Veterans and Their Family Members and the Pensioners' Fund;
- brokerage companies, brokers and investment consultants;
- institutional investors;
- the Central Depository and Clearing Company;
- the Central Registry of Insured Persons;
- insurance companies, pension insurance companies, insurance agents and brokers; and
- legal persons dealing with leasing and factoring, unless such activities are conducted by banks in the framework of their registered activity, in to the Act on CASFS and other relevant legislation.

The establishment of a single authority for the supervision of financial institutions in the non-banking financial sector has contributed, within the framework of its regulatory and supervisory responsibilities, to stability of the financial system. With the establishment of an institution for consolidated supervision of the non-banking financial sector, the preconditions for the adoption of a single financial services act were met.

The Croatian Parliament promulgated the new Capital Market Act (Official Gazette No. 88/08, 146/08 and 74/09) on 18 July 2008 which entered into force on 1 January 2009. The new Act incorporates all relevant regulations of the *acquis communautaire*.

By entry into force of the Capital Market Act, the Securities Market Act (Official Gazette Nos. 84/02 and 138/06) has ceased to have effect and the Agency's ("**HANFA**") obligation to adopt regulations pursuant to the Capital Market Act in the three month period after the Act comes into force has started. Until the adoption of the regulations in accordance with the Capital Market Act, regulations adopted pursuant to the Securities Market Act shall continue to apply accordingly insofar as they are not contrary to the Capital Market Act. Some articles of the Capital Market

Act came into force on the 1st January 2010. In addition, some provisions of the Act will come into force or, as the case may be, will cease to be in effect after the accession of Croatia to the EU.

In October 2008, HANFA decided to establish an intervention fund (the "**Fund**") that will compensate investors in the event that individual investment funds are unable to sell their financial assets and repay their investors. The duration of the Fund is five years. Initial investors in the Fund are four companies involved in the management of four mandatory pension funds (AZ mirovinsko društvo, ROMF, PBZ-CO mirovinsko društvo and Erste Plavi) and four companies involved the management of four open investment funds (ZB Invest, PBZ Invest, RBA Invest and Erste Invest). The Fund may be approached on a voluntary basis by fund management companies experiencing difficulties with the sale of a part or all of their assets and confronted with repayment requests from their stakeholders. A precondition for the purchase of assets by the Fund is that the company managing the requesting fund initiates liquidation proceedings, namely, the process of closing the fund, within a reasonable time. An initial payment of HRK 50 million was contributed by the initial investors after the establishment of the Fund, which will be increased if needed.

PUBLIC FINANCE

Fiscal Policy in 2009

Further deterioration of macroeconomic conditions in 2009 led to a need for new measures aimed at ensuring the stability and liquidity of Croatia's public finances. After the first budget revision in April 2009, a second and third budget revisions were adopted in July, decreasing projected revenues by 1.9 percentage points of GDP and projected expenditures by 0.7 percentage points of GDP.

In 2009 the Government issued two bonds after being absent from the international capital markets for five years. The first issue was in May, worth EUR 750 million and maturing in 2015, while the second issue was in November, worth US$ 1.5 billion and with a 10-year maturity.

These measures contributed to the stability of public finances in 2009 in the circumstances of an economic crisis and created a starting point for implementation of the fiscal policy in the forthcoming period, aiming at ensuring system liquidity and creating the preconditions for economic recovery.

Consolidated General Government Results for 2009

Revenue

In 2009, according to preliminary data the total revenue of the consolidated general government amounted to HRK 128.1 billion, which was HRK 260.4 million (0.2 per cent.) less than the revenue budgeted for 2009, and HRK 6.7 billion less than the revenue in 2008.

In respect of revenue of the consolidated general government in 2009: the largest portion of revenue related to budgetary central government representing 86.1 per cent.; then extra-budgetary users represented 3.0 per cent.; and local government represented 10.9 per cent. Since January 2007, all transactions of the social security funds (the Croatian Institute for Pension Insurance, the Croatian Health Insurance Institute and the Croatian Employment Service) have been included within budgetary central government. Following the supplementary budget in 2008, the sector classification of institutional units was brought into line with the ESA 95 methodology, as a result of the Croatian Motorways Ltd. is classified into the sub-sector of public non-financial corporations rather than general government sector.

Tax revenues represented the most important revenue-generating category comprising 57.4 per cent. of the consolidated general government revenue in 2009. Compared with 2008, tax revenues decreased by 7.7 per cent. in 2009. However, tax collections in 2009 were 508 million or 0.7 per cent. above the budgeted amount.

The largest part of tax revenue is generated through value added tax ("**VAT**"). In 2009, revenues from VAT, collected in their entirety by budgetary central government, amounted to HRK 37.1 billion, representing a decrease of 10.3 per cent. compared with 2008 but 0.6 per cent. above the budgeted amount for 2009.

Revenues from excise taxes amounted to HRK 11 billion in 2009, which represented a decrease of 7.4 per cent. compared with 2008 or 3.1 per cent. above the budgeted amount for 2009.

Excise duty revenues decreased across all excise goods categories, with the largest decrease coming from the excise on cars, boats and motor vehicles, at 52 per cent. The lowest decreases were recorded by excise duty revenues on oil derivatives, luxury goods and tobacco, averaging 0.3 per cent. The excise duty on oil derivatives had the highest share in total excise revenues realized in 2009, standing at 55 per cent.

Revenues from excise duty on oil derivates amounted to HRK 6 billion for the twelve months ended 31 December 2009. The figure for 2009 represented a decrease of 0.3 per cent. compared with 2008 and is approximately 4.5 per cent. above the budget for 2009. Revenues from excise duty on tobacco and tobacco products represented the second largest share in total revenues of excise duty being HRK 3.1 billion (28 per cent of total revenues) in 2009 (12.3 per cent. above the budgeted amount).

Income tax revenues payable by individuals amounted to HRK 10.4 billion in 2009, which is a decrease of 3.7 per cent. compared to 2008 and is 2.1 per cent. lower than budgeted for 2009. The annual decrease is in part due to an increase in the personal deductions amount from HRK 1,600 to HRK 1,800 which took place as of 1 July 2008.

As of January 2007, income tax revenue payable by individuals became entirely the revenue of the local government while profit tax (corporate income tax) became entirely the revenue of the budgetary central government. The change in these formerly shared taxes were enacted through the amendments to the Act on the Financing of Units of Local and Regional Self-Government where a part of income tax revenue is still being collected within the budgetary central government for the purpose of equalization and then transferred to local government units.

Amendments to the Act on the Financing of Units of Local and Regional Self-Government provide a more even and equitable distribution of tax revenues in all areas of Croatia (especially areas of special State concern) and also for a higher liquidity of the overall system of the financing of local government. The proportion of income tax revenue relating to local government was 86.5 per cent. in 2009 with the remaining 13.5 per cent. relating to budgetary central government.

One of the measures contained in the Economic Recovery Program that was adopted by the Government in May 2010 envisages certain changes to the personal income tax system. The Act on Amendments to the Income Tax Act was promulgated on 21 June 2010, and entered into force on 1 July 2010, as described in greater detail, below. The main elements of these amendments relate to the tax system and include the reduction in the number of tax brackets from four (15 per cent., 25 per cent., 35 per cent. and 45 per cent.) to three (12 per cent., 25 per cent. and 40 per cent.) as well as the abolition of certain tax deductions that existed under the previous system. The overall outcome of the new amendments should result in increase in the net payouts to the majority of employees and pensioners and a simplification of the procedures within the tax administration system regarding annual income tax settlements.

Revenues from profit tax were HRK 9.4 billion for 2009, representing a decrease of 10.6 per cent. in comparison with 2008 and those revenues were 1.1 per cent. lower than budgeted for in 2009. This can be explained by the trends of industrial production and by business results generally in 2008. With amendments to the Act on the Financing of Units of Local and Regional Self-Government, the revenues from profit tax became entirely for the account of budgetary central government.

The revenue from taxes on property amounted to HRK 1 billion, representing a decrease of 15.1 per cent. compared with 2008 and 5.5 per cent. below the 2009 budget. Approximately half of the total revenues from taxes on property were realised at the budgetary central government level and the other half at the local government level.

Revenue from taxes on international trade and transactions are all collected at the budgetary central government level. They amounted to HRK 1.7 billion in 2009, representing an annual decrease of 9.5 per cent. compared to 2008, resulting from a significant contraction in imports, and 3.6 per cent below the budget for 2009.

Other tax revenue amounted to HRK 1.4 billion in 2009, which represented a significant increase compared with 2008 figures when the amount stood at HRK 316 million. This is due to the fact that the “other tax revenue” category contains the HRK 1.06 billion proceeds from the special “crisis tax” on salaries and pensions introduced in the third supplementary budget for 2009.

The revenue from social contributions, which are the second most important revenue category of consolidated general government, amounted to 31.2 per cent. of 2009 revenue, and amounted to HRK 40 billion which represents a decrease of 1.7 per cent. compared with 2008. Within the structure of social contributions, the largest part (HRK 21.4 billion) refers to employer contributions (which have decreased by 1.7 per cent. compared with 2008). HRK 17.9 billion refers to employee contributions (which has decreased by 1 per cent. compared with 2008), and the remaining HRK 695.5 million refers to contributions made by the self employed and unemployed.

Grants received during 2009 amounted to HRK 622.9 million, 97.7 per cent. of which were grants from international organisations while the reminder refers to grants from foreign governments and grants from other general government units.

Other revenue was realised in the amount of HRK 13.9 billion in 2009. The largest part consisted of sales of goods and services (54.1 per cent.), followed by property income (28.8 per cent.), miscellaneous and unidentified revenues (12.7 per cent.) and the remainder of the amount related to fines, penalties and forfeits and voluntary transfers other than grants. The sales of goods and services amounted to HRK 7.5 billion, 87.6 per cent. of which related to administrative fees. Out of the total revenues from administrative fees, 45.2 per cent. related to extra-budgetary users, 39.9 per cent. related to local government and 14.9 per cent. to budgetary central government. Property income amounted to HRK 4 billion, which consists mainly of rents (HRK 1.6 billion), and to withdrawals from income of quasi-corporations (HRK 1.9 billion). Miscellaneous and unidentified revenues amounted to HRK 1.76 billion, fines, penalties and forfeits amounted to HRK 523 million, while voluntary transfers other than grants amounted to HRK 92.1 million.

Expense

In 2009, the total expenses of consolidated general government amounted to HRK 132.9 billion, which was HRK 0.9 billion (0.7 per cent.) above the budgeted amount and HRK 2.6 billion (2 per cent.) higher than in 2008. Out of the total expense of consolidated general government, HRK 114.3 billion related to budgetary central government, HRK 4.6 billion related to extra-budgetary users and HRK 13.9 billion related to local government. The largest share of the total expenses of consolidated general government in 2009 (42.8 per cent.) referred to social benefits, followed by compensation of employees (26.5 per cent.), use of goods and services (11.6 per cent.), other expenditure (6.9 per cent.), subsidies (6.1 per cent.), interest (4.2 per cent.) and grants made (1.8 per cent.).

Social benefits amounted to HRK 56.9 billion in 2009 an increase of 6.8 per cent. compared to 2008. Within the structure of social benefits, 71.3 per cent. related to social security benefits, 28.1 per cent. related to social assistance benefits, while the remaining 0.5 per cent. related to employer social benefits. In 2009 the expense for social benefits mostly related to the following categories: pensions, health care, maternity leave allowances, child allowance and unemployment. Expense for pensions was HRK 34.4 billion (an increase of 4.9 per cent. compared to 2008), out of which HRK 15.2 billion related to expense for old age pensions, HRK 5.2 billion to pensions for disabled persons, HRK 5.0 billion to veterans' pensions and HRK 3.9 billion related to family pensions. Expense for the healthcare system amounted to HRK 12.8 billion, child allowance totalled HRK 1.8 billion, maternity leave allowances totalled HRK 2.1 billion and unemployment benefits HRK 1.2 billion.

Compensation of government employees totalled HRK 35.2 billion in 2009, (1.4 percent above the budgeted amount), of which wages and salaries amounted to HRK 30 billion and social contributions to HRK 5.2 billion.

Government expenses for the use of goods and services in 2009 amounted to HRK 15.4 billion which was 1.6 per cent. below the budget and represented a decrease of 6.6 per cent. compared to 2008.

Expenses for subsidies totalled HRK 8.1 billion in 2009, (0.5 per cent. above budget). Subsidies to public corporations comprise more than half of the total subsidies while subsidies to private enterprises made up the rest of total subsidies. The largest part refers to subsidies to agriculture in the amount of HRK 3.5 billion and to Croatian Railways in the amount of HRK 1.6 billion.

Expenses for interest payments amounted to HRK 5.6 billion, out of which HRK 4.2 billion related to interest payments to residents, and HRK 1.4 billion to interest to non-residents.

Expenses for grants amounted to HRK 2.4 billion, of which 52.3 per cent. (HRK 1.2 billion) related to capital grants to other general government units, 38.8 per cent. (HRK 925.7 million) related to current grants to other general government units, 5.6 per cent. to grants to international organisations and the remaining 3.3 per cent. related to grants to foreign governments.

Other expenses amounted to HRK 9.2 billion, corresponding to 98.9 per cent. of the budgeted amount for 2009.

Net acquisition of non-financial assets

In 2009 total net acquisition of non-financial assets amounted to HRK 5.9 billion (comprising total acquisitions of HRK 6.7 billion and total disposals of HRK 774.7 million), which was HRK 146.6 million less than budgeted for in 2009.

Net lending/borrowing in 2009

The planned net lending/borrowing for 2009 stood at -3.3 per cent. for the consolidated general government while the final data for 2009 shows net lending/borrowing outturn at the level of -4.1 per cent. of GDP according to the ESA 95 methodology.

Adjustments to the 2009 Budget

Adverse macroeconomic conditions in 2009 led to a need for new fiscal policy measures aimed at ensuring the stability and liquidity of public finances. This, in turn, led to budget revisions and new legislation. The first 2009 budget revision was adopted in April 2009, reducing total revenues by 2.6 per cent. of GDP and total expenditures by 1.8 per cent. of GDP relative to the initial budget plan. The second and third budget revisions were adopted in July, further decreasing the projected revenues by 1.9 per cent. of GDP and the projected expenditures by 0.7 per cent. of GDP relative to the first budget revision. The following policy measures were taken on the revenue side:

- The value added tax ("VAT") rules were amended and the VAT rate was raised from 22 per cent. to 23 per cent.;
- A special "solidarity tax" on salaries, pensions and other receivables was introduced, in the amount of 2 per cent. on net payments exceeding HRK 3,000, and 4 per cent. on net payments exceeding HRK 6,000;
- The "Act on a Special Tax on Receipts from Independent Activity and Other Receivables" was adopted, taxing receipts exceeding HRK 3,000 an additional 2 per cent. and those exceeding HRK 6,000 an additional 4 per cent.

- The “Act on Fees for the Provision of Services in Mobile Electronic Communication Networks” introduced a fee for the provision of services of mobile electronic communication networks, totaling 6 per cent. of the base, i.e. of revenues from services provided during the calculation period.

In total, the revenue effect of these measures in 2009 was positive and is estimated at some 0.4 per cent. of GDP. On the expenditure side, further savings were made as well as redistributions within the budget. The base for the calculation of salaries of government officials was decreased by an additional 5 per cent. and so were pensions regulated by the “Act on the Rights and Obligations of Representatives” in the Croatian Parliament that were lowered by 10 per cent. In addition, government outlays were reduced by repealing decisions providing free transport for secondary school students and free schoolbooks for all pupils (an exception was made for pupils from low-income families).

According to preliminary data for 2009, the overall revenues and expenditures were realized above 99 per cent. to the plan. Total net lending/borrowing of the consolidated general government amounted to 3.2% of GDP compared to 2.9% of GDP planned for 2009 according to GFS 2001 methodology. The reason for this discrepancy is the local government deficit that was 0.3 percentage points higher than planned and arrears that were increased by 0.1 per cent. of GDP. In 2009, total net lending/borrowing of extra-budgetary users (a part of the consolidated general government that includes: Croatian Waters, Croatian Privatization Fund, Environment Protection Fund, Croatian Roads, State Agency for Deposit Insurance and Bank Rehabilitation), which stood at 0% of GDP.

Liabilities related to pensions

According to the Constitutional Court Decision from 1998, the Government is obligated to pay compensation to pensioners for the partial indexation in the period 1993-1998. Compensation payments started in 2006 and by the end of 2009 HRK 7.6 billion had been paid out. The remaining amount of HRK 2.6 billion will be paid by the end of 2013. On average, the yearly amount of the payments to be made, accounts for approximately 0.2 per cent of GDP. These compensation payments are made through a special private fund (the Pensioners Fund), which is not part of the general government sector.

The following table sets out the consolidated general government budget for the periods indicated:

	Year ended 31 December					Three months ended
	2007	2008	Plan 2009	2009	Plan 2010	31 March 2010
	(HRK millions)					
1. REVENUE (A+B+C)	**126,716.0**	**134,737.8**	**128,329.2**	**128,068.8**	**129,989.1**	**29,262.5**
A. Budgetary central government	108,297.0	115,766.5	110,871.5	110,251.2	112,578.4	25,290.1
B. Extrabudgetary users	5,040.0	4,223.8	3,597.0	3,785.9	3,591.2	762.1
1 Croatian Pension Insurance Administration	—	—	—	—	—	—
2 Croatian Institute for Health Insurance	—	—	—	—	—	—
3 Croatian Employment Service	—	—	—	—	—	—
4 Croatian Waters	1,992.0	2,058.6	1,773.1	1,921.9	1,778.7	357.6
5 Fund for Environmental Protection and Energy Efficiency	1,102.9	1,221.2	1,129.7	1,168.6	1,060.4	232.9
6 Croatian Motorways Ltd.	1,375.3	—	—	—	—	—
7 Croatian Roads Ltd.	119.9	81.0	77.7	96.8	59.6	41.6
8 State Agency for Deposit Insurance and Bank Rehabilitation	391.4	808.3	566.8	566.5	651.8	120.1
9 Croatian Privatisation Fund	58.3	54.7	49.5	32.2	40.8	9.8
C. Local government	13,379.0	14,747.5	13,860.7	14,031.7	13,819.5	3,210.3
2. EXPENSE (A+B+C)	**118,770.5**	**130,258.6**	**131,998.1**	**132,883.7**	**132,650.4**	**33,281.3**
A. Budgetary central government	100,936.3	111,299.7	114,495.6	114,304.6	115,595.6	29,502.4
B. Extrabudgetary users	6,015.1	5,308.1	4,568.4	4,651.6	4,148.9	683.6
1 Croatian Pension Insurance Administration	—	—	—	—	—	—
2 Croatian Institute for Health Insurance	—	—	—	—	—	—
3 Croatian Employment Service	—	—	—	—	—	—
4 Croatian Waters	2,086.6	2,313.7	1,782.7	1,708.9	1,776.1	99.3
5 Fund for Environmental Protection and Energy Efficiency	1,047.3	1,063.9	898.7	1,111.1	972.7	210.3
6 Croatian Motorways Ltd.	1,509.4	—	—	—	—	—
7 Croatian Roads Ltd.	1,235.8	1,588.7	1,537.7	1,483.0	1,274.5	352.8
8 State Agency for Deposit Insurance and Bank Rehabilitation	47.8	254.7	253.3	267.2	42.7	3.0
9 Croatian Privatisation Fund	88.2	87.0	95.9	81.4	83.0	18.2
C. Local government	11,819.0	13,650.7	12,934.1	13,927.5	12,905.9	3,095.3
NET/GROSS OPERATING BALANCE (1-2)	**7,945.5**	**4,479.2**	**(3,668.8)**	**(4,814.9)**	**(2,661.3)**	**(4,018.8)**
3. CHANGE IN NET WORTH: TRANSACTION (3.1+3.2-3.3)	**7,945.5**	**4,479.2**	**(3,668.8)**	**(4,814.9)**	**(2,661.3)**	**(4,018.8)**
3.1 CHANGE IN NET ACQUISITION OF NON-FINANCIAL ASSETS	11,015.0	7,344.1	6,070.2	5,923.5	6,625.3	1,116.6
Acquisition	12,319.4	8,876.6	6,944.6	6,698.2	7,401.9	1,282.0
A. Budgetary central government	3,043.9	3,291.5	2,496.1	2,267.4	2,362.3	340.0
B. Extrabudgetary users	5,334.7	1,421.7	1,180.4	1,225.3	1,608.7	243.9
C. Local government	3,940.8	4,163.4	3,268.2	3,205.5	3,431.0	707.1
Disposals	1,304.5	1,532.5	874.5	774.7	776.6	165.4
A. Budgetary central government	498.7	303.4	338.5	304.0	250.4	68.8
B. Extrabudgetary users	69.0	181.6	75.9	21.3	51.0	0.6
C. Local government	736.8	1,047.5	460.0	449.4	475.2	95.9
NET LENDING/BORROWING (1.2-3.1)	(3,069.4)	(2,865.0)	(9,739.0)	(10,738.5)	(9,286.6)	(5,135.4)
ESA 95 NET LENDING/NET BORROWING*	(4,357.5)	(3,603.8)	(10,336.1)	(12,787.4)	(10,216.6)	(5,163.5)
Payments for compensation of pensioners	3,347.9	1,067.1	816.3	816.3	816.3	
ESA 95 NET LENDING/NET BORRWING (with compensation of pensioners)	(7,705.4)	(4,670.9)	(11,152.3)	(13,603.7)	(11,032.9)	(5,163.5)
ESA 95 NET LENDING/NET BORROWING, % OF GDP	*(2.5)*	*(1.4)*	*(3.3)*	*(4.1)*	*(3.3)*	*(1.5)*
TRANSACTIONS IN FINANCIAL ASSETS AND LIABILITIES (FINANCING) (3.3-3.2)	3,069.4	2,865.0	9,739.0	10,738.5	9,286.6	5,135.4
3.2 CHANGE IN NET ACQUISITION OF FINANCIAL ASSETS	(2,403.1)	2,918.0	1,504.5	6,729.4	2,076.2	(3,445.6)
3.2.1 Domestic	(2,421.1)	2,905.6	1,502.8	6,727.1	2,076.2	(3,445.6)
A. Budgetary central government	(3,752.8)	1,690.5	906.4	6,823.2	1,569.9	(3,919.0)
B. Extrabudgetary users	795.6	1,073.6	507.6	533.4	521.7	374.0
C. Local government	536.1	141.4	88.7	(629.6)	(15.3)	99.4
3.2.2 Foreign	18.0	12.4	1.8	2.3	—	—
A. Budgetary central government	18.0	12.4	1.8	2.3	—	—
B. Extrabudgetary users	—	—	—	—	—	—
C. Local government	—	—	—	—	—	—
3.2.3 Monetary gold and SDRs	—	—	—	—	—	—
3.3 CHANGE IN NET INCURRENCE OF LIABILITIES	666.4	5,783.0	11,243.6	17,467.9	11,326.8	1,689.8
3.3.1 Domestic	2,147.5	6,949.5	6,620.3	10,185.5	1,480.9	4,056.4
A. Budgetary central government	1,477.6	5,656.6	5,972.0	9,576.6	487.8	3,971.8
B. Extrabudgetary users	539.5	1,139.1	514.8	564.4	788.2	62.7
C. Local government	130.4	153.8	133.6	44.5	204.8	21.9
3.3.2 Foreign	(1,481.2)	(1,166.5)	4,623.3	7,282.4	9,881.9	(2,366.6)
A. Budgetary central government	(2,980.2)	(1,445.8)	4,263.3	6,878.4	9,694.5	(2,369.3)
B. Extrabudgetary users	1,523.7	304.1	404.9	425.9	212.4	5.7
C. Local government	(24.7)	(24.9)	(45.0)	(21.8)	(25.0)	(3.0)

Source: Ministry of Finance

Note: On a cash basis unless otherwise stated.

** On accrual basis (including annual arrear change, Croatian Roads and Croatian Motorways transactions on accrual basis)*

(1) On accrual basis (including annual arrear change, Croatian Roads and Croatian Motorways transactions on accrual basis)

The following tables set out the detailed budget for the budgetary central government.

Budgetary Central Government Revenue

	Year ended 31 December			Three months ended 31 March	
	2007	2008	Preliminary 2009	2009	2010
			(HRK thousands)		
REVENUE	108,320,595	115,772,655	110,257,947	26,020,898	25,291,283
Taxes	64,234,530	69,572,699	63,678,926	13,547,073	14,641,970
Taxes of income and profits and capital gains	10,589,083	12,252,205	10,839,269	2,502,224	2,396,129
Payable by individuals	1,772,708	1,687,502	1,399,411	540,065	505,250
Payable by corporations and other enterprises	8,816,375	10,564,703	9,439,858	1,962,159	1,890,879
Taxes on property	578,621	635,930	532,297	125,995	100,172
Taxes on goods and services	51,099,930	54,482,172	49,238,277	10,447,707	11,112,474
General taxes on goods and services	37,916,509	41,474,566	37,173,833	8,152,064	8,163,470
Value-added taxes	37,747,987	41,308,036	37,050,354	8,121,721	8,135,023
Sales taxes	168,522	166,531	123,479	30,342	28,448
Excises	12,168,666	11,875,126	10,998,910	2,053,881	2,692,892
— on cars, other motor vehicles, boats and planes	1,433,427	1,452,827	696,791	199,950	127,000
— on petroleum products	6,484,816	6,065,140	6,045,624	1,048,129	1,777,575
— on alcohol	231,342	218,786	189,895	32,400	56,015
— on beer	743,000	717,401	680,567	102,691	100,908
— on nonalcoholic beverages	142,462	139,160	125,817	20,059	23,893
— on tobacco products	2,943,649	3,084,293	3,073,671	604,161	570,756
— on coffee	161,936	166,979	156,910	35,906	31,456
— on luxury goods	28,033	30,540	29,635	10,585	5,290
Taxes on international trade and transactions	1,641,478	1,900,865	1,721,164	401,159	343,308
Other taxes	325,418	301,527	1,347,920	69,988	689,887
Social contributions	37,203,486	40,703,484	39,994,739	9,913,476	9,352,762
Social security contributions	37,203,486	40,703,484	39,994,739	9,913,476	9,352,762
Employee contributions	16,531,305	18,100,364	17,925,299	4,442,279	4,216,655
Employer contributions	19,845,488	21,758,077	21,373,979	5,308,773	4,987,728
Self-employed or unemployed contributions	826,692	845,043	695,462	162,425	148,379
Unallocable contributions	0	0	0	0	0
Grants	428,038	468,634	616,307	187,519	101,313
Other revenue	6,454,541	5,027,838	5,967,975	2,372,830	1,195,238
Property income	3,526,540	1,612,229	2,367,214	1,630,688	244,004
Interest	164,558	147,911	123,488	76,110	70,592
Dividends	1,194,582	212,387	106,625	38,222	148
Withdrawals from income of quasi-corporations	117,730	504,074	1,342,502	1,342,522	498
Rent	2,049,670	747,856	794,600	173,834	172,766
Sales of goods and services	1,526,646	1,450,683	1,682,037	231,949	299,412
Sales of market establishments	0	0	0	0	0
Administrative fees	1,318,050	1,274,882	981,712	176,969	249,163
Incidental sales by nonmarket establishments	208,596	175,800	700,325	54,980	50,249
Fines, penalties, and forfeits	429,034	490,600	515,461	113,477	117,953
Voluntary transfers other than grants	11,241	9,384	15,865	455	3,864
Miscellaneous and unidentified revenue	961,080	1,464,942	1,387,397	396,260	530,005

Source: Ministry of Finance

Budgetary Central Government Expense

	Year ended 31 December			Three months ended 31 March	
	2007	2008	Preliminary 2009	2009	2010
			(HRK thousands)		
EXPENSE	108,007,605	115,292,426	117,923,992	28,841,237	30,517,629
Compensation of employees	31,117,000	33,621,000	35,243,000	7,941,928	7,717,557
Wages and salaries	26,339,000	28,643,000	29,979,000	6,716,732	6,545,368
Social contributions	4,779,000	4,979,000	4,979,000	1,225,195	1,172,189
Use of goods and services	7,162,402	8,113,694	7,364,017	1,856,917	1,885,368
Interest	4,535,008	4,683,219	5,225,174	1,866,958	1,915,569
To nonresidents	1,672,563	1,542,146	1,391,408	900,867	799,384
To residents other than general government	2,862,444	3,141,074	3,833,767	966,092	1,116,185
Subsidies	6,492,010	6,859,512	6,710,033	1,542,906	1,880,398
To public corporations	3,007,099	3,199,114	3,134,258	726,888	849,926
To private enterprises	3,484,912	3,660,398	3,575,775	816,018	1,030,472
Grants	8,363,202	5,783,063	5,559,586	1,002,181	1,619,714
To foreign governments	103,410	89,446	78,184	12,584	22,343
Current	75,261	60,246	68,150	10,981	21,131
Capital	28,149	29,200	10,034	1,603	1,212
To international organisations	73,941	96,503	134,031	51,940	62,755
Current	73,941	96,503	133,061	51,940	62,755
Capital	0	0	970	0	0
To other general government units	8,185,852	5,597,115	5,347,372	937,658	1,534,616
Current	2,305,125	2,291,490	2,598,678	559,677	787,983
Capital	5,880,726	3,305,625	2,748,694	377,981	746,633
Social benefits	48,175,989	52,593,214	56,148,295	13,520,210	13,926,989
Social security benefits	34,167,894	37,600,722	40,605,352	9,788,764	10,487,736
Social assistance benefits	13,815,777	14,745,264	15,258,234	3,671,649	3,386,818
Employer social benefits	192,318	247,228	284,709	59,796	52,435
Other expense	5,733,853	7,311,189	5,627,561	1,110,137	1,572,034
Property expense other than interest	1,132	16,015	7,730	3,005	294
Miscellaneous other expense	5,732,721	7,295,174	5,619,832	1,107,132	1,571,740
Current	2,837,557	2,626,644	2,174,864	622,489	408,383
Capital	2,895,164	4,668,530	3,444,968	484,643	1,163,358

Source: Ministry of Finance

Fiscal developments in 2010

In December 2009, the Croatian Parliament adopted the budget for 2010 which for the first time included the projections for the following two years (2011 and 2012). The general government budget for 2010 incorporates the same level of revenues as a share of GDP as those realized in 2009 and a 0.5 per cent. of savings on the expenditures side, as compared to 2009. As a result, the budgeted level of net lending/borrowing, according to GFS 2001 methodology, was reduced from 3.2 per cent. of GDP in 2009 to 2.7 per cent. of GDP in 2010. In 2011 and 2012, fiscal policy will be oriented towards further fiscal consolidation paired with continued structural reforms and adjustments in the process of Croatian accession to the EU.

While in 2009 the lack of financing liquidity within the system was a source of problems, this has been reversed since the beginning of 2010 and the level of financial liquidity is at satisfactory levels. However, the problems in passing financial resources from the banking system to businesses persists. The government has undertaken measures to address these issues with the goal to establish a scheme to support credit activity benefitting existing businesses that have been affected by the crisis as well as to ensure a framework for providing resources aimed at fostering new investments.

In order to better address economic challenges, the Government has prepared new guidelines for economic policy activities which tie together planned measures and expected goals. The Government has formulated several financing and development models, which will be used to achieve the goals of maintaining macroeconomic stability, fostering economic development and strengthening investment activities.

Model 'A': The scope of Model 'A' is the active participation of the state through the Croatian Bank for Reconstruction and Development ("HBOR") in co-financing banks' credit placements for working capital financing. The HBOR is expected to participate at 40 per cent. and commercial banks at 60 per cent. The goal is to ensure sufficient liquidity for companies to overcome the current economic climate and mitigate the negative effects of the global economic and financial crisis. As a prerequisite for implementation of this model, the Council of the Croatian National Bank has lowered the Reserve Requirement Rate from 14% to 13%. A portion of the released liquidity to banks in the amount of HRK 2 billion was directed to HBOR in the form of commercial banks' club credit. Through this set of measures, a potential credit amount of approximately HRK 5 billion is created for entrepreneurs. Thus, a substantial credit potential that will be channelled to the economy is being created, with the aim of strengthening the competitiveness of businesses by improving liquidity and maintaining and expanding business activity. The criterion for selection of banks for participation in the program is the interest rate which the bank is willing to offer for its 60-per cent. share in the credit. HBOR's interest rate on its 40-percent share in the credit is fixed at 3.8 per cent. The final interest rate is the weighted average of interest rate offered by the bank on the auction and the HBOR interest rate.

Model 'B': The second model encompasses the establishment of the guarantee fund with the aim to assume part of the risk coverage for new banks' credit placements. The maximum amount of the guarantee which the Government will approve within the guarantee fund is HRK 2 billion. The fund scheme is organized with the HBOR which conducts all activities under the scheme on behalf of the Government. The Government would guarantee at most 50 per cent. of any funding, with the remainder to be provided by banks in competitive auctions. Thus, at least HRK 4 billion could be channelled to entrepreneurs through this Model. This Model is primarily intended for investment projects to ensure new investment and business cycle. However, in the structure credits could also include credits which are necessary for the sustainability of investment including financing part of the working capital and reprogramming credits that have been contracted after 1 July 2008. The criteria for selecting banks for purposes of assigning guarantees are the risk percentage which the bank is ready to assume and the effective interest rate.

Model 'C': The third model is defined by the Guidelines for aid to enterprises which are experiencing difficulties. The model complements the two other models by creating foundation for rapid, efficient and final assistance to enterprises that are experiencing difficulties over extended periods of time. The only criterion for receiving the government's assistance under Model C would be to submit sustainable restructuring plans in cases where the only other viable option would be bankruptcy.

In addition to these measures, the Government has adopted an Economic Recovery Programme. The main goal of the programme is economic recovery and the creation of competitive economy for achieving high standard and quality of life.

In connection with the implementation of the Economic Recovery Programme, the Government has adopted the Programme Activities Implementation Plan which spells out all key activities to be undertaken with specifically defined deadlines. According to the Programme Activities Implementation Plan, nearly 70 per cent. of the Programme measures will be achieved during 2010 to support Croatia's economic recovery. The programme is based upon stability, sustainability and social responsibility, while encompassing a series of areas among which the fiscal policy, public administration operation, government asset management, justice reform, pension system reform, social policy, including education and environmental protection systems should be emphasized. The intention behind all the measures to be conducted within the Programme is to address various structural challenges in the Croatian economy. The fiscal policy measures include a reduction in expenditure along with an improved efficiency and transparency and redirecting budgetary resources from cost ineffective spending towards targeted social transfers and making economically justified capital investments. In addition, the Economic Recovery Programme includes a series of measures towards reducing government interference in economic activity and igniting a new investment cycle with economically measurable long-term effects, coupled with maximum participation from the private sector.

As the majority of the envisaged measures are to be undertaken by the end of 2010, the intention is to prioritize those that can be undertaken in the shortest of time. In this respect, the intention is to proceed as follows:

- commence the drafting of an act on fiscal accountability, scheduled to be adopted by Parliament in November 2010;
- commence with the work on defining the Government's Strategy of public debt management;
- begin the set-up of a register of public employees;

- enhance supervision within the public procurement system;
- legally prescribe the obligation to report on tax debt while registering a new business entity;
- formulate recommendations to the Croatian Employers Association for continuously making available the list of entrepreneurs with the largest overdue liabilities;
- undertake measures aimed at exit strategies for noncompetitive industry segments along with providing support for social assistance and professional retraining;
- adopt the program of measures for a simplification of the business environment for small- and medium-sized entrepreneurs;
- compile a catalog of public investment projects with the aim of bolstering the investment cycle;
- by legal measures, create the preconditions for the more efficient conclusion of bankruptcy proceedings, the speeding of the enforcement procedure and the introduction of public enforcement creditor;
- introduce action plans for courts with the largest number of pending cases;
- setting up teams for defining strategic projects to be financed from EU structural funds;
- finalize all preparatory actions needed for reforming the pensions system;
- continue with the health sector reform through the rationalization of business activity and the health institutions network and introducing technology within the system of primary health care;
- continue with current measures in the area of education and science as well as environment protection.

Consolidated general government results in the first quarter of 2010

In the first three months of 2010, the total revenue of the consolidated general government amounted to HRK 29.3 billion. Tax revenues, as the most significant revenue category, amounted to HRK 17.0 billion. Among tax revenues, revenue generated through VAT amounted to HRK 8.1 billion; income tax revenue amounted to HRK 2.7 billion while corporate tax revenue amounted to HRK 1.9 billion; and revenue generated from excise duties recorded the level of HRK 2.7 billion. The revenue from social contributions, which is the second most important revenue category, amounted to HRK 9.4 billion.

The total expense of the consolidated general government, on the other hand, amounted to HRK 33.3 billion in the first quarter of 2010. The largest share of the total expense of the consolidated general government related to social benefits which recorded HRK 14.1 billion. Compensation of employees amounted to HRK 8.7 billion, use of goods and services to HRK 3.5 billion, subsidies to HRK 2.2 billion, other expense to HRK 2.1 billion, interest to HRK 2.0 billion and grants to HRK 669.3 million.

In the first three months of 2010 net acquisition of the non-financial assets amounted to HRK 1.1 billion (comprising total acquisitions of HRK 1.3 billion and total disposals of HRK 165.4 million).

The level of net lending/borrowing of the consolidated general government, in the first quarter of 2010, stood at 1.5 percent of GDP, according to the ESA 95 methodology.

Budget Process

The legal framework regulating the area of public finance is set on four levels: the Constitution; the Budget Act and its implementing regulations; the annual budget of Croatia; and various ordinances and instructions. The principal legal act regulating the budgetary processes, regulating relations between institutions within the system and establishing prerequisites for ensuring fiscal discipline and the quality of public finance management is the Budget Act.

On 1 January 2009 the new Budget Act entered into force, which incorporates the new best practices for efficient budget management. It specifies the instruments for public expenditure management and regulates the process of planning, preparation, adoption and execution of the budget, asset management and debt management, public debt management, borrowing and issuance of guarantees by the central government and the units of local and regional self-government, budgetary relations in the public sector, accounting, as well as budgetary supervision.

The Strategy for Improvement and Modernisation of the Processes within the State Treasury for 2007-2011 sets out the basic development for the area of budget management. The State Treasury carries out, amongst other activities, budget preparation and consolidation, budget execution, state accounting, public debt management and manages the affairs of financial management of EU aid funds. The legal obligation of assessing the fiscal impact of the proposed laws and bylaws, for which a standard methodology was created, has been extended to also cover planning acts (including strategies, programmes, plans and policies). Internal auditing units have been established in all ministries and a number of other budget users and efforts are currently focused on further development of the methodology and capacity building, thus resulting in the improvement of the internal control process.

In order to additionally improve the budget execution process, the Ministry of Finance is implementing a project aimed at developing an IT solution to facilitate the efficient and accurate exchange of data between the financial management information systems of the budget users and the financial management information system of the State Treasury.

Budget preparation has been improved and consists of five steps:

1. The Strategic Plans for a three-year period are prepared by the budgetary users based on the instructions of the Ministry of Finance and Central Office for Development Strategy and Co-ordination of the EU funds (the CODEF) (by mid-April).

2. The Strategy of the Government Programmes is adopted by the Government on the proposal of the Ministry of Finance and the CODEF on the basis of such Strategic Plans for the three-year period (by the end of April).

3. Economic and Fiscal Policy Guidelines for a three-year period are adopted by the Government covering strategic goals of economic and fiscal policy, key macroeconomic indicators, key indicators of fiscal policy, revenue and expenditure estimates of all budgetary levels, limits of financial plans for a three-year period for ministries, central government offices and agencies as well as projections of the public debt trends and sensitivity tests based on changes in macroeconomic and fiscal conditions and presumptions (by mid-June).

4. Instructions for the preparation of the State budget proposal are prepared and delivered to the budgetary and extra-budgetary users by the Ministry of Finance based on the Economic and Fiscal Policy Guidelines. Responsible ministries submit coordinated proposals of financial plans to the Ministry of Finance, which is followed by the negotiation and co-ordination stage (by the end of June).

5. Finally, the Ministry of Finance prepares the draft State budget and projections for the next two-year period and delivers it to the Government (by 15 October).

After adoption of the budget by the Government (by 15 November) and by the Parliament (by the end of the year), the budget planning and preparation process ends. Thereafter, the budget execution process starts with the State Treasury taking a central role in the budget execution, liquidity management and budget funds spending supervision and control.

If, during the course of a given year, expenditures and/or expenses increase, or if revenues and/or receipts decrease in reference to the budget plan adopted at the beginning of the year, whether as a result of the occurrence of new liabilities for the state budget or changes in the economic developments, the Government may propose amendments to the state budget, which are subject to the same approvals process as the original budget.

Fiscal developments in the medium-term period

In September 2009, the Government adopted the Strategy of the Government Programmes. The Strategy is adopted for the three year period and therefore the objectives stated in the Strategy are not to be changed every year. The main objectives for the upcoming period have been modified due to the current macroeconomic situation. In May 2010, the Government presented a comprehensive Economic Recovery Programme that will serve as a ground for the Strategy of Government Programmes for the period 2011 — 2013. The Strategy is based on the Strategic plans that all Ministries and other State bodies compiled by mid-June and it will be adopted by the Government in July 2010. See "*The Economy — Economic Policy*" for an outline of the goals of the Strategy of Government Programmes for the period 2011 — 2013.

Taxation System

The Constitution stipulates that everyone in Croatia must contribute to the payment of public expenses in accordance with their economic capabilities and that the tax system should be based on principles of equality and equity as well as on economic efficiency. Croatia's tax year is the calendar year. The country's tax structure includes both direct taxation through income taxes and corporation taxes, and indirect taxation through value added tax. In addition, there are excise duties, taxes on property and custom duties. Income taxes are assessed on individuals. About 2.2 million individuals and businesses pay income and profit and corporation tax in Croatia.

In the medium term changes to the tax system will be aimed at simplifying the tax system, while the process of aligning the tax system with the EU legislation will continue.

The Tax Administration is the administrative organisation within the Ministry of Finance whose basic duty is to implement tax regulations and regulations concerning the payment of obligatory contributions.

The Croatian tax system comprises:

- National taxes:

- Value Added Tax;

- Profit tax (i.e., corporate income tax);

- Special taxes (excise) on passenger cars, other motor vehicles, vessels and aircraft; alcohol and alcoholic beverages, tobacco products, energy-generating products and electrical energy; non-alcoholic beverages; coffee; luxury products; tax on liability and comprehensive road vehicle insurance premiums; salaries, pensions and other income; and income from self-employment activities and other incomes.

- County taxes: inheritance and gifts tax; tax on road motor vehicles; tax on vessels; and a levy on coin-operated machines for amusement;

- City or municipal taxes: surtax on income tax; consumption tax; tax on holiday homes; tax on trade name; and tax on the use of public land;

- Joint taxes (the income from which is distributed among the State, the municipality, the city and the county): income tax and real estate transfer tax;

- Fees for providing services in mobile electronic communication networks;

- Levies on the winnings and organisation of games of chance, including: lottery games (monthly fee for organisation of lottery games and tax on winnings); casino games; betting games (fees for organisation of betting games and tax on winnings); coin-operated machine games; and fees on one-time organisation of lotteries. There is also a levy on the organisers of prize games for the benefit of the Croatian Red Cross.

With the amendments of the Act on the Financing of Units of Local and Regional Self-Government, profit tax has entirely become a source of State budget revenues, whereas income tax revenues have been allocated to local and regional governments.

Income tax is regulated by the Income Tax Act (Official Gazette No. 177/2004, entry into force on 1 January 2005 and Official Gazette No. 73/2008, entry into force on 1 July 2008) and Official Gazette No. 80/2010, entry into force on 1 July 2010).

Income tax is assessed on individuals and paid for the tax period (a calendar year). Taxable income includes: employment income; self employment income; income from property and property rights; income from capital; income from insurance; and other income. According to the Income Tax Act, income from capital includes: interest income, withdrawals of assets and the use of services at the expense of the profit realised in the current tax period, as well as the shares in profits realised through the allocation of own shares or purchased call options of own shares, which were acquired during a tax period. Receipts from interest on HRK and foreign currency savings or on deposits; receipts from interest on securities issued pursuant to a special act; direct payments of insurance premiums for the purchase of supplementary part of lifetime pension benefits; pensions of residents acquired abroad; and others do not count as income.

Income tax is levied at a rate of (i) 12 per cent. on a sum equivalent to up to twice the amount of the basic personal allowance; (ii) 25 per cent. on the difference between that threshold and six times the amount of the basic personal allowance; and (iii) 40 per cent. on the tax base exceeding six times the amount of the basic personal allowance referred to in Article 36, Paragraph 1 of the Income Tax Act. No income tax is applicable to earnings that fall below the base personal allowance.

The income tax referred to in Paragraph 1 of Article 36 may be increased by a surtax on income tax imposed by units of local self-government pursuant to special legislation.

The monthly tax base	The annual tax base	Tax rates
— Up to HRK 1,800	— up to HRK 21,600	0 per cent. (personal allowance)
— Up to HRK 3,600	— Up to HRK 43,200	15 per cent.
— Over HRK 3,600 up to HRK 9,000 *(the next HRK 5,400,00)*	— Over HRK 43,200 up to HRK 108,000 *(the next HRK 64,800,00)*	25 per cent.
— Over HRK 9,000 up to HRK 25,200 *(the next HRK 16,200)*	— Over HRK 108,000 up to HRK 302,400 *(the next HRK 194,400)*	35 per cent.
— Over HRK 25,200	— Over HRK 302,400	45 per cent.

The amendments to the Income Tax Act (Official Gazette No. 73/2008), increased the base personal allowance from HRK 1,600 to HRK 1,800. In order to mitigate the consequences this measure has on the revenues of local and regional government, the Act on the Financing of Units of Local and Regional Self-Government was also amended (Official Gazette No. 73/2008, into force as of 1 July 2008) to enforce additional distribution of income tax to the local units so as to enable them to execute their functions. The former distribution of income tax has been amended whereby the share of income tax has been increased by 3 percentage points for towns and municipalities and by 0.5 percentage points for counties. These amendments are targeted at achieving more balanced and even distribution of taxes in all areas of Croatia, particularly relating to the areas of special state concern, and to improve the liquidity of the financial system at the local level.

In line with the aforementioned Economic Recovery Programme, Parliament has adopted the Act on Amendments to the Income Tax Act, whereby the number of tax rates has been reduced to three: 12, 25 and 40 per cent. and certain tax relief provisions have been abolished. It is estimated that the total net effect of these measures would result in the reduction in budget revenue by 0.3- 0.4 per cent of GDP.

The Special Tax Act introduced within the third supplementary budget for 2009 will be gradually phased out. The 2 per cent. rate will be abolished with effect from 1 July 2010, and the second rate of 4 per cent. will be abolished with effect from 1 November 2010.

Profit tax (Corporate Income Tax) is regulated by the Profit Tax Act (Official Gazette No. 177/2004, 90/2005, 57/2006, 146/08 and 80/2010). The profit tax is paid at the rate of 20 per cent. of the assessed tax base. In June 2010, the Parliament also adopted the Act on supplements to the Profit Tax Act which shall enter into force on the day of Croatia's accession to the EU.

The following are subject to profit tax:

- a company or another legal or natural person resident in Croatia, who is permanently and independently engaged in an economic activity for the purpose of deriving a profit, an income or revenue or other assessable economic benefits;
- a resident permanent establishment of a non resident entrepreneur;
- a person who derives income pursuant to the income tax regulations, if he/she declares that he/she intends to pay profit tax instead of income tax; and
- an entrepreneur, namely a natural person who derives income from small business or the activities equalised therewith, if:
  1. his/her total revenue in the preceding tax period exceeded HRK 2,000,000;
  2. his/her total income in the preceding tax period exceeded HRK 400,000;
  3. the value of his/her long term assets exceeds HRK 2,000,000; or
  4. his/her employed more than 15 employees on average during the preceding tax period.

In addition, a withholding tax of 15 per cent. was introduced in 2005. Withholding tax is tax levied on profits generated by a non-resident in Croatia and is charged on interest and copyright as well as other intellectual property rights, market research services, tax and auditing services, and business counselling services paid to foreign entities.

In Croatia, double taxation avoidance treaties are applied, which have been ratified by Croatia and other countries. According to these treaties the double taxation of certain income is avoided, with the intention that profits and assets defined by the treaty are subject to tax in only one state or at a rate which is less than the one prescribed by domestic tax regulations.

In Croatia, value added tax was introduced on 1 January 1998, replacing retail sales tax, and is regulated by the Value Added Tax Act (Official Gazette Nos. 47/1995, 106/1996, 164/1998, 105/1999, 54/2000, 73/2000, 48/2004, 82/2004, 90/2005, 76/2007 and 94/09). From 1 January 2006 the VAT rates have been 0 per cent., 10 per cent. and 22 per cent., both goods and services are assessed at the same rate. Since 1 August 2007, a differentiated 10 per cent. VAT rate has been in effect, and it applies to daily and periodical newspapers and magazines, with the exception of those that mainly or only contain advertisements and serve advertising purposes. Since August 2009, amendments to the Value Added Tax Act (Official Gazette No. 94/09) have been in effect whereby the VAT rate has been increased by 1 per cent., i.e. from 22 per cent. to 23 per cent. Furthermore, the Special Tax Act has been introduced (Official Gazette No. 94/09), as well as the Act on Special Tax on Income from Independent Personal Activities and Other Incomes (Official Gazette No. 119/09) and amendments have been made to the Act on Excise Duties on Passenger Cars, Other Motor Vehicles, Vessels and Aircraft (Official Gazette No. 94/09) (for further information on each of these, see "*Fiscal Developments in 2010*" above).

In addition to the changes in the Income Tax Act, changes in the Profit Tax Act were also proposed by the Government and subsequently adopted by the Croatian Parliament on 18 June 2010. These changes primarily aim to reduce tax evasion and to increase collection rates. The amended Profit Tax Act will aid in the implementation of the activities contained in the Economic Recovery Programme by providing tax recognition of expenses on the basis of voluntary pension insurance premiums paid. It also requires that large corporate taxpayers (as defined in the accounting regulations) file their corporate profit tax declaration in an electronic format. The regulatory arrangement in cases of settling private costs at the expense of operating resources, as well as the use of business asses for private purposes (especially concerning yachts, speedboats, airplanes, apartments and holiday houses) will contribute to the reduction of tax evasion. Furthermore, the proposed piece of legislation will reduce the possibility of tax avoidance by taking over those companies that generate tax losses solely to employ such a loss to reduce the tax base and pay less corporate profits tax. Additionally, limitations are placed on transferring profits between affiliated residents enjoying preferential status for the purpose of paying less corporate profits tax. The payment of the withholding profits tax for the services paid to legal persons with their seat or the place of actual management or supervision in the countries, save for the European Union member-states, in which the corporate profits tax rate stands at under 12.5 per cent, will also reduce tax evasion options. Finally, accurate application of the Profit Tax Act will contribute to increased tax revenue generation.

PUBLIC DEBT

The total general government debt (which includes both the internal and external debt of the central government, extra-budgetary funds and local government) plus direct guarantee obligations (i.e. other than the guarantee obligations of HBOR) "**Consolidated Public Debt**") of Croatia stood at HRK 134.2 and HRK 155.9 billion as at the end of 2008 and 2009 respectively. This comprised total general government debt of HRK 100.4 and HRK117.7 billion, and direct guarantees by the Republic of HRK 33.8 and HRK 38.2 billion as at 2008 and 2009 respectively. As at 31 March 2010 the Consolidated Public Debt of the Republic stood at HRK 160.8 billion, comprising total general government debt of HRK 120.0 billion and direct guarantees by the Republic of HRK 40.8 billion.

Total general government debt was composed of 68.0 per cent. (HRK 80.0 billion) in internal debt as at the end of 2009 (compared with 69.6 per cent., HRK 69.9 billion at the end of 2008) and 32.0 per cent. (HRK 37.7 billion) in external debt at the end of 2009 (compared with 30.4 per cent., HRK 30.5 billion at the end of 2008). As at 31 March 2010 the general government debt consisted of 70.3 per cent. (HRK 84.4 billion) in internal debt and 29.7 per cent. (HRK 35.7 billion) in external debt.

The Consolidated Public Debt as at the end of 2009 represented 46.8 per cent. of nominal GDP, which was an increase of 7.6 percentage points from 39.2 per cent. at the end of 2008. As at 31 March 2010, a proportional amount of the Consolidated Public Debt for the first three months of 2010 represented 47.6 per cent. of nominal GDP for that period, and reflecting an increase of 0.8 per cent. compared with the full year figures for 2009. General government internal debt as a proportion of nominal GDP represented 21.4 per cent. of nominal GDP at the end of 2006, 20.8 per cent. at the end of 2007, 20.4 per cent. at the end of 2008, 24.0 per cent. at the end of 2009, and has risen to 25.0 per cent. of nominal GDP as at 31 March 2010. General government external debt as a proportion of nominal GDP has decreased since 2006, representing 14.5 per cent. of nominal GDP at the end of 2006, 12.7 per cent. at the end of 2007, 8.9 per cent. at the end of 2008, and has risen to 11.3 per cent. at the end of 2009, and 10.6 per cent. as at 31 March 2010.

The Republic intends to repay its internal debt maturing in 2010 through syndicated lending with domestic banks and domestic bonds issuance. The Republic intends to borrow approximately EUR 2 billion in the international capital markets during 2010 to repay external debt and to finance the deficit. The Government aims for 65 to 75 per cent. of its debt obligations to be fixed rate obligations. No syndicated loans are scheduled to mature during 2011.

Total general government debt amounted to 75.5 per cent. of Consolidated Public Debt in 2009 and 74.8 per cent. in 2008, with guarantees amounting to 14.5 per cent. of Consolidated Public Debt in 2009 and 15.2 per cent. in 2008. As at 31 March 2010 total general government debt amounted to 74.6 per cent. of Consolidated Public Debt, and guarantees amounted to 15.4 per cent. As at 31 March 2010 guarantees issued by Croatia amounted to HRK 53.979 billion comprising HRK 18.525 billion in domestic guarantees (of which HRK 2.041 billion related to guarantees made by HBOR), and HRK 35.453 billion in external guarantees (HRK 11.160 billion of which related to guarantees made by HBOR).

Total general government debt increased by HRK 17.3 billion from 2008 to 2009, which was accompanied by an increase in the proportion of total general government debt as percentage of nominal GDP from 29.3 per cent. in 2008 to 35.3 per cent. in 2009. The external component of general government debt stood at 11.3 per cent. of nominal GDP at the end of 2009, which is an annual increase of 2.4 percentage points in comparison with 2008 when it was 8.9 per cent. of nominal GDP.

The internal component of the total general government debt recorded an increase of HRK 10.1 billion, and its share of nominal GDP increased from 20.4 per cent. in 2008 to 24.0 per cent. in 2009. As at 31 March 2010, total general government debt had increased by HRK 2.3 billion in comparison to the end of 2009, with the internal component increasing by HRK 4.4 billion and the external component decreasing by HRK 2.1 billion. Based on a proportional amount of the general government debt for the first three months of 2010, total general government debt represented 35.5 per cent. of nominal GDP, with the internal component representing 25.0 per cent. of nominal GDP and the external component representing 10.5 per cent.

The largest share of general government debt relates to central government, which was HRK 93.4 billion in 2008, HRK 110.3 billion in 2009, and HRK 112.6 billion as at 31 March 2010. This represented 93.0 per cent., 93.7 per cent. and 93.8 per cent. of total general government debt, respectively.

The total amount of debt relating to extra-budgetary users was HRK 4.8 billion in 2008, HRK 5.5 billion in 2009, and HRK 5.5 billion as at 31 March 2010. This represented 4.8 per cent., 4.7 per cent. and 4.6 per cent. of total general government debt, respectively.

The total amount of debt relating to local government was HRK 2.1 billion in 2008, 1.96 billion in 2009, and HRK 1.9 billion as at 31 March 2010. This represented 2.1 per cent., 1.7 per cent. and 1.6 per cent. of total general government debt, respectively.

Extra-budgetary funds are established through an act of law that are financed from special purpose taxes, i.e., contributions and/or non-tax revenues, and that are managed predominantly by the Government or local/regional governments (State Budget Act, Official Gazette No. 87/2008).

Total guarantees issued by Croatia increased from HRK 44.6 billion at the end of 2008 (13.0 per cent. of nominal GDP), to HRK 50.5 billion at the end of 2009 (15.2 per cent. of nominal GDP) and to HRK 53.9 billion as at 31 March 2010. Based on a proportional amount of the guarantees for the first three months of 2010, the total amount of guarantees represented 16.0 per cent. of nominal GDP as at 31 March 2010. The proportion of guarantees which were external has increased from 6.3 per cent. at the end of 2008, to 10.5 per cent. at the end of 2009 and to 10.5 per cent. as at 31 March 2010.

According to Art. 74 of the Budget Law (National Gazette No. 87/2008) the maximum permitted level of government debt is 60 per cent. of nominal GDP. Pursuant to Art. 75 of the Budget Law (National Gazette No. 87/2008) provides for more restrictive limits to be established annually under the Budget Execution Law for the relevant year. Under Art. 29 of the Budget Execution Law for 2010 (National Gazette No. 151/2009,) the current limitation on state debt is set at 48 per cent. of GDP.

Croatia currently has a flexible credit line with the IMF. The general allocation of special drawing rights ("**SDRs**") has been done in a way that each member was allocated 74.13 per cent. of their quota by the IMF. As a result, on 28 August 2009, the IMF allocated to Croatia's SDR account the amount of SDR 270.6 million (equivalent to U.S.$$421 million), this amount is managed at the CNB. In addition, a special one-off allocation of SDR has also been made in the amount of SDR 21.4 billion (based on the amendments to the IMF Statute on special allocation of SDR). The objective of the special one-off allocation is to equalize the member states with respect to the ratio of the allocation it has received and its quota (a significant number of IMF members have never received their SDR allocation, the last SDR allocation being approved by the IMF between 1979 and 1981). Based on this special allocation, the Republic of Croatia received additional SDR 32.4 million (equivalent to U.S.$50.5 million) on 9 September 2009 and these funds will also add to international reserves of the Republic of Croatia. The Republic of Croatia has not yet used these allocations and no additional allocations have been made since September 2009.

The following table shows the Central Domestic Debt Stock of Croatia for the periods indicated.

Debt Item	Year ended 31 December 2007	2008	2009	Three months ended 31 March 2010	Maturity	Interest rate
	(HRK thousands)				(year)	(per cent.)
Big Bonds — Series I	1,964,084	2,179,752	2,140,826	2,149,389	2011	5
Big Bonds — Series II	304,995	236,586	162,803	123,418	2011	7.20
Big Bonds — Series III	319,974	257,403	189,809	153,524	2012	7.20
G Bonds — Series 02 D-08	1,465,026	0	0	0	2008	6.875
G Bonds — Series 03 D-12	3,662,566	3,662,213	3,653,100	3,629,667	2012	6.875
G Bonds — Series 04 D-08	1,000,000	0	0	0	2008	6.125
G Bonds — Series 05 D-14	4,761,335	4,760,876	4,749,029	4,718,567	2014	5.500
G Bonds — Series 06 D-07	0	0	0	0	2007	3.875
G Bonds — Series 07 D-19	3,662,566	3,662,213	3,653,100	3,629,667	2019	5.375
G Bonds — Series 08 D-10	3,000,000	3,000,000	3,000,000	0	2010	6.750
G Bonds — Series 09 D-15	2,563,796	2,563,549	2,557,170	2,540,767	2015	4.250
G Bonds — Series 10 D-15	5,500,000	5,500,000	5,500,000	5,500,000	2015	5.250
G Bonds — Series 11 D-13	4,000,000	4,000,000	4,000,000	4,000,000	2013	4.500
G Bonds — Series 12 D-17	5,500,000	5,500,000	5,500,000	5,500,000	2017	4.750
G Bonds — Series 13 D-20	0	0	0	3,500,000	2020	6.750
G Bonds — Series 14 D-20	0	0	0	2,540,767	2020	6.500
BRA Bonds I	0	0	0	0	2007	6.00
BRA Bonds II	123,299	98,200	71,665	57,654	2012	5
BRA Bonds III	331,787	266,906	196,817	159,192	2012	7.20
BRA Bonds IV	168,777	134,421	98,099	78,919	2012	5
BRA Bonds Va	0	0	0	0	2007	6
BRA Bonds Vb	212,561	0	0	0	2008	7
Syndicated Loan I	3,662,566	3,662,213	3,653,100	3,629,667	2014	5.15
Syndicated Loan II	0	5,566,563	5,552,711	5,517,094	2013	4.71
Syndicated Loan III	0	0	5,479,649	5,444,501	2010	6.90
Medium and Long Term Debt	**42,203,332**	**45,050,895**	**50,157,878**	**52,872,793**		
Treasury Bills	11,975,258	14,605,000	12,135,000	12,878,000		
Other short term debt	476,268	300,000	0	50,000		
Treasury Bills FX	0	2,170,169	9,968,278	10,241,505		
Short term debt	12,451,526	17,075,169	22,103,278	23,169,505		
Total debt	**54,654,858**	**62,126,064**	**72,261,156**	**76,042,298**		

Source: Ministry of Finance

Internal Debt Instruments

There are no limitations on the aggregate amount of internal debt, or on its component parts.

Big Bonds represent the bonds issued as part of the restructuring of the economy during 1991 and 1992, and which replaced the Croatian banks' bad loans to the state owned companies. HRK 5.86 billion of Big Bonds were issued, carrying coupons of 5 per cent. and 7.5 per cent.

BRA Bonds represent the bonds, issued to the Bank Rehabilitation Agency, to serve as a capital injection for a few banks as part of their rehabilitation process. A total of HRK 5.52 billion in principal amount of these bonds were issued during 1996 to 1999 with maturities of 10 and 15 years, carrying coupons of 5 per cent., 6 per cent. and 7.2 per cent.

G-Bonds are bullet bonds issued through a syndicate of domestic banks and listed on the ZSE.

Syndicated Loans are loans arranged through a syndicate of domestic banks.

Treasury Bills are announced through publicly announced auctions and are issued under the Ministry of Finance's Treasury Bills Issuance Programme, which was created in July 1996. Please see below the average weighted treasury bill yield for the period indicated:

	Year ended 31 December			Six months ended 30 June
	2007	**2008**	**2009**	**2010**
		(per cent.)		*(per cent.)*
364 days HRK	4.13	6.27	7.15	3.80
364 days EUR	—	7.95	6.98	3.59

Source: Office of Public Debt

Croatia has strengthened its internal and external debt systems and market infrastructure with support from a loan from the World Bank and grants under the EU CARDS programme. The development focussed on education of operating personnel, installation and development of information technology systems for debt management and debt recordings, establishment of electronic auction facilities for internal debt, as well as development of central depositary and agency functions. This process was started in 2005 and completed in 2007.

The following table sets forth Croatia's domestic debt which is, as of 31 March 2010, scheduled to be redeemed between 2010 and 2018.

Redemption of domestic debt	From 31 March 2010	2011	2012	2013	2014	2015	2016	2017	2018
					(HRK million)				
Redemption of principal	**5,589.02**	**2,458.93**	**6,506.86**	**8,573.38**	**6,533.40**	**8,040.77**	**0.00**	**5,500.00**	**0.00**
Big bonds I	0.00	2,149.39	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Big bonds II	39.22	84.19	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Big bonds III	35.78	76.95	40.79	0.00	0.00	0.00	0.00	0.00	0.00
BRA bonds — Series II	13.67	28.95	15.04	0.00	0.00	0.00	0.00	0.00	0.00
BRA bonds — Series III	37.09	79.85	42.25	0.00	0.00	0.00	0.00	0.00	0.00
BRA bonds — Series IV	18.76	39.60	20.56	0.00	0.00	0.00	0.00	0.00	0.00
Bonds — Series 03 D-12	0.00	0.00	3,629.67	0.00	0.00	0.00	0.00	0.00	0.00
Bonds — Series 05 D-14	0.00	0.00	0.00	0.00	4,718.57	0.00	0.00	0.00	0.00
Bonds — Series 07 D-19	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Bonds — Series 09 D-15	0.00	0.00	0.00	0.00	0.00	2,540.77	0.00	0.00	0.00
Bonds — Series 10 D-15	0.00	0.00	0.00	0.00	0.00	5,500.00	0.00	0.00	0.00
Bonds — Series 11 D-13	0.00	0.00	0.00	4,000.00	0.00	0.00	0.00	0.00	0.00
Bonds — Series 12 D-17	0.00	0.00	0.00	0.00	0.00	0.00	0.00	5,500.00	0.00
Bonds — Series 13 D-20	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Bonds — Series 14 D-20	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
FX Syndicated Loan I	0.00	0.00	0.00	1,814.83	1,814.83	0.00	0.00	0.00	0.00
FX Syndicated Loan II	0.00	0.00	2,758.55	2,758.55	0.00	0.00	0.00	0.00	0.00
FX Syndicated Loan III	5,444.50	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Interest payments	**1,809.63**	**2,344.24**	**2,088.31**	**1,861.20**	**1,431.42**	**1,254.48**	**857.74**	**727.12**	**596.49**
Big bonds I	86.05	86.05	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Big bonds II	5.65	4.52	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Big bonds III	6.20	7.07	1.46	0.00	0.00	0.00	0.00	0.00	0.00
BRA bonds — Series II	1.60	1.82	0.36	0.00	0.00	0.00	0.00	0.00	0.00
BRA bonds — Series III	6.42	7.36	1.53	0.00	0.00	0.00	0.00	0.00	0.00
BRA bonds — Series IV	2.22	2.55	0.51	0.00	0.00	0.00	0.00	0.00	0.00
Bonds — Series 03 D-12	249.54	249.54	124.77	0.00	0.00	0.00	0.00	0.00	0.00
Bonds — Series 05 D-14	129.76	259.52	259.52	259.52	129.76	0.00	0.00	0.00	0.00
Bonds — Series 07 D-19	195.09	195.09	195.09	195.09	195.09	195.09	195.09	195.09	195.09
Bonds — Series 09 D-15	53.99	107.98	107.98	107.98	107.98	107.98	0.00	0.00	0.00
Bonds — Series 10 D-15	288.75	288.75	288.75	288.75	288.75	288.75	0.00	0.00	0.00
Bonds — Series 11 D-13	90.00	180.00	180.00	180.00	0.00	0.00	0.00	0.00	0.00
Bonds — Series 12 D-17	130.63	261.25	261.25	261.25	261.25	261.25	261.25	130.63	0.00
Bonds — Series 13 D-20	118.13	236.25	236.25	236.25	236.25	236.25	236.25	236.25	236.25
Bonds — Series 14 D-20	82.57	165.15	165.15	165.15	165.15	165.15	165.15	165.15	165.15
FX Syndicated Loan I	94.37	188.74	188.74	141.56	47.19	0.00	0.00	0.00	0.00
FX Syndicated Loan II	80.75	102.58	76.94	25.65	0.00	0.00	0.00	0.00	0.00
FX Syndicated Loan III	187.92	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Total debt service	**7,398.66**	**4,803.17**	**8,595.17**	**10,434.58**	**7,964.82**	**9,295.24**	**857.74**	**6,227.12**	**596.49**

Source: Ministry of Finance

Note: Exchange rate is midpoint exchange rate of the CNB as of 31 March 2010.

External Debt

The following table sets out Croatia's external debt ratios at the end of the periods indicated:

	Year ended 31 December					Three months ended 31 March
	2005	2006	2007	2008	2009	2010
			(per cent.)			
Total outstanding external debt*/GDP	72.1	74.9	76.9	82.6	94.9	94.6
General government external debt/GDP	17.2	14.5	12.5	8.9	11.4	10.8
Governmental external guaranties/ GDP	2.7	2.4	3.0	6.3	10.5	10.5

Source: Croatian National Bank

* *Total external debt excluding round-tripping transactions.*

The following table sets out the ratio of total debt service to exports of goods and services at the end of the periods indicated:

	Year ended 31 December				
	2005	2006	2007	2008	2009
Ratio of total debt service to exports of goods and services	25.0	35.8	33.3	28.2	46.4

The average original maturity of all total outstanding external debt is 8 years as of 31 March 2010.

As at 30 June 2010, Croatia has not raised any new external debt in 2010.

Obligations relating to external debt of the former Yugoslavia

The international loans on which former Yugoslavia defaulted following its dissolution fall into two categories: loans to public creditors (Paris club) and loans to commercial banks (London club).

Paris Club

On 16 December 2005, Croatia and the Republic of Italy entered into an agreement on the consolidation and rescheduling of Croatia's debt to the Republic of Italy. This agreement marked the completion of Croatia's involvement in the rescheduling of the former Yugoslavia's debts to the Paris Club members. In particular, this was the last of the 15 bilateral agreements signed with the public creditors of the Paris Club, comprising Austria, Belgium, Denmark, France, Italy, Japan, Kuwait, Netherlands, Norway, Germany, U.S.A, Spain, Sweden, Switzerland and Great Britain. These loans have been repaid and as at 31 March 2010, Croatia does not have any outstanding debt to Paris Club members.

London Club

On 26 April 1996, Croatia reached an agreement with the International Coordinating Committee of the Bank Creditors of the former Yugoslavia. Pursuant to this agreement, Croatia assumed 29.5 per cent. of loans for the refinancing of the debt of the former Yugoslavia under the New Financing Agreements dated 20 September 1988, and 19.7 per cent. of loans under the Trade and Deposit Facility Agreement dated 20 September 1988. On 3 July 1996, this debt was exchanged for Croatian Series A securities in the amount of U.S.$857.8 million due 2010 and Series B securities in the amount of U.S.$604.4 million due 2006, each at an interest rate of 6-month U.S.$ LIBOR plus a margin of 81.25 bps. The Series B securities were repaid in full in 2006. As at 31 March 2010, the outstanding principal amount of the Series A U.S.$37.0 million.

As part of the agreement with each of the Paris Club and the London Club on the consolidation and rescheduling of its share of the former Yugoslavia's debt to the Clubs, Croatia assumed 28.49 per cent. of former Yugoslavia's debt to the Paris Club creditors and 29.5 per cent. of former Yugoslavia's debt to the London Club creditors. After signing the agreement with the London Club in July 1996, Croatia normalised relations with all its foreign creditors.

The following table sets out the outstanding bonds issued by Croatia in the international bond market as at 31 March 2010 and the debt service schedule for each year until 2019:

Projections of Repayments of International Bonds of Croatia

		Original Principal Amount	Projections of Repayments of International Bonds of Croatia				
			From 31 March 2010	2011	2012	2013	2014
				(EUR*)			
London Club Series A: U.S.							
$857,796,000	*Principal:*	637,198,012	28,830,641	0			
Floating Rate Notes due 2010	*Interest**:*		362,112	0			
EUR 750,000,000	*Principal:*	750,000,000	0	750,000,000			
6.75 per cent, Notes due 2011	*Interest:*			50,625,000			
EUR 500,000,000	*Principal:*	500,000,000	0	0	0	0	500,000,000
5.0 per cent, Notes due 2014	*Interest:*		25,000,000	25,000,000	25,000,000	25,000,000	25,000,000
EUR 750,000,000	*Principal:*	750,000,000	0	0	0	0	0
6.5 per cent, Notes due 2015	*Interest:*		0	48,750,000	48,750,000	48,750,000	48,750,000
U.S. $1,500,000,000	*Principal:*	1,114,247,464	0	0	0	0	0
6.75 per cent Notes due 2019	*Interest:*		75,211,704	75,211,704	75,211,704	75,211,704	75,211,704
Principal Repayment (EUR)			28,830,641	750,000,000	0	0	500,000,000
Interest Payment (EUR)			100,573,816	199,586,704	148,961,704	148,961,704	148,961,704
Total Sercicing Costs (EUR)			129,404,457	949,586,704	148,961,704	148,961,704	648,961,704
total Principal Outstanding (at year end) (EUR)			3,114,247,464	2,364,247,464	2,364,247,464	2,364,247,464	1,864,247,464

		Projections of Repayments of International Bonds of Croatia				
		2015	2016	2017	2018	2019
				(EUR*)		
London Club Series A: U.S.						
$857,796,000						
Floating Rate Notes due 2010						
EUR 750,000,000						
6.75 per cent, Notes due 2011						
EUR 500,000,000						
5.0 per cent, Notes due 2014						
EUR 750,000,000	*Principal:*	750,000,000				
6.5 per cent, Notes due 2015	*Interest:*	48,750,000				
U.S. $1,500,000,000	*Principal:*	0	0	0	0	1,114,247,464
6.75 per cent Notes due 2019	*Interest:*	75,211,704	75,211,704	75,211,704	75,211,704	75,211,704
Principal Repayment (EUR)		750,000,000	0	0	0	1,114,247,464
Interest Payment (EUR)		123,961,704	75,211,704	75,211,704	75,211,704	75,211,704
Total Sercicing Costs (EUR)		873,961,704	75,211,704	75,211,704	75,211,704	1,189,459,168
total Principal Outstanding (at year end) (EUR)		1,114,247,464	1,114,247,464	1,114,247,464	1,114,247,464	0

Source: *Ministry of Finance*

* Exchange rate: Mid exchange rate of the CNB as of 31 March 2010.

** 6m U.S.$ LIBOR + 13/16

The following table sets forth a breakdown of the total general government debt of Croatia as at the end of the periods indicated.

General Government Debt	Year ended 31 December			Three months ended 31 March		
	2005	2006	2007	2008	2009	2010
			(HRK million)			
1. General Government Internal Debt	56,358.6	61,389.3	65,211.8	69,879.8	79,994.7	84,385.6
1.1 Central Government	50,840.7	54,490.4	56,883.1	64,961.8	74,473.7	78,871.9
Treasury Bills	12,278.0	12,412.9	11,740.6	14,440.7	18,802.5	20,745.5
Money Market Instruments	0.9	—	—	10.7	19.3	20.3
Bonds	31,151.8	35,249.6	39,273.5	39,306.7	39,369.3	42,104.6
CNB Loans	1.4	0.9	1.0	2.2	2.9	—
Bank Loans	7,408.6	6,827.0	5,867.9	11,201.5	16,279.8	16,001.6
1.2 Government Funds & Agencies	3,953.5	5,198.0	6,357.8	3,035.0	3,794.4	3,816.8
Money Market Instruments	—	—	—	—	—	—
Bonds	—	—	—	—	—	—
Bank Loans	3,953.5	5,198.0	6,357.8	3,035.0	3,794.4	3,816.8
1.3 Local Governments	1,564.4	1,700.9	1,970.9	1,883.0	1,726.5	1,696.9
Money Market Instruments	40.7	29.3	36.8	12.0	6.8	2.4
Bonds	185.1	294.2	472.3	582.7	574.6	559.9
Bank Loans	1,338.6	1,377.4	1,461.8	1,288.3	1,145.1	1,134.7
2. General Government External Debt	45,380.3	41,647.2	39,834.6	30,523.0	37,738.3	35,653.4
2.1 Central Government	36,414.5	32,556.6	29,424.0	28,459.4	35,786.0	33,732.7
Money Market Instruments	—	—	—	—	—	—
Bonds	27,020.1	22,836.9	20,397.3	18,768.2	26,101.8	22,331.6
Loans	9,394.5	9,719.7	9,026.7	9,691.2	9,684.2	11,401.1
2.2 Government Funds & Agencies	8,749.8	8,938.2	10,186.7	1,800.3	1,715.1	1,725.5
Money Market Instruments	—	—	—	—	—	—
Bonds	—	—	—	—	—	—
Loans	8,749.8	8,938.2	10,186.7	1,800.3	1,715.1	1,725.5
2.3 Local Governments	216.0	152.5	223.9	263.2	237.2	195.2
Money Market Instruments	—	—	—	—	—	—
Bonds	—	—	—	—	—	—
Loans	216.0	152.5	223.9	263.2	237.2	195.2
3. Total (1+2)	**101,738.9**	**103,036.5**	**105,046.4**	**100,402.7**	**117,733.0**	**120,039.1**
Government Guaranties:						
1. Internal	5,802.7	7,599.8	8,058.5	13,255.1	15,652.8	18,525.6
of which: HBOR	534.2	347.5	190.7	807.9	41.4	2,041.1
2. External	13,791.8	14,274.6	19,002.8	31,393.4	34,880.0	35,453.7
of which: HBOR	6,605.1	7,338.8	9,471.5	10,005.1	12,282.2	11,160.2

Source: Ministry of Finance and Croatian National Bank

(1) As from CNB Bulletin No. 146 (March 2009) the HBOR (Croatian Bank for restructuring and Development) is reclassified from the subsector central government funds to the subsector non-banking financial institutions. The reclassification covers the entire statistical series. As well, the HAC (Croatian Motorways) is reclassified from the subsector central government funds to the subsector public enterprises. This reclassification covers the statistical series from January 2008 onwards.

Note: Exchange rate as at 31 December 2006-2009 and 31 March 2010

The following table sets forth a breakdown of the total external debt of Croatia divided according to sector.

Gross External Debt of Domestic Sectors

	Year ended 31 December[1]					Three months ended 31 March
	2005	2006	2007	2008	2009	2010
	(EUR millions)					
Government	6,152.7	5,670.1	5,371.8	4,197.3	5,165.2	4,911.4
Short-term	2.0	1.3	5.3	35.7	0.1	0.1
Money market instruments	0.0	0.0	0.0	0.0	0.0	0.0
Credits	0.0	0.0	0.0	31.7	0.0	0.0
Trade credits	0.0	0.0	0.0	0.0	0.0	0.0
Other debt liabilities	2.0	1.3	5.3	4.0	0.1	0.1
Principal arrears	1.8	0.0	1.1	3.9	0.1	0.0
Interest arrears	0.2	1.2	4.2	0.1	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0	0.0
Long-term	6,150.7	5,668.8	5,366.5	4,161.6	5,165.1	4,911.3
Bonds	3,663.4	3,109.1	2,756.9	2,621.9	3,572.5	3,076.3
Credits	2,484.8	2,557.8	2,608.4	1,538.9	1,592.6	1,835.1
Trade credits	2.6	1.9	1.2	0.7	0.0	0.0
Other debt liabilities	0.0	0.0	0.0	0.0	0.0	0.0
Croatian National Bank	2.6	2.6	2.3	2.3	1.1	1.2
Short-term	2.6	2.6	2.3	2.3	1.1	1.2
Money market instruments	0.0	0.0	0.0	0.0	0.0	0.0
Credits	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	2.6	2.6	2.3	2.3	1.1	1.2
Other debt liabilities	0.0	0.0	0.0	0.0	0.0	0.0
Long-term	0.0	0.0	0.0	0.0	0.0	0.0
Banks	8,978.7	10,222.6	8,879.1	10,079.1	10,679.8	10,657.8
Short-term	2,505.2	3,362.7	2,361.2	3,793.3	3,101.8	2,919.6
Money market instruments	0.0	0.0	0.0	0.0	0.0	0.0
Credits	1,064.8	1,150.4	710.8	1,121.1	816.8	1,095.0
Currency and deposits	1,438.6	2,211.1	1,648.8	2,670.3	2,283.9	1,823.3
Other debt liabilities	1.7	1.2	1.7	2.0	1.2	1.4
Principal arrears	0.0	0.0	0.1	0.0	0.0	0.0
Interest arrears	1.7	1.2	1.5	2.0	1.2	1.4
Other	0.0	0.0	0.0	0.0	0.0	0.0
Long-term	6,473.6	6,859.9	6,517.9	6,285.8	7,578.0	7,738.2
Bonds	456.6	457.9	459.0	456.8	0.0	0.0
Credits	3,822.7	4,217.3	3,565.1	3,373.9	3,535.3	3,504.1
Currency and deposits	2,194.3	2,184.7	2,493.9	2,455.0	4,042.7	4,234.1
Other debt liabilities	0.0	0.0	0.0	0.0	0.0	0.0
Other Sectors	8,176.4	10,500.2	14,743.1	19,835.7	21,344.1	21,512.7
Short-term	706.7	700.9	1,478.2	925.2	1,372.1	1,532.9
Money market instruments	0.0	0.0	0.0	0.0	0.0	0.0
Credits	133.0	155.0	681.0	652.9	693.8	669.0
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0
Trade Credits	27.8	35.9	31.1	39.5	28.2	37.1
Other debt liabilities	545.9	510.0	766.0	232.9	650.1	826.8
Principal arrears	502.1	460.6	683.4	170.4	527.4	694.4
Interest arrears	43.8	49.4	82.6	62.5	122.7	132.4
Other	0.0	0.0	0.0	0.0	0.0	0.0
Long-term	7,469.7	9,799.3	13,264.9	18,910.5	19,972.0	19,979.8
Bonds	763.9	837.8	1,208.3	1,186.4	1,612.7	1,647.1
Credits	6,542.1	8,816.1	11,766.9	17,391.3	18,071.2	18,041.1
Currency and deposits	0.0	0.0	0.0	10.6	0.0	0.0
Trade Credits	163.7	145.4	289.8	322.2	288.1	291.5
Other debt liabilities	0.0	0.0	0.0	0.0	0.0	0.0
Direct Investment	2,450.7	2,878.4	3,932.8	5,835.9	7,390.0	7,481.1
of which round-tripping transactions				825.6	1,499.0	1,560.1
Short-term	177.5	233.9	540.4	1,415.7	436.3	495.1
Money market instruments	0.0	0.0	0.0	0.0	0.0	0.0
Credits	36.3	51.2	216.8	1,314.0	337.9	371.5
Trade credits	0.0	0.0	0.0	0.0	0.0	0.0
Other debt liabilities	141.2	182.7	323.6	101.6	98.4	123.6
Principal arrears	121.8	158.2	293.9	85.8	74.9	100.0
Interest arrears	19.4	24.5	29.7	15.8	23.5	23.6
Other	0.0	0.0	0.0	0.0	0.0	0.0
Long-term	2,273.2	2,644.5	3,392.5	4,420.2	6,953.7	6,986.1
Bonds	0.0	0.0	0.0	0.0	0.0	0.0
Credits	2,239.3	2,618.1	3,374.5	4,414.7	6,952.6	6,985.3
Trade credits	33.9	26.4	18.0	5.5	1.0	0.7
Other debt liabilities	0.0	0.0	0.0	0.0	0.0	0.0
Total	**25,761.1**	**29,273.9**	**32,929.2**	**39,950.2**	**44,580.3**	**44,564.2**
Total (excluding round-tripping transactions)	**25,761.1**	**29,273.9**	**32,929.2**	**39,124.6**	**43,081.3**	**43,004.1**

Source: *Croatian National Bank*

(1) Exchange rate as at 31 December in the relevant year.

At the end of 2009, bank liabilities amounted to EUR 10.7 billion. Please see below a table setting out in percentage terms the structure of bank liabilities for the periods indicated:

Structure of bank liabilities	**Year ended 31 December 2009** *(EUR millions)*	*(per cent.)*
Short term loans	816.8	7.6
Short term currency and deposits	2,283.9	21.4
Other short term liabilities	1.2	0.0
Long term bonds	0.0	0.0
Long term credits	3,535.3	33.1
Long term currency and deposits	4,042.7	37.9

Source: Croatian National Bank

The projected servicing of short, medium and long term outstanding external debt as at 31 March 2010 is provided in the following table:

Gross External Debt by Domestic Sectors and Projected Principal Future Payments

	Gross External Debt as at 31 March 2010	**Immediate**	**Projected future principal payments during** *(EUR millions)* **2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**Other**
Public sector	**12,107.0**	**45.2**	**1,074.1**	**2,148.8**	**998.7**	**1,282.9**	**1,075.3**	**1,272.2**	**386.3**	**938.1**	**237.8**	**1,464.3**	**1,183.3**
Short-term	108.4	45.2	1.2	62.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Long-term	11,794.1	0.0	970.5	1,986.2	998.7	1,282.9	1,075.3	1,272.2	386.3	938.1	237.8	1,464.3	1,181.7
Direct investment	204.5	0.0	102.4	100.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.6
Short-term	50.4	0.0	26.1	24.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Long-term	154.1	0.0	76.2	76.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.6
Publicly guaranteed private sector	**7.2**	**0.0**	**1.7**	**2.8**	**2.3**	**0.3**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Short-term	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Long-term	7.2	0.0	1.7	2.8	2.3	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Direct investment	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Non-publicly guaranteed private sector	32,449.9	906.6	10,421.7	6,569.2	3,269.3	2,290.1	1,505.0	908.1	1,582.2	761.3	438.8	952.1	2,845.7
Short-term	4,345.3	783.1	3,164.9	397.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Long-term	20,828.0	0.0	4,721.1	4,885.5	2,643.8	1,975.4	1,242.6	773.0	1,351.0	641.3	389.9	709.6	1,494.8
Direct investment	7,276.6	123.6	2,535.6	1,286.4	625.5	314.7	262.4	135.1	231.2	119.9	48.9	242.4	1,350.9
of which round-tripping	***1,560.1***	***0.0***	***893.5***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***666.5***
Short-term	444.6	123.6	312.3	8.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Long-term	6,8/32.0	0.0	2,223.4	1,277.6	625.5	314.7	262.4	135.1	231.2	119.9	48.9	242.4	1,350.9
Total	44,564.2	**951.8**	**11,497.5**	**8,720.9**	**4,270.4**	**3,573.3**	**2,580.2**	**2,180.3**	**1,968.4**	**1,699.4**	**676.6**	**2,416.4**	**4,028.9**

Gross External Debt by Domestic Sectors and Projected Interest Future Payments

	Gross External Debt as at 31 March 2010	Immediate	Projected Future Interest Payments during										
			2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Other
			(EUR millions)										
Public sector	**12,107.0**	**0.0**	**177.5**	**410.2**	**325.9**	**282.9**	**266.3**	**218.6**	**159.4**	**149.8**	**112.7**	**173.3**	**118.0**
Short-term	108.4	0.0	0.7	1.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Long-term	11,794.1	0.0	169.4	406.6	325.9	282.9	266.3	218.6	159.4	149.8	112.7	173.3	118.0
Direct investment	204.5	0.0	7.4	1.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Short-term	50.4	0.0	1.9	0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Long-term	154.1	0.0	5.5	1.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Publicly guaranteed private sector	**7.2**	**0.0**	**0.1**	**0.1**	**0.1**	**1.7**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Short-term	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Long-term	7.2	0.0	0.1	0.1	0.1	1.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Direct investment	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Non-publicly guaranteed private sector	**32,449.9**	**0.0**	**510.3**	**556.4**	**392.7**	**347.4**	**243.3**	**179.6**	**161.8**	**98.6**	**77.5**	**260.4**	**1,191.6**
Short-term	4,345.3	0.0	31.0	9.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Long-term	20,828.0	0.0	406.0	478.0	340.7	315.7	212.1	157.9	135.9	80.3	66.6	43.7	213.2
Direct investment	7,276.6	0.0	73.2	68.7	52.0	31.6	31.2	21.7	25.9	18.3	10.9	216.7	978.4
of which round-tripping	***1,560.1***	***0.0***	***8.9***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***779.6***
Short-term	444.6	0.0	4.4	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Long-term	6,832.0	0.0	68.8	68.2	52.0	31.6	31.2	21.7	25.9	18.3	10.9	216.7	978.4
Total	**44,564.2**	**0.0**	**687.9**	**966.8**	**718.6**	**631.9**	**509.7**	**398.2**	**321.2**	**248.3**	**190.2**	**433.7**	**1,309.6**

TAXATION

The comments below are of a general nature only and are based on the provisions currently in force. Prospective Noteholders should consult their tax advisers as to the tax laws and specific tax consequences of acquiring, holding and disposing of the Notes.

Croatia

Under existing Croatian laws and regulations, payments of principal on the Notes to any individual or legal entity which is not resident or incorporated in Croatia will not be subject to taxation in Croatia, and no withholding of any Croatian tax will be required on any such payments. Pursuant to the Personal Income Tax Act payment of the interest on the Notes to foreign natural persons is not subject to personal income tax. Pursuant to the Profit Tax Act, interest on Notes held by foreign legal persons are exempted from payment of a withholding tax.

No Croatian tax will be payable in respect of any gain, whether realised or unrealised, made by a holder (which is not resident or incorporated in Croatia) in respect of any Notes. No stamp, registration or similar duties or taxes will be payable in Croatia by Noteholders in connection with the issue or transfer of the Notes. However, subject to any applicable double taxation treaty, a natural or legal person who inherits or receives gifts (including Notes) in the Republic is under an obligation to pay Croatian tax in respect of such inheritance or gift, in accordance with applicable laws.

United States

U.S. Federal Income Taxation

The discussion of U.S. tax matters in this Prospectus is not intended or written to be used, and cannot be used by any person, for the purpose of avoiding U.S. federal, state or local tax penalties, and was written to support the promotion or marketing of the offering of the Notes. Each taxpayer should seek advice based on such person's particular circumstances from an independent tax adviser.

The following summary of the material U.S. federal income tax considerations of the purchase, ownership and disposition of the Notes by a U.S. Holder (as defined below) is based upon the U.S. Internal Revenue Code of 1986, as amended (the "**Code**"), final, temporary and proposed Treasury regulations issued thereunder, and published judicial and administrative interpretations thereof, each as of the date hereof, and all of which are subject to change, possibly with retroactive effect.

This summary does not purport to be a complete analysis of all potential tax consequences. This discussion does not address all of the U.S. federal income tax consequences that may be relevant to an investor in light of such investor's particular circumstances or to investors subject to special treatment under U.S. federal income tax laws, such as certain financial institutions, certain U.S. expatriates, insurance companies, retirement plans, dealers in securities or foreign currencies, traders in securities that elect mark-to-market tax accounting, U.S. Holders whose functional currency is not the US dollar, partnerships, tax-exempt organisations, regulated investment companies, real estate investment trusts, persons subject to alternative minimum tax and persons holding the Notes as part of a "straddle," "hedge," "conversion transaction" or other integrated transaction. In addition, this discussion is limited to persons that purchase the Notes for cash at original issue and at their "issue price" (the first price at which a substantial part of the Notes are sold to the public for cash, excluding sales to bond houses, brokers or similar persons or organisations acting in the capacity of underwriters, placement agents or wholesalers) and that hold the Notes as capital assets for U.S. federal income tax purposes.

For purposes of this discussion, the term "U.S. Holder" means a beneficial owner of a Note that is, for U.S. federal income tax purposes, (i) an individual that is a citizen or resident of the United States, (ii) a corporation created or organised in, or under the laws of, the United States, any state therein or the District of Columbia, (iii) an estate the income of which is subject to U.S. federal income tax regardless of its source, or (iv) a trust primarily supervised by a U.S. court and controlled by U.S. persons.

If a partnership or an entity classified as a partnership for U.S. federal income tax purposes invests in Notes, the U.S. federal income tax treatment of a partner in such partnership will generally depend upon the status of such partner and the activities of the partnership. Prospective investors that are partnerships, and partners in such partnerships, should consult their own tax advisers to determine the U.S. federal income tax consequences to them of the purchase, ownership and disposition of the Notes.

The Republic does not currently intend to issue further notes forming a single Series with the Notes that have more than *de minimis* original issue discount for U.S. federal income tax purposes ("**OID**") unless such further notes are issued in a "qualified reopening" for U.S. federal income tax purposes. However, the determination regarding whether to proceed with any proposed further issue will be made at the time of such further issue and the Republic may decide to proceed even if a particular further issue would be issued with more than *de minimis* OID and not in a qualified reopening. The Republic is under no obligation to notify Noteholders of any such determination and no assurances can be given in respect of such determination.

Prospective purchasers of the Notes should consult their own tax advisers concerning the tax consequences of investing in Notes in light of their particular circumstances, including the application of the U.S. federal income tax considerations discussed below, as well as the application of other tax laws.

Payments of interest

Payments of stated interest on the Notes generally will be taxable to a U.S. Holder as ordinary income at the time that such payments are received or accrued, in accordance with such U.S. Holder's usual method of accounting for U.S. federal income tax purposes. Interest income on a Note generally will constitute foreign source income for U.S. federal income tax purposes and generally will be considered "passive" income, which is treated separately from other types of income in computing the foreign tax credit that may be allowable to U.S. Holders under U.S. federal income tax laws. U.S. Holders should consult their own tax advisers regarding the calculation and availability of foreign tax credits.

Sale, exchange and redemption of Notes

Generally, upon the sale, exchange or redemption of a Note, a U.S. Holder will recognise taxable gain or loss equal to the difference between the amount realised on the sale, exchange, or redemption (less any amount attributable to accrued but unpaid interest, which will be treated as a payment of interest in the manner described above) and such U.S. Holder's adjusted tax basis in the Note. A U.S. Holder's adjusted tax basis in a Note generally will equal the amount paid for the Note. Such gain or loss generally will be capital gain or loss and will be long term capital gain or loss if at the time of sale, exchange or redemption the Note has been held by such U.S. Holder for more than one year. The deductibility of capital losses by U.S. Holders is subject to limitations. Gain or loss realised by a U.S. Holder on the sale or retirement of a Note generally will be U.S. source.

Information reporting and backup withholding

Information returns may be filed with the U.S. Internal Revenue Service (the "**IRS**") (unless the U.S. Holder establishes, if requested to do so, that it is an exempt recipient) in connection with payments on the Notes, and the proceeds from the sale, exchange or other disposition of Notes. If information reports are required to be made, a U.S. Holder may be subject to U.S. backup withholding if it fails to provide its taxpayer identification number, or to establish that it is exempt from backup withholding. The amount of any backup withholding imposed on a payment will be allowed as a credit against any U.S. federal income tax liability of a U.S. Holder and may entitle the U.S. Holder to a refund, provided the required information is timely furnished to the IRS.

U.S. Holders should consult their own tax advisers regarding any reporting obligations they may have as a result of their acquisition, ownership or disposition of Notes.

EU Savings Directive

Under EC Council Directive 2003/48/EC on the taxation of savings income, Member States are required to provide to the tax authorities of another Member State details of payments of interest (or similar income) paid by a person within its jurisdiction to an individual resident in that other Member State or to certain limited types of entities established in that other Member State. However, for a transitional period Luxembourg and Austria are instead required (unless during that period they elect otherwise) to operate a withholding system in relation to such payments (the ending of such transitional period being dependent upon the conclusion of certain other agreements relating to information exchange with certain other countries). A number of non-EU countries and territories including Switzerland have adopted similar measures (a withholding system in the case of Switzerland).

On 15 September 2008 the European Commission issued a report to the Council of the European Union on the operation of the Directive, which included the Commission's advice on the need for changes to the Directive. On 13 November 2008 the European Commission published a more detailed proposal for amendments to the Directive, which included an number of suggested changes. If any of those proposed changes are made in relation to the Directive, they may amend or broaden the scope of the requirements described above.

CLEARING AND SETTLEMENT ARRANGEMENTS

*The information set out below is subject to any change in or reinterpretation of the rules, regulations and procedures of DTC, Euroclear or Clearstream, Luxembourg (together, the "**Clearing Systems**") currently in effect. The information in this section concerning the Clearing Systems has been obtained from sources that the Republic believes to be reliable, but neither the Republic or the Joint Lead Managers takes any responsibility for the accuracy of this section. Investors wishing to use the facilities of any of the Clearing Systems are advised to confirm the continued applicability of the rules, regulations and procedures of the relevant Clearing System. None of the Republic and any other party to the Agency Agreement will have any responsibility or liability for any aspect of the records relating to, or payments made on account of, beneficial ownership interests in the Notes held through the facilities of any Clearing System or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests.*

Clearing Systems

Euroclear and Clearstream, Luxembourg

Euroclear and Clearstream, Luxembourg each hold securities for their customers and facilitate the clearance and settlement of securities transactions by electronic book-entry transfer between their respective account holders. Euroclear and Clearstream, Luxembourg provide various services including safekeeping, administration, clearance and settlement of internationally traded securities and securities lending and borrowing. Euroclear and Clearstream, Luxembourg also deal with domestic securities markets in several countries through established depositary and custodial relationships. Euroclear and Clearstream, Luxembourg have established an electronic bridge between their two systems across which their respective participants may settle trades with each other.

Euroclear and Clearstream, Luxembourg customers are worldwide financial institutions, including underwriters, securities brokers and dealers, banks, trust companies and clearing corporations. Indirect access to Euroclear and Clearstream, Luxembourg is available to other institutions that clear through or maintain a custodial relationship with an account holder of either system.

DTC

DTC has advised the Republic that it is a limited purpose trust company organised under the New York Banking Law, a member of the Federal Reserve System, a "banking organisation" within the meaning of the New York Banking Law, a "clearing corporation" within the meaning of the New York Uniform Commercial Code and a "clearing agency" registered pursuant to Section 17A of the Exchange Act. DTC holds securities that its participants ("**Direct Participants**") deposit with DTC. DTC also facilitates the settlement among Direct Participants of securities transactions, such as transfers and pledges, in deposited securities through electronic computerised book-entry changes in Direct Participants' accounts, thereby eliminating the need for physical movement of securities certificates. Direct Participants include both U.S. and non U.S. securities brokers and dealers, banks, trust companies, clearing corporations and certain other organisations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("**DTCC**"). DTCC is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non U.S. securities brokers and dealers, banks and trust companies that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("**Indirect Participants**" and, together with Direct Participants, "**Participants**"). More information about DTC can be found at www.dtcc.com and www.dtc.org.

Under the rules, regulations and procedures creating and affecting DTC and its operations (the "**DTC Rules**"), DTC makes book-entry transfers of Registered Notes among Direct Participants on whose behalf it acts with respect to Notes accepted into DTC's book-entry settlement system ("**DTC Notes**") as described below and receives and transmits distributions of principal and interest on DTC Notes. The DTC Rules are on file with the Securities and Exchange Commission. Direct Participants and Indirect Participants with which beneficial owners of DTC Notes ("**Owners**") have accounts with respect to the DTC Notes similarly are required to make book-entry transfers and receive and transmit such payments on behalf of their respective Owners. Accordingly, although Owners who hold DTC Notes through Direct Participants or Indirect Participants will not possess Registered Certificates, the DTC Rules, by virtue of the requirements described above, provide a mechanism by which Direct Participants will receive payments and will be able to transfer their interest in respect of the DTC Notes.

Purchases of DTC Notes under the DTC system must be made by or through Direct Participants, which will receive a credit for the DTC Notes on DTC's records. The ownership interest of each actual purchaser of each DTC Note ("**Beneficial Owner**") is in turn to be recorded on the Direct and Indirect Participant's records. Beneficial Owners will not receive written confirmation from DTC of their purchase, but Beneficial Owners are expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the DTC Notes are to be accomplished by entries made on the books of Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in DTC Notes, except in the event that use of the book-entry system for the DTC Notes is discontinued.

To facilitate subsequent transfers, all DTC Notes deposited by Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorised representative of DTC. The deposit of DTC Notes with DTC and their registration in the name of Cede & Co. or such other DTC nominee effect no change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the DTC Notes; DTC's records reflect only the identity of the Direct Participants to whose accounts such DTC Notes are credited, which may or may not be the Beneficial Owners. The Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

Redemption notices shall be sent to DTC. If less than all of the DTC Notes within an issue are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to DTC Notes unless authorised by a Direct Participant in accordance with DTC's Money Market Instrument Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the Issuer as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the DTC Notes are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal and interest payments on the DTC Notes will be made to Cede & Co., or such other nominee as may be requested by an authorised representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the Issuer or the relevant agent (or such other nominee as may be requested by an authorised representative of DTC), on the relevant payment date in accordance with their respective holdings shown in DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name", and will be the responsibility of such Participant and not of DTC, relevant agents or the Issuer, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal and interest to DTC is the responsibility of the Issuer, disbursement of such payments to Direct Participants is the responsibility of DTC, and disbursement of such payments to the Beneficial Owners is the responsibility of Direct and Indirect Participants.

Under certain circumstances, including if there is an Event of Default under the Notes, DTC will exchange the DTC Notes for definitive Registered Notes, which it will distribute to its Participants in accordance with their proportionate entitlements and which, if representing interests in a Rule 144A Global Note, will be legended as set forth under "*Subscription and Sale*" and "*Transfer Restrictions*".

A Beneficial Owner shall give notice to elect to have its DTC Notes purchased or tendered, through its Participant, to the relevant agent, and shall effect delivery of such DTC Notes by causing the Direct Participant to transfer the Participant's interest in the DTC Notes, on DTC's records, to the relevant agent. The requirement for physical delivery of DTC Notes in connection with an optional tender or a mandatory purchase will be deemed satisfied when the ownership rights in the DTC Notes are transferred by Direct Participants on DTC's records and followed by a book-entry credit of tendered DTC Notes to the relevant agent's DTC account.

DTC may discontinue providing its services as depository with respect to the DTC Notes at any time by giving reasonable notice to the Issuer or the relevant agent. Under such circumstances, in the event that a successor depository is not obtained, DTC Note certificates are required to be printed and delivered.

The Issuer may decide to discontinue use of the system of book-entry-only transfers through DTC (or a successor securities depository). In that event, DTC Note certificates will be printed and delivered to DTC.

Since DTC may only act on behalf of Direct Participants, who in turn act on behalf of Indirect Participants, any Owner desiring to pledge DTC Notes to persons or entities that do not participate in DTC, or otherwise take actions with respect to such DTC Notes, will be required to withdraw its Registered Certificates from DTC.

The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that Issuer believes to be reliable, but Issuer takes no responsibility for the accuracy thereof.

Registration and Form

Book-entry interests in the Notes held through Euroclear and Clearstream, Luxembourg will be represented by the Unrestricted Global Certificate registered in the name of a nominee of, and held by, a common depositary for Euroclear and Clearstream, Luxembourg. Book-entry interests in the Notes held through DTC will be represented by the Restricted Global Certificate registered in the name of Cede & Co., as nominee for DTC, and held by a custodian for DTC. As necessary, the Registrar will adjust the amounts of Notes on the Register for the accounts of Euroclear, Clearstream, Luxembourg and DTC to reflect the amounts of Notes held through Euroclear, Clearstream, Luxembourg and DTC, respectively. Beneficial ownership of book-entry interests in Notes will be held through financial institutions as direct and indirect participants in Euroclear, Clearstream, Luxembourg and DTC.

The aggregate holdings of book-entry interests in the Notes in Euroclear, Clearstream, Luxembourg and DTC will be reflected in the book-entry accounts of each such institution. Euroclear, Clearstream, Luxembourg or DTC, as the case may be, and every other intermediate holder in the chain to the beneficial owner of book-entry interests in the Notes will be responsible for establishing and maintaining accounts for their participants and customers having interests in the book-entry interests in the Notes. The Registrar will be responsible for maintaining a record of the aggregate holdings of Notes registered in the name of a common nominee for Euroclear and Clearstream, Luxembourg, a nominee for DTC and/or, if individual Certificates are issued in the limited circumstances described under "*The Global Certificates — Registration of Title*", holders of Notes represented by those individual Certificates. The Fiscal Agent will be responsible for ensuring that payments received by it from the Republic for holders of book-entry interests in the Notes holding through Euroclear and Clearstream, Luxembourg are credited to Euroclear or Clearstream, Luxembourg, as the case may be, and the Fiscal Agent will also be responsible for ensuring that payments received by the Fiscal Agent from the Republic for holders of book-entry interests in the Notes holding through DTC are credited to DTC.

The Republic will not impose any fees in respect of holding the Notes; however, holders of book-entry interests in the Notes may incur fees normally payable in respect of the maintenance and operation of accounts in Euroclear, Clearstream, Luxembourg or DTC.

Clearing and Settlement Procedures

Initial Settlement

Upon their original issue, the Notes will be in global form represented by the two Global Certificates. Interests in the Notes will be in uncertified book-entry form. Purchasers electing to hold book-entry interests in the Notes through Euroclear and Clearstream, Luxembourg accounts will follow the settlement procedures applicable to conventional Eurobonds. Book-entry interests in the Notes will be credited to Euroclear and Clearstream, Luxembourg participants' securities clearance accounts on the business day following the Closing Date against payment (value the Closing Date). DTC participants acting on behalf of purchasers electing to hold book-entry interests in the Notes through DTC will follow the delivery practices applicable to securities eligible for DTC's Same Day Funds Settlement system. DTC participants' securities accounts will be credited with book-entry interests in the Notes following confirmation of receipt of payment to the Republic on the Closing Date.

Secondary Market Trading

Secondary market trades in the Notes will be settled by transfer of title to book-entry interests in the Clearing Systems. Title to such book-entry interests will pass by registration of the transfer within the records of Euroclear, Clearstream, Luxembourg or DTC, as the case may be, in accordance with their respective procedures. Book-entry interests in the Notes may be transferred within Euroclear and within Clearstream, Luxembourg and between Euroclear and Clearstream, Luxembourg in accordance with procedures established for these purposes by Euroclear and Clearstream, Luxembourg. Book-entry interests in the Notes may be transferred within DTC in accordance with procedures established for this purpose by DTC. Transfer of book-entry interests in the Notes between Euroclear or Clearstream, Luxembourg and DTC may be effected in accordance with procedures established for this purpose by Euroclear, Clearstream, Luxembourg and DTC.

General

None of Euroclear, Clearstream, Luxembourg or DTC is under any obligation to perform or continue to perform the procedures referred to above, and such procedures may be discontinued at any time.

None of the Republic or any of their agents will have any responsibility for the performance by Euroclear, Clearstream, Luxembourg or DTC or their respective participants of their respective obligations under the rules and procedures governing their operations or the arrangements referred to above.

SUBSCRIPTION AND SALE

Barclays Bank PLC, Citigroup Global Markets Limited and J.P. Morgan Securities Ltd. (the "**Joint Lead Managers**") have, pursuant to a Subscription Agreement (the "**Subscription Agreement**") dated 13 July 2010, jointly and severally agreed to subscribe or procure subscribers for the Notes at the issue price of 99.102 per cent. of the principal amount of Notes less a combined selling concession and management and underwriting commission of 0.25 per cent. of the principal amount of the Notes, subject to the provisions of the Subscription Agreement. The Republic will also reimburse the Joint Lead Managers in respect of certain of their expenses, and has agreed to indemnify the Joint Lead Managers against certain liabilities (including liabilities under the Securities Act), incurred in connection with the issue of the Notes. The Subscription Agreement may be terminated in certain circumstances prior to payment of the issue price to the Republic.

United States

The Notes have not been and will not be registered under the Securities Act and, subject to certain exceptions, may not be offered or sold within the United States or to or for the account or benefit of a U.S. person except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act. Accordingly, the Notes are being offered and sold only (a) outside the United States to persons other than U.S. persons as defined in Regulation S in offshore transactions in reliance on, and in compliance with, Regulation S and (b) in the United States to a limited number of QIBs as defined in the Securities Act in connection with resales by the Joint Lead Manager, in reliance on, and in compliance with, Rule 144A.

In addition, until 40 days after the commencement of the offering, an offer or sale of Notes within the United States by any dealer (whether or not participating in the offering of the Notes) may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than in accordance with Rule 144A.

Each Joint Lead Manager has agreed that it has offered and sold, and will offer and sell, the Notes (a) as part of its distribution at any time and (b) otherwise until 40 days after the later of the commencement of the offering and the Closing Date, only in accordance with Rule 903 of Regulation S or Rule 144A. Accordingly, neither such Joint Lead Manager nor its affiliates, nor any persons acting on its or their behalf, have engaged or will engage in any directed selling efforts (as defined in Regulation S) with respect to the Notes, and such Joint Lead Manager, its affiliates and all persons acting on its or their behalf have complied and will comply with the offering restrictions requirement of Regulation S. Each Joint Lead Manager has agreed that, at or prior to confirmation of sale of the Notes (other than a sale pursuant to Rule 144A), it will have sent to each distributor, dealer or person receiving a selling concession, fee or other remuneration that purchases the Notes from it during the restricted period a confirmation or notice to substantially the foregoing effect.

Each purchaser of a Note, by its acceptance thereof, will be deemed to have acknowledged, represented to and agreed with the Republic and the Joint Lead Managers as follows:

(a) It understands and acknowledges that the Notes have not been registered under the Securities Act or any other applicable securities law, and that the Notes are being offered for sale in transactions not requiring registration under the Securities Act or any other securities laws, including sales pursuant to Rule 144A and Regulation S and, unless so registered, may not be offered, sold or otherwise transferred except in compliance with the registration requirements of the Securities Act or any other applicable securities laws, pursuant to an exemption therefrom or pursuant to a transaction not subject thereto.

(b) It is either (i) a QIB and is aware that any sale of the Notes to it will be made in reliance on Rule 144A and it is acquiring the Notes for its own account or for the account of another QIB with respect to which it exercises full investment discretion, or (ii) it is not a U.S. person (as defined in Regulation S) or purchasing for the account or benefit of a U.S. person and is purchasing the Notes in an offshore transaction (as defined in Regulation S) in accordance with Regulation S.

(c) It is purchasing the Notes for its own account or for the account of investors meeting the requirements of paragraph (b) above for which it is acting as a fiduciary or agent and with respect to which it has the authority to make these acknowledgements, representations and agreements, in each case not with a view to, or for offer or sale in connection with, any distribution thereof in violation of the Securities Act.

(d) If it is a QIB purchasing the Notes pursuant to Rule 144A, it will not offer, sell, pledge or otherwise transfer the Notes except (i) (A) to the Republic, (B) to a person whom the purchaser reasonably believes is a QIB in a transaction meeting the requirements of Rule 144A, (C) in an offshore transaction complying with Rule 903 or Rule 904 of Regulation S or (D) in a transaction that is otherwise exempt from the registration requirements of the

Securities Act but only upon delivery to the Republic of an opinion of counsel in form and scope satisfactory to the Republic and (ii) in accordance with all applicable securities laws of the States of the United States.

(e) It acknowledges that certificates in respect of Notes purchased pursuant to Rule 144A, unless otherwise agreed by the Republic, will bear a legend to the following effect:

THE SECURITIES REPRESENTED HEREBY HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE SECURITIES ACT). THE HOLDER HEREOF, BY PURCHASING THE NOTES IN RESPECT OF WHICH THIS CERTIFICATE IS ISSUED, AGREES, FOR THE BENEFIT OF THE REPUBLIC, THAT SUCH NOTES MAY BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED ONLY (A)(1) TO THE REPUBLIC, (2) IN COMPLIANCE WITH RULE 144A UNDER THE SECURITIES ACT TO A PERSON THAT THE HOLDER REASONABLY BELIEVES IS A QUALIFIED INSTITUTIONAL BUYER WITHIN THE MEANING OF RULE 144A UNDER THE SECURITIES ACT PURCHASING FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER WHOM THE HOLDER HAS INFORMED, IN EACH CASE, THAT THE OFFER, SALE, PLEDGE OR OTHER TRANSFER IS BEING MADE IN RELIANCE ON RULE 144A, (3) IN AN OFFSHORE TRANSACTION COMPLYING WITH RULE 903 OR 904 OF REGULATION S UNDER THE SECURITIES ACT, OR (4) IN A TRANSACTION THAT IS OTHERWISE EXEMPT FROM THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT BUT ONLY UPON DELIVERY TO THE REPUBLIC OF AN OPINION OF COUNSEL IN FORM AND SCOPE SATISFACTORY TO THE REPUBLIC; AND (B) IN COMPLIANCE WITH ALL APPLICABLE SECURITIES LAWS OF THE STATES OF THE UNITED STATES.

It acknowledges that certificates in respect of Notes purchased pursuant to Regulation S, unless otherwise agreed by the Republic, will bear a legend to the following effect:

THIS NOTE HAS NOT BEEN AND WILL NOT BE REGISTERED UNDER THE US SECURITIES ACT OF 1933, AS AMENDED (THE SECURITIES ACT), OR WITH ANY SECURITIES REGULATORY AUTHORITY OF ANY STATE OR OTHER JURISDICTION OF THE UNITED STATES AND MAY NOT BE OFFERED OR SOLD, PLEDGED OR OTHERWISE TRANSFERRED WITHIN THE UNITED STATES EXCEPT PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT

Each purchaser further acknowledges that the Joint Lead Managers and their affiliates and otherwise will rely upon the truth and accuracy of the foregoing acknowledgements, representations and agreements. If it is acquiring any Restricted Global Certificates for the account of one or more QIBs, the purchaser thereof represents that it has sole investment discretion with respect to each such account and that it has full power to make the foregoing acknowledgements, representations and agreements on behalf of each such account.

United Kingdom

Each Joint Lead Manager has represented and agreed that:

(a) it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of Section 21 of the FSMA) received by it in connection with the issue or sale of the Notes in circumstances in which Section 21(1) of the FSMA does not apply to the Republic; and

(b) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Notes in, from or otherwise involving the United Kingdom.

Croatia

Each Joint Lead Manager has represented and agreed that it will not, as part of its initial distribution, offer or sell any Notes to residents of the Republic of Croatia or legal entities incorporated in the Republic of Croatia unless such residents or legal entities are authorised or licensed under Croatian law to acquire, hold, manage or dispose of the Notes on the date of their Offer.

General

No action has been taken by the Republic or any of the Joint Lead Managers that would, or is intended to, permit a public offer of the Notes in any country or jurisdiction where any such action for that purpose is required. Accordingly, each Joint Lead Manager has undertaken that it will not, directly or indirectly, offer or sell any Notes or distribute or publish any offering circular, prospectus, form of application, advertisement or other document or information in any country or jurisdiction except under circumstances that will, to the best of its knowledge and belief, result in compliance with any applicable laws and regulations and all offers and sales of Notes by it will be made on the same terms.

TRANSFER RESTRICTIONS

Due to the following significant transfer restrictions applicable to the notes, investors are advised to consult legal counsel prior to making any reoffer, resale, pledge, transfer or disposal of the Notes.

The Notes have not been registered under the Securities Act, and may not be offered or sold in the United States or to, or for the account or benefit of, U.S. persons (as defined in Regulation S under the Securities Act) except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act. Accordingly, the Notes are being offered and sold (1) in the United States only to persons reasonably believed to be "qualified institutional buyers," which are referred to as QIBs, as defined in Rule 144A under the Securities Act in compliance with Rule 144A and (2) to persons outside the United States ("**foreign purchasers**") in offshore transactions pursuant to Regulation S under the Securities Act.

By its purchase of Notes, each purchaser of Notes will be deemed to:

(a) represent that it is purchasing the Notes for its own account or an account with respect to which it exercises sole investment discretion and that it and any such account is (i) a QIB, and is aware that the sale to it is being made in reliance on Rule 144A or (ii) a foreign purchaser that is outside the United States;

(b) acknowledge that the Notes have not been registered under the Securities Act and may not be offered or sold within the United States except as set forth below;

(c) if it is a person other than a foreign purchaser outside the United States after the expiration of the distribution compliance period, agree that if it should resell or otherwise transfer the Notes within the time period referred to in Rule 144 under the Securities Act after the original issuance of the Notes, it will do so only (i) to the Issuer, (ii) to a QIB in compliance with Rule 144A, (iii) outside the United States in an offshore transaction in compliance with Rule 903 or 904 of Regulation S under the Securities Act, (iv) pursuant to the exemption from registration provided by Rule 144 under the Securities Act (if available) but only upon delivery to the Issuer of an opinion of counsel in form and scope satisfactory to the Issuer or (v) pursuant to an effective registration statement under the Securities Act. Subject to the procedures set forth in the Agency Agreement, prior to any proposed transfer of the Notes (other than pursuant to an effective registration statement) within the time period referred to in Rule 144 under the Securities Act after the original issuance of the Notes, the holder thereof must check the appropriate box set forth on the reverse of its Notes relating to the manner of such transfer and submit the Notes to the Fiscal Agent;

(d) agree that it will deliver to each person to whom it transfers Notes notice of any restriction on transfer of such Notes;

(e) understand and agree that Notes initially offered in the United States to QIBs will be represented by one or more Restricted Global Certificates and that Notes offered outside the United States in offshore transactions pursuant to Regulation S will be represented by one or more Unrestricted Global Certificates;

(f) understand that unless registered under the Securities Act, the Notes (other than those issued to foreign purchasers after expiration of the distribution compliance period) will bear a legend to the following effect, unless otherwise agreed by the Issuer and the holder thereof:

THE NOTES REPRESENTED HEREBY HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE SECURITIES ACT), OR ANY SECURITIES LAW OF ANY STATE IN THE UNITED STATES OF AMERICA, AND MAY NOT BE REOFFERED, RESOLD, PLEDGED OR OTHERWISE TRANSFERRED EXCEPT AS PERMITTED BY THE FOLLOWING SENTENCES. THE HOLDER HEREOF, BY PURCHASING THE NOTES IN RESPECT OF WHICH THIS CERTIFICATE IS ISSUED, ACKNOWLEDGES AND AGREES, FOR THE BENEFIT OF THE ISSUER, THAT SUCH NOTES MAY BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED ONLY (A)(l) TO THE ISSUER, (2) IN COMPLIANCE WITH RULE 144A UNDER THE SECURITIES ACT TO A PERSON THAT THE HOLDER REASONABLY BELIEVES IS A QUALIFIED INSTITUTIONAL BUYER WITHIN THE MEANING OF RULE 144A UNDER THE SECURITIES ACT PURCHASING FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER WHOM THE HOLDER HAS INFORMED, IN EACH CASE, THAT THE OFFER, SALE, PLEDGE OR OTHER TRANSFER IS BEING MADE IN RELIANCE ON RULE 144A, (3) IN AN OFFSHORE TRANSACTION COMPLYING WITH RULE 903 OR 904 OF REGULATION S UNDER THE SECURITIES ACT, OR (4) IN A TRANSACTION THAT IS OTHERWISE EXEMPT FROM THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT BUT ONLY IF AVAILABLE AND

UPON DELIVERY TO THE ISSUER OF AN OPINION OF COUNSEL IN FORM AND SCOPE SATISFACTORY TO THE ISSUER; AND (B) IN EACH CASE IN COMPLIANCE WITH ALL APPLICABLE SECURITIES LAWS OF THE STATES OF THE UNITED STATES;

(g) acknowledge that the Issuer and the Joint Lead Managers will rely upon the truth and accuracy of the foregoing acknowledgments, representations and agreements, and agree that if any of the acknowledgments, representations or warranties deemed to have been made by it by its purchase of Notes are no longer accurate, it shall promptly notify the Issuer and the Joint Lead Managers; and

(h) if it is acquiring Notes as a fiduciary or agent for one or more investor accounts, represent that it has sole investment discretion with respect to each such account and it has full power to make the foregoing acknowledgments, representations and agreements on behalf of each such account.

GENERAL INFORMATION

Authorisation

The Republic has obtained all necessary consents, approvals and authorisations in the Republic of Croatia in connection with the issue and performance of the Notes. The issue of the Notes was authorised pursuant to the resolution of the Government of the Republic of Croatia dated 13 July 2010, passed in accordance with the Law on Execution of the Budget of the Republic of Croatia for the year 2010 (*Narodne novine* No. 151/09).

Listing and Admission to Trading

Application has been made to the CSSF to approve this document as a prospectus. Application has also been made to the Luxembourg Stock Exchange for the Notes to be admitted to trading on the Luxembourg Stock Exchange's regulated market and to be listed on the Official List of the Luxembourg Stock Exchange. The Luxembourg Stock Exchange's regulated market is a regulated market for the purposes of the Markets in Financial Instruments Directive (Directive 2004/39/EC).

The total expenses related to the admission to trading of the Notes are approximately €8,800.

Clearing Systems

Application has been made for acceptance of the Restricted Global Certificates into DTC's book-entry settlement system. The Unrestricted and Restricted Global Certificates have been accepted for clearance through Euroclear and Clearstream, Luxembourg. The ISIN for the Unrestricted Global Certificates is XS0525827845 and for the Restricted Global Certificates is US226775AC83. The Common Code for the Unrestricted Global Certificates is 052582784 and for the Restricted Global Certificates is 052571707. The CUSIP number for the Restricted Global Certificates is 226775AC8.

No significant change

There has been no significant change in the tax and budgetary systems, gross public debt, foreign trade and balance of payments, foreign exchange reserves, financial position and resources and income and expenditure figures of the Republic since 31 December 2009.

Litigation

The Republic is not, nor has it been involved in any governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the Republic is aware) in the 12 months preceding the date of this document which may have or have in such period had a significant effect on the financial position of the Republic.

Documents

For the period of 12 months following the date of this Prospectus, copies (and certified English translations where the documents in question are not in English) of the following documents will be available for inspection during usual business hours on any weekday (Saturdays, Sundays and public holidays excepted) from the specified office of the Paying Agent for the time being in Luxembourg:

(a) the Subscription Agreement;

(b) the Agency Agreement which includes the forms of the Global Notes;

(c) the resolution of the Government of the Republic of Croatia dated 13 July 2010 authorising the issue of the Notes; and

(d) the budget of the Republic for the current fiscal year.

In addition, copies of this Prospectus are available on the Luxembourg Stock Exchange's website at www.bourse.lu.

Joint Lead Managers transacting with the Republic

Certain of the Joint Lead Managers and their affiliates have engaged, and may in the future engage, in investment banking and/or commercial banking transactions with, and may perform services to the Republic and its affiliates in the ordinary course of business.

Yield

On the basis of the issue price of the Notes of 99.102 per cent. of their principal amount, the yield on the Notes is 6.75 per cent. on an annual basis.

Third Party Information

The Issuer confirms that where information included in this Prospectus has been sourced from a third party, that information has been accurately reproduced and that as far as the Issuer is aware and is able to ascertain from information published by that third party, no facts have been omitted which would render the reproduced information inaccurate or misleading.

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