



REPUBLIC OF CROATIA
€1,500,000,000 1.125 per cent. Notes due 2029

Issue price: 98.148 per cent.

The issue price of the €1,500,000,000 1.125 per cent. Fixed Rate Notes due 2029 (the "**Notes**") issued by the Republic of Croatia (the "**Issuer**", the "**Republic**" or "**Croatia**"), will be 98.148 per cent. of their principal amount. The Notes will mature on 19 June 2029 at their principal amount.

The Notes will be in registered form in denominations of €100,000 and integral multiples of €1,000 in excess thereof. Interest on the Notes will accrue at the rate of 1.125 per cent. per annum from and including 19 June 2019 and will be payable in Euro annually in arrear on 19 June in each year, commencing on 19 June 2020. Payments on the Notes will be made without withholding or deduction for or on account of taxes imposed by the Issuer except to the extent described under "*Terms and Conditions of the Notes — Taxation*".

This Offering Circular neither constitutes a prospectus pursuant to Part II of the Luxembourg law on prospectuses for securities (*loi relative aux prospectus pour valeurs mobilières*) dated 10 July 2005 (the "**Luxembourg Act**") which implements Directive 2003/71/EC (as amended or superseded), and includes any relevant implementing measure in a relevant Member State of the European Economic Area (the "**Prospectus Directive**") nor a simplified prospectus pursuant to Part III of the Luxembourg Act. Accordingly, this Offering Circular does not purport to meet the format and the disclosure requirements of the Prospectus Directive and Commission Regulation (EC) No. 809/2004 implementing the Prospectus Directive, and it has not been, and will not be, submitted for approval to any competent authority within the meaning of the Prospectus Directive and in particular the Supervisory Commission of the Financial Sector (*Commission de Surveillance du Secteur Financier*), in its capacity as competent authority under the Luxembourg Act.

The Issuer is rated Ba2 (positive outlook) by Moody's Investors Service, Inc. ("**Moody's**"), BBB- (stable outlook) by S&P Global Ratings Europe Ltd. ("**S&P**"), and the Issuer has a long term foreign currency issuer default rating of BBB- (positive outlook) by Fitch Ratings Ltd. ("**Fitch**"). The Notes will be rated Ba2 by Moody's, BBB- by S&P, and BBB- by Fitch. 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. As at the date of this Offering Circular, S&P and Fitch are established in the European Union and is registered under Regulation (EU) No 1060/2009 (as amended) (the "**CRA Regulation**"). Moody's is not established in the EEA but the rating it has given to the Notes is endorsed by Moody's Investors Service, Ltd, which is established in the EEA and registered under the CRA Regulation. As such, each of the rating agencies is included in the list of credit rating agencies published by the European Securities and Markets Authority ("**ESMA**") on its website in accordance with such Regulation. In general, European regulated investors are restricted under the CRA Regulation from using credit ratings for regulatory purposes, unless such ratings are issued by a credit rating agency established in the EU and registered under the CRA Regulation (and such registration has not been withdrawn or suspended), subject to transitional provisions that apply in certain circumstances whilst the registration application is pending. Such general restriction will also apply in the case of credit ratings issued by non EU credit rating agencies, unless the relevant credit ratings are endorsed by an EU registered credit rating agency or the relevant non EU rating agency is certified in accordance with the CRA Regulation (and such endorsement action or certification, as the case may be, has not been withdrawn or suspended). The list of registered and certified rating agencies published by ESMA on its website in accordance with the CRA Regulation is not conclusive evidence of the status of the relevant rating agency included in such list, as there may be delays between certain supervisory measures being taken against a relevant rating agency and the publication of the updated ESMA list. Certain information with respect to the credit rating agencies and ratings is set out in the sections entitled "*There can be no assurance that Croatia's credit ratings will not change*" and "*Credit Ratings may not reflect all risks*" of this Offering Circular.

The Notes have not been and will not be registered under the United States Securities Act of 1933, as amended (the "**Securities Act**"), or any state securities law, and may not be offered or sold within the United States except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act.

MIFID II product governance / Professional investors and eligible counterparties only target market – Solely for the purposes of each manufacturer's product approval process, the target market assessment in respect of the Notes has led to the conclusion that: (i) the target market for the Notes is eligible counterparties and professional clients only, each as defined in Directive 2014/65/EU (as amended, "**MiFID II**"); and (ii) all channels for distribution of the Notes to eligible counterparties and professional clients are appropriate. Any person subsequently offering, selling or recommending the Notes (a "**distributor**") should take into consideration the manufacturers' target market assessment; however, a distributor subject to MiFID II is responsible for undertaking its own target market assessment in respect of the Notes (by either adopting or refining the manufacturer's target market assessment) and determining appropriate distribution channels.

The Notes will initially be represented by a global certificate (the "**Global Certificate**"), in registered form, without interest coupons attached and will be registered in the name of a nominee of a common safekeeper for Clearstream Banking S.A. ("**Clearstream, Luxembourg**") and Euroclear Bank SA/NV ("**Euroclear**"), on or about 19 June 2019 (the "**Closing Date**"). The Notes will be issued in the New Safekeeping Structure ("**NSS**"). This means that the Notes are intended to be registered in the name of a nominee of a common safekeeper for Euroclear and Clearstream, Luxembourg and does not necessarily mean that the Notes will be recognised as eligible collateral for Eurosystem monetary policy and intra-day credit operations by the Eurosystem either upon issue or at any or all times during their life. Such recognition will depend upon satisfaction of the Eurosystem eligibility criteria established by the European Central Bank from time to time.

An investment in the Notes involves certain risks. See "*Risk Factors*" for a discussion of certain factors that should be considered in connection with an investment in the Notes.

Joint Lead Managers

CITIGROUP

ERSTE GROUP BANK AG

J.P. MORGAN

17 June 2019

THE REPUBLIC OF CROATIA



The Issuer accepts responsibility for the information contained in this Offering Circular. To the best of the knowledge of the Issuer (having taken all reasonable care to ensure that such is the case) the information contained in this Offering Circular is in accordance with the facts and does not omit anything likely to affect the import of such information. The Issuer, having made all reasonable enquiries, confirms that this Offering Circular contains all information with respect to the Issuer and the Notes which is material in the context of the issue and offering of the Notes, that the information contained in this Offering Circular is true and accurate in every material respect and is not misleading, that the opinions and intentions expressed in this Offering Circular are honestly held and that there are no other facts the omission of which makes misleading any statement herein, whether of fact or opinion.

No person has been authorised in connection with the offering of the Notes to give any information or make any representation regarding the Issuer or the Notes other than as contained in this Offering Circular. Any such representation or information should not be relied upon as having been authorised by the Issuer or any agency thereof or the Joint Lead Managers (as defined under "Subscription and Sale"). Neither the delivery of this Offering Circular nor any sales made in connection with the issue of the Notes shall, under any circumstances, constitute a representation that there has been no change in the affairs of the Issuer since the date hereof.

The Joint Lead Managers make no representation or warranty, express or implied, as to the accuracy or completeness of the information in this Offering Circular. Each person receiving this Offering Circular acknowledges that such person has not relied on any Joint Lead Manager or any person affiliated with any Joint Lead Manager in connection with its investigation of the accuracy of such information or its investment decision. Each person contemplating making an investment in the Notes must make its own investigation and analysis of the creditworthiness of the Issuer and its own determination of the suitability of any such investment, with particular reference to its own investment objectives and experience, and any other factors which may be relevant to it in connection with such investment.

This Offering Circular does not constitute an offer of, or an invitation by or on behalf of the Issuer or any agency thereof or any Joint Lead Manager to subscribe or purchase, any of the Notes. The distribution of this Offering Circular and the offering of the Notes in certain jurisdictions may be restricted by law. Persons into whose possession this Offering Circular comes are required by the Joint Lead Managers to inform themselves about and to observe any such restrictions. For a description of certain further restrictions on offers and sales of Notes and distribution of this Offering Circular, see "Subscription and Sale".

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:

- (i) 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 Offering Circular or any applicable supplement;*
- (ii) 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;*
- (iii) 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;*
- (iv) understand thoroughly the terms of the Notes and be familiar with the behaviour of any relevant financial markets; and*
- (v) 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.*

In this Offering Circular, all references to "HRK" and "kuna" are to the lawful currency for the time being of the Issuer, all references to "€", "EUR", "euro" and "Euro" are to the currency introduced at the start of the third stage of European economic and monetary union pursuant to the Treaty on the Functioning of the European Union, all references to "U.S. dollars", "US\$" and "U.S.\$" are to the lawful currency for the time being of the United States of America and all references to "CHF" or "Swiss franc" are to Swiss Francs. Certain amounts which appear in this Offering Circular have been subject to rounding adjustments; accordingly, figures shown as totals may not be an arithmetic aggregation of the figures which precede them.

IN CONNECTION WITH THE ISSUE OF THE NOTES, J.P. MORGAN SECURITIES PLC AS STABILISATION MANAGER (THE "**STABILISATION MANAGER**") (OR PERSONS ACTING ON BEHALF OF THE STABILISATION 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, STABILISATION MAY NOT NECESSARILY OCCUR. 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 CEASE AT ANY TIME, BUT IT MUST END NO LATER THAN THE EARLIER OF 30 DAYS AFTER THE ISSUE 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 STABILISATION MANAGER (OR PERSONS ACTING ON BEHALF OF THE STABILISATION MANAGER) IN ACCORDANCE WITH ALL APPLICABLE LAWS AND RULES.

EXCHANGE RATES

The following table sets forth for the periods indicated, the average monthly rates published by the Croatian National Bank (Hrvatska narodna banka) (the "HNB"), expressed as kuna per Euro.

	2014	2015	2016	2017	2018	2019
	(HRK/EUR)					
January	7.629820	7.679826	7.652777	7.534989	7.440202	7.424741
February	7.654972	7.709544	7.636668	7.450718	7.434137	7.411951
March	7.654440	7.648124	7.566498	7.419710	7.436512	7.416254
April	7.627459	7.594858	7.494619	7.441166	7.418312	7.426090
May	7.593665	7.553892	7.494223	7.433633	7.388816	7.413388
June	7.573554	7.565026	7.511915	7.405667	7.376993	
July	7.599809	7.579293	7.489517	7.405674	7.388817	
August	7.626000	7.554396	7.477713	7.398765	7.412997	
September	7.618519	7.574467	7.490070	7.450196	7.422715	
October	7.650459	7.622835	7.502932	7.501332	7.418863	
November	7.663895	7.598376	7.513263	7.544639	7.425220	
December	7.667075	7.634682	7.534257	7.543915	7.401281	
Yearly average	7.630014	7.609601	7.529383	7.460100	7.414111	

Source: HNB

Croatia has a managed floating exchange rate regime, 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 HNB does not predetermine the floor or the ceiling level of the exchange rate that it attempts to maintain or the level at which it will necessarily intervene. However, the HNB attempts to prevent excessive exchange rate volatility by occasional market interventions or by other monetary policy instruments that influence the foreign exchange market or money market conditions such as open market operations and reserve requirements, among others. The HNB aims to maintain the stability of the EUR/HRK exchange rate in order to meet its primary objective of maintaining price stability 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 significantly impact household inflationary expectations. The effect of this is augmented by the population's sensitivity to inflation as a result of hyperinflation episodes in the former Yugoslavia and in the early 1990s.

In 2015, the nominal EUR/HRK exchange rate appreciated mildly. The daily kuna/euro exchange rate moved within a rather narrow range from -1.1 per cent. to 1.5 per cent. around an average annual exchange rate of HRK 7.61 to EUR 1, appreciating by 0.3 per cent. from 2014. At the beginning of 2015, depreciation pressures appeared on the EUR/HRK exchange rate. This was due to the adjustment of bank currency positions as a result of the Government's decision to fix the CHF/HRK exchange rate for Swiss franc indexed loans. In order to prevent further depreciation of the EUR/HRK exchange rate, the HNB intervened twice on the foreign exchange market during January 2015 and February 2015 by selling EUR 498.9 million worth of foreign currency to banks. Depreciation pressures appeared again during September 2015, mainly as a result of the adopted amendments to the Consumer Credit Act and the Credit Institutions Acts that enabled conversion of the Swiss franc indexed loans to euro loans. The HNB intervened on the foreign exchange market to prevent further depreciation of the EUR/HRK exchange rate at the end of September 2015, by selling EUR 268.3 million worth of foreign currency to banks. The daily kuna/euro exchange rate was stable during the last quarter of 2015. At the end of December 2015, it stood at HRK 7.64 to EUR 1, an appreciation of only 0.3 per cent. from the end of 2014.

In 2015, the HNB intervened three times on the foreign exchange market by selling a total amount of EUR 767.2 million worth of foreign currency to banks. When transactions with the European Commission and the central Government are included (net foreign purchase of EUR 935.1 million), total foreign exchange transactions of the HNB resulted in a net foreign exchange purchase in the amount of EUR 167.9 million and the creation of HRK 1.2 billion.

In 2016, appreciation of the nominal EUR/HRK exchange rate continued. The daily kuna/euro exchange rate moved within a range from -0.9 per cent. to 1.8 per cent. around an average annual exchange rate of HRK 7.53 to EUR 1, appreciating by 1.1 per cent. from 2015. This was mostly attributable to the continuation of the surplus in the current account of the balance of payments, stronger inflows of EU

funds, increase in demand for kuna denominated loans (mostly from households) and a slowdown in credit institutions' deleveraging.

The HNB intervened on the foreign exchange market several times in 2016 to prevent stronger appreciation of the EUR/HRK exchange rate by buying a total amount of EUR 1,018.8 million worth of foreign currency from banks. It purchased EUR 83.5 million in May 2016, EUR 69.0 million in September 2016 and EUR 866.3 million in December 2016 (EUR 716.3 million in two foreign exchange auctions and EUR 150.0 million out of auction).

Total foreign exchange transactions of the HNB in 2016 resulted in a net foreign exchange purchase in the amount of EUR 866.6 million (creating HRK 6.5 billion of reserve money). The HNB purchased EUR 1,018.8 million from banks and EUR 125.6 million from the central Government and sold EUR 277.8 million to the European Commission.

During the first eight months of 2017, appreciation of the nominal EUR/HRK exchange rate continued. This trend reversed in September when the nominal EUR/HRK exchange rate started to depreciate. By the end of 2017 it returned to a level similar to the one observed at the beginning of the year. The daily kuna/euro exchange rate moved within a range from -1.0 per cent. to 1.5 per cent. around an average exchange rate of HRK 7.46 to EUR 1. By 31 December 2017, the EUR/HRK exchange rate appreciated by 0.6 per cent., from HRK 7.56 to EUR 1 at the end of 2016 to HRK 7.51 to EUR 1.

The HNB intervened in the foreign exchange market several times in 2017 to alleviate appreciation pressures on the EUR/HRK exchange rate by buying a total amount of EUR 1,757.0 million worth of foreign currency from banks. It purchased EUR 424.0 million in June 2017 (EUR 374.0 million in two foreign exchange auctions and EUR 50.0 million out of auction), EUR 101.5 million in July 2017, EUR 126.0 million in August 2017, EUR 120.0 million out of auction in September 2017, EUR 80.0 million out of auction in October, EUR 40.0 million out of auction in November 2017 and EUR 765.5 million in December 2017 (EUR 345.5 million in a foreign exchange auction and EUR 420.0 million out of auction). Data for 2017 also includes a direct purchase of foreign exchange from banks outside auctions of EUR 100.0 million on 29 December 2016, as the value date of that transaction was 2 January 2017.

Total foreign exchange transactions of the HNB during 2017 resulted in a net foreign exchange purchase of EUR 1,787.6 million (creating HRK 13.4 billion of reserve money). The HNB purchased EUR 1,757.0 million from banks and EUR 30.6 million from the central Government. There were no transactions done with the European Commission.

In 2018, appreciation of the nominal EUR/HRK exchange rate continued. The nominal daily kuna/euro exchange rate moved within a rather narrow range from -0.6 per cent. to 1.3 per cent. with an average annual exchange rate of around HRK 7.41 to EUR 1, appreciating by 0.6 per cent. from 2017. In 2018, HNB intervened on the foreign exchange market by buying a total amount of EUR 1,808.9 million worth of foreign currency from banks and EUR 30.4 million worth of foreign currency from the central Government (creating HRK 13.6 billion of reserve money). There were no transactions done with the European Commission.

During the first four months of 2019, the nominal EUR/HRK exchange rate appreciated mildly, from HRK 7.42 to EUR 1 at the end of 2018 to HRK 7.41 to EUR 1 at the end of April 2019. At the beginning of February, somewhat stronger appreciation pressures appeared so the HNB intervened in the foreign exchange market by buying a total amount of EUR 450.3 million worth of foreign currency from banks. During the first four months of 2019, the HNB also sold EUR 452.0 million worth of foreign currency to central Government. There were no transactions done with the European Commission.

The following table sets forth the period end, average, high and low official mid-point rates, expressed as kuna per U.S. dollar:

	Period End	Average ⁽¹⁾	High	Low
2014	6.302107	5.749322	6.302107	5.44043
2015	6.991801	6.862262	7.258268	6.299529
2016	7.168536	6.803718	7.247732	6.479354
2017	6.269733	6.622397	7.260492	6.154188
2018	6.469192	6.278406	6.604879	5.948045
January 2019	6.496932	6.503106	6.556329	6.439358
February 2019	6.517828	6.527974	6.569177	6.467111
March 2019	6.610040	6.554411	6.614007	6.503872
April 2019	6.641671	6.606620	6.663806	6.568564

Source: HNB

Note: Calculations based on mid exchange rate.

⁽¹⁾ Average of daily rates.

The kuna depreciated significantly against the U.S. dollar in 2014, mainly reflecting movements in the global foreign exchange markets during the second half of the year, due to the strengthening of the U.S. dollar against the euro. The U.S.\$/HRK exchange rate depreciated by 13.6 per cent. in 2014, from U.S.\$/HRK 5.55 at the end of 2013 to U.S.\$/HRK 6.30 at the end of 2014. In 2015, depreciation of the kuna against the U.S. dollar continued, mainly as a result of the strengthening of the U.S. dollar against the euro on the global foreign exchange markets. At 31 December 2015, the exchange rate stood at U.S.\$/HRK 6.99, depreciating by 10.9 per cent. from the end of 2014. Depreciation of the kuna against the U.S. dollar continued in 2016, reflecting the strengthening of the U.S. dollar against the euro on the global foreign exchange markets. In such an environment, the U.S.\$/HRK exchange rate depreciated by 2.5 per cent. in 2016 and stood at U.S.\$/HRK 6.99 at the end of 2015 to U.S.\$/HRK 7.17 at the end of 2016.

In 2017, the kuna appreciated significantly against the U.S. dollar, mainly reflecting movements in the global foreign exchange markets, due to the weakening of the U.S. dollar against the euro. By 31 December 2017, the U.S.\$/HRK exchange rate appreciated by 12.5 per cent., from U.S.\$/HRK 7.17 at the end of 2016 to U.S.\$/HRK 6.27 at the end of 2017. In 2018, the U.S.\$/HRK exchange rate depreciated by 3.2 per cent., from U.S.\$/HRK 6.27 at the end of 2017 to U.S.\$/HRK 6.47 at the end of 2018. During the first four months of 2019, depreciation of the kuna against the U.S. dollar continued, as a result of the strengthening of the U.S. dollar against the euro on the global foreign exchange markets. At 30 April 2019, the exchange rate stood at U.S.\$/HRK 6.64, depreciating by 2.7 per cent compared to the level observed at the end of 2018.

After unfavourable trends in 2013, the indicators of Croatian export price competitiveness improved again in 2014. The average real effective kuna exchange rate deflated by producer prices continued to depreciate at a broadly similar pace compared to the previous year. In 2015, depreciation continued at its fastest pace since 2010 (by 3.8 per cent.), mostly due to the nominal effective depreciation of the kuna. In contrast, after appreciating during 2013, the average real effective kuna exchange rate deflated by consumer prices depreciated in 2014. This mainly reflected price developments in Croatia relative to Croatia's main trading partners, thus returning to its 2012 level. In 2015, a combination of the kuna nominal effective depreciation and favourable price developments in Croatia relative to its main trading partners contributed to further depreciation of the real effective kuna exchange rate deflated by consumer prices (by 4.3 per cent.). Overall, the indicators of Croatian export price competitiveness reveal mixed developments in 2016. The average real effective kuna exchange rate deflated by producer prices was broadly stable during 2016, with more favourable domestic price developments (relative to main trading partners) offsetting nominal effective appreciation of the kuna. In contrast, the average real effective kuna exchange rate deflated by consumer prices, appreciated mildly. Both indicators of Croatian export price competitiveness deteriorated slightly during 2017. This was due to the appreciation of the kuna's nominal effective exchange rate, which was only partly alleviated by the relatively favourable domestic price trends. In 2018, the real effective exchange rates of the kuna deflated by consumer and producer prices depreciated slightly, due to the appreciation of the kuna's nominal effective exchange rate, which was only partly alleviated by the relatively favourable domestic price trends. In the years before the crisis, the kuna real effective exchange rate indices deflated by unit labour costs in the whole economy and in industry were signalling deterioration of cost competitiveness due to the nominal effective appreciation of the kuna as well as due to faster growth of unit labour costs in Croatia than in its main trading partners. These negative trends reversed in 2009, 2010, 2011 and 2012 when kuna real effective exchange rate indices, deflated by unit labour costs, depreciated. The real effective kuna exchange rate, deflated by unit labour costs, in the whole economy continued to depreciate in 2013 and 2014 but at a much slower pace compared to 2012. In 2015, the real effective kuna exchange rate deflated by unit labour costs in the whole economy and in industry depreciated further, with the

former depreciating even faster than the year before. In 2016, depreciation of the real effective kuna exchange rate, deflated by unit labour costs, continued, both in the whole economy and in industry, although at a slower pace. In 2017, depreciation of the real effective kuna exchange rate deflated by unit labour costs in the whole economy continued, at a similar pace. At the same time, the real effective kuna exchange rate deflated by unit labour costs in industry appreciated slightly, due to the nominal effective exchange rate appreciation of the kuna, which was only partly mitigated by relatively favourable domestic costs trends. In 2018, the real effective kuna exchange rate, deflated by unit labour costs in the whole economy, was broadly stable, with more favourable domestic cost developments (relative to main trading partners) offsetting nominal effective appreciation of the kuna. At the same time, the real effective kuna exchange rate deflated by unit labour costs in industry appreciated, due to the nominal effective exchange rate appreciation of the kuna and relatively unfavourable domestic costs trends.

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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 Offering Circular, 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 Croatia 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 Croatia or that Croatia currently deems to be immaterial may also materially affect Croatia'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 "Terms and Conditions of the Notes" or elsewhere in this Offering Circular have the same meanings in this section.

Risk Factors Relating to Croatia

Having acceded to the European Union ("EU") on the back of a raft of legal, economic, financial and other reforms and policies, Croatia is undergoing a period of transition which may adversely affect the Croatian economy and Croatia's ability to repay principal and make payments of interest on the Notes

On 1 July 2013, Croatia joined the EU and became its 28th member state. To facilitate this, the Government of Croatia (the "**Government**") introduced structural measures in 2012 and 2013 with the aim of strengthening the quality of public finances and bringing political, economic and judicial structures in line with EU requirements.

Croatia has also undergone and continues to undergo changes in legislation due to its EU accession. As a result, there is a lack of an established practice under many securities, tax and other regulatory regimes in Croatia and new regulations may be subject to contradictory, ambiguous or changing interpretations by the Croatian regulatory authorities. Consequently, companies operating in the region may face tax, securities and other regulatory compliance related risks that may be less predictable than in countries with more stable regulatory systems.

As a result of EU membership, Croatia may be eligible to receive financial assistance from EU structural funds pursuant to the EU Cohesion Policy. However, there is no guarantee that Croatia will meet the criteria to receive disbursements under these funds or that such funds would be available or the timing of any such disbursements (see "*The Economy — Economic Policy — EU Structural Funds*").

Following accession to the EU, Croatia's economy is exposed to increased competition with other EU Member States (a "**Member State**"). As part of its EU accession, Croatia also exited from the Central European Free Trade Agreement ("**CEFTA**") - a trade agreement between the non-EU countries in Southeast Europe, which previously accounted for a significant portion of Croatia's exports, particularly in the agriculture and food industries. Croatia's trade with its non-EU trade partners now relies on each country's respective Stabilisation and Association Agreement ("**SSA**"), which is each such country's bilateral trade agreement with the EU. Following accession to the EU, Croatia's trade with CEFTA countries declined, specifically in agro-food exports. In addition, as a result of EU accession Croatia is also required to significantly reduce the level of domestic subsidies to the agriculture sector (see "*The Economy — Government Subsidies*").

Croatia will be eligible to adopt the euro once it fulfils the necessary conditions, and will seek to enter the Exchange Rate Mechanism ("**ERM II**"), although the timing for completion of this process remains uncertain and is unlikely to be in the short term. Under ERM II, the exchange rate of a non-euro area Member State is fixed against the euro and is only allowed to fluctuate within set limits. Entry into ERM II is based on an agreement between the ministers and central bank governors of the non-euro area Member State and the euro area Member States, and the European Central Bank (the "**ECB**"). Entry into ERM II will be a step towards the full adoption of the euro in Croatia, in line with Croatia's commitment pursuant to the treaty for Croatia's accession into the EU (the "**Accession Treaty**"). On 27 May 2019, the Republic of Croatia submitted a request to the ECB for the establishment of a close cooperation between the ECB and the Croatian National Bank in the exercise of supervisory tasks over credit institutions within the Single Supervisory Mechanism ("**SSM**"). This step is part of the procedure for the entry of the Republic of Croatia to ERM II and, subsequently, to the euro area. The Republic of Croatia intends to concurrently enter into a

close cooperation with the ECB and into the ERM II, although no assurance can be made regarding the timing and conditions of Croatia's entry into the ERM II. Croatia's date of entry into ERM II and, subsequently, into the eurozone, will primarily depend on Croatia's macroeconomic indicators, i.e. its ability to fulfil a set of membership criteria which are more stringent than those applied to previous candidates. The policy measures required to meet such criteria, Croatia's entry into ERM II and adoption of the euro could each result in adverse macroeconomic effects on Croatia's economy and lead to lower rates of, or negative, economic growth.

Croatia's economy remains vulnerable to external shocks and internal economic challenges which could have an adverse effect on Croatia's economic growth and its ability to service its public debt

Croatia's economy remains vulnerable to external shocks, which negatively affected the Croatian economy, and the ongoing political turmoil in certain emerging markets as well as the continuing uncertainty regarding certain Member States.

As a result of the ongoing hostilities between Russia and Ukraine, which commenced in 2014, the EU and the United States have supported Ukraine and imposed trade restrictions and sanctions which continue to be in effect on certain persons and entities affiliated with Russia as well as on certain key sectors of the Russian economy. The restriction on EU exports of agricultural and food products to Russia have to date had a limited effect on Croatia. Nonetheless, the potential repercussions surrounding the situation are unknown. The emergence of new or escalated tensions in the region, or the imposition of further economic or other sanctions in response to such tensions, which may include targeted sanctions against certain industries, could negatively affect other economies in the region and the eurozone in general. Although Ukraine is not a material trading partner for Croatia, any contingent and ongoing escalation of the current tension in Ukraine may in turn have negative economic and geopolitical consequences for Europe as a whole and indirectly impact Croatia through its trading partners Austria and Germany and in turn impact the Croatian economy. Further, Croatia could be adversely affected by rising tensions in the EU and a subsequent slowdown in the EU economy as Croatia has various trade linkages within the EU (See "*Foreign Trade and International Balance of Payments – Geographical Distribution of Croatia's Trade in Goods*").

Croatia continues to face a number of economic challenges including low worker participation and deleveraging of the private sector. There can be no assurance that Croatia will return to the growth pattern experienced in the period from 2001 to 2008 given that it relied heavily on substantial inflows of foreign capital during this period. Even if the global economy continues to recover in the future, the recovery may not be sustained and may reverse. Unfavourable demographic trends (i.e. ageing population, emigration of skilled workers and/or declining workforce) could have negative implications for economic growth and fiscal policy. This could have a material adverse effect on Croatia's ability to repay principal and make payments of interest on the Notes and on Croatia's credit rating.

Croatia's economy remains vulnerable to external adverse economic and financial conditions including the impact of general "contagion" effects. These could have a material adverse effect on Croatia's economic growth

International investors' reactions to the events occurring in one market sometimes appear to demonstrate a "contagion" effect, in which an entire region or class of investment is disfavoured by international investors. Croatia could be adversely affected by negative economic or financial developments in neighbouring countries, EU countries or countries with similar credit ratings. While in recent years Croatia has reduced its external vulnerability and implemented sound macroeconomic policies, Croatia has been adversely affected by such contagion effects on a number of occasions, including following the 1998 Russian financial crisis and the 2008 global financial crisis. Similar developments can be expected to affect the Croatian economy in the future.

There can be no assurance that the factors such as those described above or similar events will not negatively affect investor confidence in markets such as Croatia. In addition, there can be no assurance that these events will not adversely affect Croatia's economy and its ability to raise capital in the external debt markets in the future.

The uncertainties surrounding the fallout from Agrokor could have a material adverse effect on Croatia's economic performance

In 2013, Croatia's privately held food and retail group Agrokor, acquired Mercator (a Slovenian retail company), creating one of the largest food and retail businesses in central and eastern Europe. During this

acquisition, Agrokor amassed significant debts to its creditors and suppliers, resulting in the need for increased liquidity from banks and bondholders.

Over-expansion backed by high leverage, led to an immediate need for a cash injection. In January 2017, Agrokor was unable to refinance and rating agencies downgraded its debt.

Subsequently, Agrokor (together with other companies from the Agrokor group) became subject to the newly passed Act on Emergency Administration in Companies of Systemic Importance for the Republic of Croatia that entered into force on 7 April 2017 and created a form of bankruptcy protection for systemic enterprises allowing for the procedure of extraordinary administration in companies that independently or together with their affiliates cumulatively fulfil the following conditions: (i) employ more than 5,000 employees in average in the calendar year preceding the year in which the application for opening the extraordinary administration procedure was submitted and (ii) whose liabilities amount to more than 7.5 billion kuna on the day of the submission of the application for opening the extraordinary administration procedure.

Due to the financial situation of Agrokor, the HNB asked banks to provision their Agrokor exposure by at least 50 per cent., impacting banks' profitability and reducing capital outflows in the form of profit dividends to their parents in 2017. Recent improvements in Croatia's banking sector including recovering profitability, increased lending and declining nonperforming loans could be impacted by Agrokor's financial stress. However, due to the banks' higher capitalisation levels they are better placed to withstand such an impact. Further, Agrokor's direct liabilities are mostly towards foreign banks and should therefore not affect the stability of the Croatian banking system.

Pursuant to the Act on Emergency Administration in Companies of Systemic Importance for the Republic of Croatia, Agrokor's outstanding debt obligations as of 9 Apr 2017 were frozen, interest accrual was discontinued and a 15-month period was set to satisfy the debt obligations. The settlement deal has now received majority lender consent. Restructuring efforts at Agrokor are underway and the potential fallout from the situation around Agrokor remains contained. Aside from a small dent in consumer confidence in the immediate aftermath of the Government installing an extraordinary commissioner at Agrokor, investments and consumption have held up over the course of 2017 and 2018. However, the uncertainties surrounding the fallout from Agrokor and the restructuring process could increase the vulnerability of the banking sector and could also 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.

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

A significant portion (approximately 75 per cent.) of Croatia's public external debt and domestic debt is denominated in or linked to foreign currencies. In addition, government guarantees are denominated in or linked to foreign currency. In the event of foreign currency fluctuations, and a depreciation of the kuna relative to the U.S. dollar, the euro or the Swiss franc, the negative impact on the service obligations in respect of the debt denominated in foreign currencies will likely not be offset by any positive impact on the service obligations in respect of debt denominated in kuna. Any significant depreciation 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. The HNB has intervened in the foreign currency as part of its policy of pursuing a stable euro/kuna exchange rate. The depreciation 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. (See "*Monetary Developments, International Reserves and Financial System — Monetary Policy and Instruments*").

The further proliferation of the euro in the Croatian economy may adversely affect the HNB'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 the kuna and has limited impact on other currencies including the euro, the further proliferation of the euro in the Croatian economy and widespread use of euro by the population may undermine the ability of the HNB to implement its monetary policies. Similarly, the policies of the ECB affecting the euro are likely to indirectly impact the Croatian economy. Any limitations on the ability of

the HNB 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 balance may deteriorate

Croatia's current account deficit has declined gradually since 2008 and recorded surpluses in each year since 2014. Nevertheless, as a small, open economy, Croatia's current account balance is significantly affected by its trade balance and any future negative changes in the trade balance and the current account balance could 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.

If Government revenue decreases, some or all of the Government's expenditure reduction plans prove insufficient, 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

Without an on-going and 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, revenue raising measures could prove inadequate. The Government's ability to make payments may become further affected by economic cyclical trends. Lower than expected growth would have a negative impact on budget revenue and would increase the Government deficit with resulting negative implications. Moreover, as noted above demographic trends, including an ageing population, are likely to limit the ability of the Croatian government to reduce expenditures.

Taken as a whole, reduced revenue, coupled with high 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.

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

The long term foreign and domestic currency debt of the Republic is currently rated BBB- (stable outlook) by S&P and Ba2 (positive outlook) by Moody's and BBB- (positive outlook) by Fitch. There can be no guarantee that the Republic will not experience credit downgrades or negative revisions to the outlook. Deterioration in key economic indicators or the materialisation of any of the risks discussed herein may contribute to credit rating downgrades. Any adverse changes in an applicable credit rating or credit rating outlook could adversely affect the trading price for the Notes. In addition, negative ratings action could adversely affect Croatia's ability to refinance existing indebtedness or finance its deficit and could affect payment of principal and interest under the Notes.

As at the date of this Offering Circular, S&P and Fitch are established in the European Union and are registered under Regulation (EU) No 1060/2009 (as amended) (the "CRA Regulation"). Moody's is not established in the European Economic Area ("EEA") but the rating it has given to the Notes is endorsed by Moody's Investors Service, Ltd, which is established in the EEA and registered under the CRA Regulation. 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.

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

Croatia has substantial amounts of internal and external public debt. As at 31 December 2018, general Government debt stood at HRK 284.7 billion (74.6 per cent. of GDP) and Government guarantees stood at HRK 6.3 billion (1.7 per cent. of GDP), for a total amount of HRK 291.0 billion or 76.3 per cent. of GDP (See "Public Debt – Overview"). As of 31 January 2019, the weighted average remaining maturity of external government debt was 6.3 years whereas the average maturity of the domestic public debt outstanding as at 31 December 2018 was 5.1 years. In recent years Croatia has been able to refinance its existing debt on favourable terms due to the historically low interest rate environment since the financial crisis. However, any increase in global or emerging market rates may impact Croatia's ability to refinance its debt on favourable or similar terms. Furthermore, contingent liabilities could crystallise and further increase Croatia's public debt. Accordingly, any negative change in external credit markets or material increase in Croatia's public debt could have a negative impact on Croatia's public debt position.

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

Private debt in Croatia has grown rapidly since the mid-2000s as corporate and household sectors accumulated a heavy debt burden. Household debt in Croatia as a proportion of GDP is one of the highest among Central and Eastern European countries. Non-performing loans increased considerably since the global financial crisis, from 4.8 per cent. in 2008 to 16.7 per cent. as at 31 December 2015. Although non-performing loans have decreased in recent years due to loan sales and collections, levels remain elevated with the share of non-performing loans 9.8 per cent at the end of 2018. Non-performing loans to enterprises remain particularly elevated and stood at 20.4 per cent. as at 31 December 2018. (See "Monetary Developments, International Reserves and Financial System — Loan Exposure").

Failure of private borrowers to repay or reschedule their debt may have a material adverse effect on the Croatian banking system and the Croatian economy. In turn, this may affect Croatia's ability to repay principal and make payments of interest on the Notes.

The high level of foreign ownership in the Croatian banking system makes it vulnerable to disruption as a result of internal or external factors

As at 31 December 2018, foreign banks owned approximately 90.2 per cent. of banks' assets in Croatia. The Croatian banking system is exposed to the banking systems of other European countries, including Italy (which owns approximately 46.8 per cent. of banks' assets in Croatia) and Austria (which owns approximately 30.5 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, including as a result of adverse economic developments in the Eurozone, negative factors impacting the sovereign debt markets and regulatory changes. In addition, foreign banks may decrease funding to their subsidiaries operating in Croatia due to actual or perceived deterioration in asset quality or performance, particularly in the event of weakening economic conditions and further increases in non-performing loans. Furthermore, foreign banks, after several years of deleveraging against foreign affiliated companies, caused the share of liabilities to parent banks in their total liabilities to drop significantly and this trend continues. Due to such trends, bank funding became less dependent on parent banks and increasingly reliant on domestic funding. 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 the kuna. Resulting balance sheet mismatches may negatively affect the Croatian economy and, as a result, have an adverse effect on 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 and otherwise have a material adverse effect on Croatia

Independent analysts have identified corruption and money laundering as continuing problems in Croatia. In the 2019 Transparency International Corruption Perceptions Index, Croatia ranked 60 out of 180 countries under review, with a score of 48/100 (Western Europe average: 66). Any future allegations or evidence of corruption or money laundering in Croatia may have a material 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 Croatia declared independence in 1991, the Croatian legal system has been evolving to support the country's transition to a market-based economy. Although, further to Croatia's accession to the EU, EU regulations have become an integral part of Croatia's legal system, and a significant part of EU directives has already been implemented in Croatian law, Croatia's legal system still 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, 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 may impact 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 its 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 interference in Croatia remains questionable. The application and interpretation of the Croatian Constitution (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 and the courts are generally not bound by earlier court decisions taken under the same or similar circumstances. This may result in an inconsistent application of Croatian legislation to resolve the same or similar disputes. Because legislation in a number of areas was adopted following independence and is still fairly recent, relevant judicial decisions may not be publicly available and, therefore, the role of judicial decisions as guidelines in interpreting applicable Croatian legislation to the public at large may be 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 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

Tourism contributes substantially to Croatia's GDP. Revenue generated by the tourism industry depends on various factors including consumer spending power, which generally is adversely affected by economic downturns, and public perception of the attractiveness and safety of a potential tourist destination.

Negative developments 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 trade flows with certain other countries, including Russia, 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 or natural gas to Croatia were to be restricted or if the price of oil or natural gas were to significantly increase, the Republic's economy could be adversely affected. Continued sanctions on Russia may restrict the supply of oil or natural gas, which could lead to oil and natural gas price increases. Furthermore, although there has been 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 adversely affect the Croatian economy.

Official economic data may not be accurate and could be revised

A range of Government ministries, including the Ministry of Finance, along with the HNB and the Croatian Bureau of Statistics ("CBS"), produce statistics on Croatia and its economy. There can, however, be no assurance that these statistics are comparable with those compiled by other bodies, or in other countries, which use different methodologies. Prospective investors in the Notes should be aware that figures relating to Croatia's GDP and many other aggregate figures cited in this Offering Circular may differ from figures

prepared by international bodies, such as the International Monetary Fund (the "IMF"), which may use different methodologies. The statistical information presented herein is based on the latest official information currently available from the stated source. The development of statistical information relating to Croatia is, however, an ongoing process and revised figures and estimates are produced on a regular basis. Figures presented may be subject to rounding and GDP figures are initially provisional. In addition, the existence of an unofficial or unobserved economy may affect the accuracy and reliability of statistical information. Prospective investors should be aware that none of the statistical information in this Offering Circular has been independently verified.

Risk Factors Relating to an Investment in the Notes

The terms of the Notes may be modified or waived 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 and for the passing of written resolutions of Noteholders without the need for a meeting. Such provisions are commonly referred to as "collective action clauses". These provisions permit defined majorities to bind all Noteholders including Noteholders who did not attend and vote at the relevant meeting or sign the relevant written resolution and Noteholders who voted in a manner contrary to the majority.

The Issuer has in the past and may in the future issue debt securities which contain collective action clauses in the same form as the collective action clauses in the conditions of the Notes. If this occurs, the Notes could be capable of aggregation with any such future debt securities, meaning that a defined majority of the holders of such debt securities (when taken in the aggregate) would be able to bind all holders of all the relevant aggregated series of debt securities, including the Notes.

Any modification or actions relating to any Reserved Matter (as defined in the conditions of the Notes), including in respect of payments and other important terms, may be made (a) to the Notes with the consent of the holders of 75 per cent. of the aggregate principal amount of the outstanding Notes, and (b) to multiple series of debt securities which may be issued by the Issuer (including the Notes) with the consent of both (i) the holders of at least two thirds of the aggregate principal amount of all outstanding debt securities being aggregated and (ii) the holders of at least 50 per cent. in aggregate principal amount of the outstanding debt securities of each series being aggregated. In addition, under certain circumstances, including the satisfaction of the Uniformly Applicable condition (as more particularly described in the conditions of the Notes), any such modification or action relating to any Reserved Matter may be made to multiple series of the Issuer's debt securities (including the Notes) with the consent of 75 per cent. of the aggregate principal amount of the outstanding debt securities of all affected series, without requiring a particular percentage of the holders of any individual affected debt securities to vote in favour of or approve any proposed modification or action. Any modification or action proposed by the Issuer may, as the option of the Issuer, be made in respect of certain series of the Issuer's debt securities only and, for the avoidance of doubt, the collective action provisions may be used for different groups of two or more debt securities simultaneously. At the time of any proposed modification or action, the Issuer will be obliged, *inter alia*, to specify which method or methods of aggregation will be used by the Issuer.

There is therefore a risk that the conditions of the Notes may be amended, modified or waived in circumstances whereby the holders of debt securities voting in favour of or signing a written resolution in respect of an amendment, modification or waiver may be holders of different series of debt securities and, as such, the majority of Noteholders would not necessarily have voted in favour of or signed a written resolution in respect of such amendment, modification or waiver. In addition, there is a risk that the provisions allowing for aggregation across multiple series of debt securities may make the Notes less attractive to purchasers in the secondary market on the occurrence of an Event of Default or in a distress situation.

The conditions of the Notes also 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, or where the modification is of a formal, minor or technical nature or is not materially prejudicial to the interests of the Noteholders.

Any such amendment, modification or waiver in relation to the Notes may adversely affect their trading price.

The Issuer may choose to grant preferential treatment to other unsecured creditors

In accordance with Condition 3 (*Status*), the Notes are the direct, unconditional and unsecured obligations of the Issuer and will at all times rank at least *pari passu* with all other unsecured obligations of the Issuer, from time to time outstanding. However, under Condition 3 (*Status*), the Issuer has no obligation to effect equal or rateable payment(s) at any time with respect to any other unsecured obligations of the Issuer and, in particular, the Issuer will have no obligation to make payment under the Notes at the same time or as a condition of paying sums under other unsecured obligations. Accordingly, the Issuer may choose to prioritise payment obligations to other unsecured creditors of the Issuer as payments fall due.

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.

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 Offering Circular. 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 Offering Circular.

Certificates not denominated in an integral multiple of €100,000 or its equivalent may be illiquid and difficult to trade

The Notes have denominations consisting of a minimum of €100,000 plus integral multiples of €1,000 in excess thereof. It is possible that the Notes may be traded in amounts that are not integral multiples of €100,000. In each such case a holder who, as a result of trading such amounts, holds an amount which is less than €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 at least €100,000.

If Certificates are issued, holders should be aware that Certificates which have a denomination that is not an integral multiple of €100,000 may be illiquid and more difficult to trade than Notes denominated in an integral multiple of €100,000.

Croatian courts may not recognise or may not enforce an English or non-EU court judgment

In respect of recognition and/or enforcement of a judgment obtained in an EU jurisdiction other than Croatia (including, but not limited to, England), Croatian courts may refuse to recognise such a judgment if there are grounds for refusal of recognition as provided in the provisions of the Council Regulation (EC) No 1215/2012 of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters. In respect of recognition and/or enforcement of a non-EU court judgment, Croatian courts may refuse to recognise such judgments if there are grounds for non-recognition as provided in the Croatian Act on International Private Law (OG 101/2017), subject to any applicable bilateral or multilateral international treaty or other special Croatian laws. Once recognised (to the extent applicable), the judgment of a non-Croatian court is equal to the judgment of a Croatian court and is fit for enforcement in the Republic of Croatia (for enforcement of English court judgments for so long as the United Kingdom remains a Member State of the EU, the conditions prescribed by the Council Regulation (EC) No. 1215/2012 of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters or, as the case may be, the Regulation (EC) No 805/2004 of the European Parliament and of the Council of 21 April 2004 creating a European Enforcement Order of uncontested claims must be met).

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 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. In addition, liquidity may be limited if the Issuer makes large allocations to a limited number of investors.

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, 2008 and 2009 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 HNB, 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.

On 15 October 2012, the new Execution Law (OG 112/2012, 25/2013, 93/2014 and 73/2017) came into force prescribing, similar to the old law on execution, certain assets that are not available for enforcement (such as, *inter alia*, assets out of trade and other assets regulated as such by a special law, as well as claims on the basis of taxes and other charges). In addition to those restrictions, the new law introduced certain additional assets owned by Croatia, *inter alia*, the equipment and facilities intended for the purposes of the functioning of local and regional self-government units and judicial authorities, which are unavailable 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 euro. 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 euro. These include the risk that exchange rates may significantly change (including changes due to devaluation of the euro 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 euro 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 or the ability of the Republic to make payment in respect of the Notes. 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 will assign 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, suspended or withdrawn by the relevant rating agency at any time.

TERMS AND CONDITIONS OF THE NOTES

The following is the text of the terms and 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 €1,500,000,000 1.125 per cent. Notes due 2029 (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 19 June 2019 (such agreement as amended and/or supplemented and/or restated from time to time, the "**Agency Agreement**") made between the Republic and Citigroup Global Markets Europe AG as registrar (the "**Registrar**"), Citibank N.A., London Branch as fiscal agent (the "**Fiscal Agent**"), Citibank N.A., London Branch as transfer agent (the "**Transfer Agent**" and together with the Registrar, the "**Transfer Agents**") 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, the Transfer Agents 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 19 June 2019 (the "**Deed of Covenant**") and made by the Republic. The original of the Deed of Covenant is held by the common safekeeper for Euroclear (as defined below) and Clearstream, Luxembourg (as defined below).

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 and the Deed of Covenant are available for inspection during normal business hours by 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 Transfer Agents, the Paying Agents and the Agents shall include any successor appointed under the Agency Agreement.

The owners shown in the records of Euroclear Bank SA/NV ("**Euroclear**") and Clearstream Banking S.A. ("**Clearstream, Luxembourg**") 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 €100,000 and integral multiples of €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.

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 Certificate — Registration of Title" and "The Global Certificate — 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.

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 general obligations of the Republic. The Notes rank *pari passu*, without any preference among themselves, 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, from time to time outstanding, **provided, however, that** the Republic shall have no obligation to effect equal or rateable payment(s) at any time with respect to any such other obligations and, in particular, shall have no obligations to pay other such obligations at the same time or as a condition of paying sums due on the Notes and *vice versa*.

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 (i) 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, or (ii) any obligation for the payment of money in respect of a derivative transaction (which for the avoidance of doubt shall include any swap transaction), such derivative transaction being entered into in connection with hedging the interest rate or foreign exchange exposure in respect of an obligation that qualifies under (i) above, **provided that**, in each case, if at any time the lawful currency of the Republic is the euro, then any indebtedness 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 19 June 2019 at the rate of 1.125 per cent. per annum, payable annually in arrear on 19 June in each year (from and including 19 June 2020) until maturity (each an "**Interest Payment Date**"). The first payment for the period from and including 19 June 2019 to but excluding 19 June 2020 and amounting to €11.25 per €1,000 principal amount of Notes shall be made on 19 June 2020.

The period beginning on, and including, 19 June 2019 and ending on but excluding the first Interest Payment Date and each successive period beginning on and including an Interest Payment Date and ending on but excluding the next successive Interest Payment Date is called an "**Interest Period**".

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**

Where interest is to be calculated in respect of a period which is equal to or shorter than an Interest Period, it will be calculated on the basis of the number of days in the relevant period, from and including the date from which interest begins to accrue to but excluding the date on which it falls due, divided by the number of days in the Interest Period in which the relevant period falls (including the first such day but excluding the last).

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 euro cheque drawn on a bank that processes payments in euro 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 euro account maintained by or on behalf of it with a bank that processes payments in euro, 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 of 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 on which the Trans-European Automated Real-time Gross Settlement Express Transfer (TARGET2) System is open and a day on which commercial banks and foreign exchange markets settle payments and are open for general business in London 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; and
- (c) there will at all times be 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 19 June 2029.

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 any meetings of Noteholders or for the purpose of Condition 13 (*Meetings of Noteholders; Written Resolutions*).

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*)).

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 **Events of Default**

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, or any amount under, 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 (d) have occurred equals or exceeds U.S.\$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 **Withdrawal**

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 and/or security as the Republic or Agent 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.

12.2 Notices to the Republic

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; Written Resolutions

13.1 Convening Meetings of Noteholders; Conduct of Meetings of Noteholders; Written Resolutions

- (a) The Republic may convene a meeting of the Noteholders at any time in respect of the Notes in accordance with the Agency Agreement. The Republic will determine the time and place of the meeting. The Republic will notify the Noteholders of the time, place and purpose of the meeting not less than 21 and not more than 45 days before the meeting.
- (b) The Republic will convene a meeting of Noteholders if the holders of at least 10 per cent. in principal amount of the outstanding Notes (as defined in the Agency Agreement and described in Condition 13.9 (*Notes controlled by the Republic*) below) have delivered a written request to the Republic or the Fiscal Agent (with a copy to the Republic) setting out the purpose of the meeting. The Fiscal Agent will agree the time and place of the meeting with the Republic promptly. The Republic will notify the Noteholders within 10 days of receipt of such written request of the time and place of the meeting, which shall take place not less than 21 and not more than 45 days after the date on which such notification is given.
- (c) The Republic (with the agreement of the Fiscal Agent) will set the procedures governing the conduct of any meeting in accordance with the Agency Agreement. If the Agency Agreement does not include such procedures, or additional procedures are required, the Republic and the Fiscal Agent will agree such procedures as are customary in the market and in such a manner as to facilitate any multiple series aggregation, if in relation to a Reserved Matter the Republic proposes any modification to the terms and conditions of, or action with respect to, two or more series of debt securities issued by it.
- (d) The notice convening any meeting will specify, *inter alia*;
 - (i) the date, time and location of the meeting;
 - (ii) the agenda and the text of any Extraordinary Resolution to be proposed for adoption at the meeting;
 - (iii) the record date for the meeting, which shall be no more than five business days before the date of the meeting;
 - (iv) the documentation required to be produced by a Noteholder in order to be entitled to participate at the meeting or to appoint a proxy to act on the Noteholder's behalf at the meeting;
 - (v) any time deadline and procedures required by any relevant international and/or domestic clearing systems or similar through which the Notes are traded and/or held by Noteholders;
 - (vi) whether Condition 13.2 (*Modification of this Series of Notes only*), or Condition 13.3 (*Multiple Series Aggregation – Single limb voting*), or Condition 13.4 (*Multiple Series Aggregation – Two limb voting*) shall apply and, if relevant, in relation to which other series of debt securities it applies;
 - (vii) if the proposed modification or action relates to two or more series of debt securities issued by the Republic and contemplates such series of debt securities

being aggregated in more than one group of debt securities, a description of the proposed treatment of each such group of debt securities;

- (viii) such information that is required to be provided by the Republic in accordance with Condition 13.6 (*Information*);
 - (ix) the identity of the Aggregation Agent and the Calculation Agent, if any, for any proposed modification or action to be voted on at the meeting, and the details of any applicable methodology referred to in Condition 13.7 (*Claims Valuation*); and
 - (x) any additional procedures which may be necessary and, if applicable, the conditions under which a multiple series aggregation will be deemed to have been satisfied if it is approved as to some but not all of the affected series of debt securities.
- (e) In addition, the Agency Agreement contains provisions relating to Written Resolutions. All information to be provided pursuant to Condition 13.1(d) (*Convening Meetings of Noteholders; Conduct of Meetings of Noteholders; Written Resolutions*) shall also be provided, mutatis mutandis, in respect of Written Resolutions.
- (f) A "**record date**" in relation to any proposed modification or action means the date fixed by the Republic for determining the Noteholders and, in the case of a multiple series aggregation, the holders of debt securities of each other affected series that are entitled to vote on a Multiple Series Single Limb Extraordinary Resolution or a Multiple Series Two Limb Extraordinary Resolution, or to sign a Multiple Series Single Limb Written Resolution or a Multiple Series Two Limb Written Resolution.
- (g) An "**Extraordinary Resolution**" means any of a Single Series Extraordinary Resolution, a Multiple Series Single Limb Extraordinary Resolution and/or a Multiple Series Two Limb Extraordinary Resolution, as the case may be.
- (h) A "**Written Resolution**" means any of a Single Series Written Resolution, a Multiple Series Single Limb Written Resolution and/or a Multiple Series Two Limb Written Resolution, as the case may be.
- (i) Any reference to "**debt securities**" means any notes (including the Notes), bonds, debentures or other debt securities issued by the Republic in one or more series with an original stated maturity of more than one year.
- (j) "**Debt Securities Capable of Aggregation**" means those debt securities which include or incorporate by reference this Condition 13 (*Meetings of Noteholders; Written Resolutions*) and Condition 14 (*Aggregation Agent; Aggregation Procedures*) or provisions substantially in these terms which provide for the debt securities which include such provisions to be capable of being aggregated for voting purposes with other series of debt securities.

13.2 **Modification of this Series of Notes only**

- (a) Any modification of any provision of, or any action in respect of, the Notes, the Agency Agreement and/or the Deed of Covenant may be made or taken if approved by a Single Series Extraordinary Resolution or a Single Series Written Resolution as set out below.
- (b) A "**Single Series Extraordinary Resolution**" means a resolution passed at a meeting of Noteholders duly convened and held in accordance with the procedures prescribed by the Republic and the Fiscal Agent pursuant to Condition 13.1 (*Convening Meetings of Noteholders; Conduct of Meetings of Noteholders; Written Resolutions*) by a majority of:
 - (i) in the case of a Reserved Matter, at least 75 per cent. of the aggregate principal amount of the outstanding Notes; or
 - (ii) in the case of a matter other than a Reserved Matter, more than 50 per cent. of the aggregate principal amount of the outstanding Notes.

- (c) A **"Single Series Written Resolution"** means a resolution in writing signed or confirmed in writing by or on behalf of the holders of:
 - (i) in the case of a Reserved Matter, at least 75 per cent. of the aggregate principal amount of the outstanding Notes; or
 - (ii) in the case of a matter other than a Reserved Matter more than 50 per cent. of the aggregate principal amount of the outstanding Notes.

Any Single Series Written Resolution may be contained in one document or several documents in the same form, each signed or confirmed in writing by or on behalf of one or more Noteholders.

- (d) Any Single Series Extraordinary Resolution duly passed or Single Series Written Resolution approved shall be binding on all Noteholders, whether or not they attended any meeting, whether or not they voted in favour thereof and whether or not they signed or confirmed in writing any such Single Series Written Resolution, as the case may be.

13.3 Multiple Series Aggregation – Single limb voting

- (a) In relation to a proposal that includes a Reserved Matter, any modification to the terms and conditions of, or any action with respect to, two or more series of Debt Securities Capable of Aggregation may be made or taken if approved by a Multiple Series Single Limb Extraordinary Resolution or by a Multiple Series Single Limb Written Resolution as set out below, provided that the Uniformly Applicable condition is satisfied.
- (b) A **"Multiple Series Single Limb Extraordinary Resolution"** means a resolution considered at separate meetings of the holders of each affected series of Debt Securities Capable of Aggregation, duly convened and held in accordance with the procedures prescribed by the Republic and the Fiscal Agent pursuant to Condition 13.1 (*Convening Meetings of Noteholders; Conduct of Meetings of Noteholders; Written Resolutions*), as supplemented if necessary, which is passed by a majority of at least 75 per cent. of the aggregate principal amount of the outstanding debt securities of all affected series of Debt Securities Capable of Aggregation (taken in aggregate).
- (c) A **"Multiple Series Single Limb Written Resolution"** means each resolution in writing (with a separate resolution in writing or multiple separate resolutions in writing distributed to the holders of each affected series of Debt Securities Capable of Aggregation, in accordance with the applicable bond documentation) which, when taken together, has been signed or confirmed in writing by or on behalf of the holders of at least 75 per cent. of the aggregate principal amount of the outstanding debt securities of all affected series of Debt Securities Capable of Aggregation (taken in aggregate). Any Multiple Series Single Limb Written Resolution may be contained in one document or several documents in substantially the same form, each signed or confirmed in writing by or on behalf of one or more Noteholders or one or more holders of each affected series of debt securities.
- (d) Any Multiple Series Single Limb Extraordinary Resolution duly passed or Multiple Series Single Limb Written Resolution approved shall be binding on all Noteholders and holders of each other affected series of Debt Securities Capable of Aggregation, whether or not they attended any meeting, whether or not they voted in favour thereof, whether or not any other holder or holders of the same series voted in favour thereof and whether or not they signed or confirmed in writing any such Multiple Series Single Limb Written Resolution, as the case may be, and on all couponholders (where applicable) of each other affected series of Debt Securities Capable of Aggregation.
- (e) The **"Uniformly Applicable"** condition will be satisfied if:
 - (i) the holders of all affected series of Debt Securities Capable of Aggregation are invited to exchange, convert, or substitute their debt securities, on the same terms, for (i) the same new instrument or other consideration or (ii) a new instrument, new instruments or other consideration from an identical menu of instruments or other consideration; or

- (ii) the amendments proposed to the terms and conditions of each affected series of Debt Securities Capable of Aggregation would, following implementation of such amendments, result in the amended instruments having identical provisions (other than provisions which are necessarily different, having regard to different currency of issuance),
- (f) It is understood that a proposal under Condition 13.3(a) above will not be considered to satisfy the Uniformly Applicable condition if each exchanging, converting, substituting or amending holder of each affected series of Debt Securities Capable of Aggregation is not offered the same amount of consideration per amount of principal, the same amount of consideration per amount of interest accrued but unpaid and the same amount of consideration per amount of past due interest, respectively, as that offered to each other exchanging, converting, substituting or amending holder of each affected series of Debt Securities Capable of Aggregation (or, where a menu of instruments or other consideration is offered, each exchanging, converting, substituting or amending holder of each affected series of Debt Securities Capable of Aggregation is not offered the same amount of consideration per amount of principal, the same amount of consideration per amount of interest accrued but unpaid and the same amount of consideration per amount of past due interest, respectively, as that offered to each other exchanging, converting, substituting or amending holder of each affected series of Debt Securities Capable of Aggregation electing the same option from such menu of instruments).
- (g) Any modification or action proposed under Condition 13.3(a) may be made in respect of some series only of the Debt Securities Capable of Aggregation and, for the avoidance of doubt, the provisions described in this Condition 13.3 may be used for different groups of two or more series of Debt Securities Capable of Aggregation simultaneously.

13.4 **Multiple Series Aggregation – Two limb voting**

- (a) In relation to a proposal that includes a Reserved Matter, any modification to the terms and conditions of, or any action with respect to, two or more series of Debt Securities Capable of Aggregation may be made or taken if approved by a Multiple Series Two Limb Extraordinary Resolution or by a Multiple Series Two Limb Written Resolution as set out below.
- (b) A "**Multiple Series Two Limb Extraordinary Resolution**" means a resolution considered at separate meetings of the holders of each affected series of Debt Securities Capable of Aggregation, duly convened and held in accordance with the procedures prescribed by the Republic and the Fiscal Agent pursuant to Condition 13.1 (*Convening Meetings of Noteholders; Conduct of Meetings of Noteholders; Written Resolutions*), as supplemented if necessary, which is passed by a majority of:
 - (i) at least two thirds of the aggregate principal amount of the outstanding debt securities of all affected series of Debt Securities Capable of Aggregation (taken in aggregate); and
 - (ii) more than 50 per cent. of the aggregate principal amount of the outstanding debt securities in each affected series of Debt Securities Capable of Aggregation (taken individually).
- (c) A "**Multiple Series Two Limb Written Resolution**" means each resolution in writing (with a separate resolution in writing or multiple separate resolutions in writing distributed to the holders of each affected series of Debt Securities Capable of Aggregation, in accordance with the applicable bond documentation) which, when taken together, has been signed or confirmed in writing by or on behalf of the holders of:
 - (i) at least two thirds of the aggregate principal amount of the outstanding debt securities of all the affected series of Debt Securities Capable of Aggregation (taken in aggregate); and

- (ii) more than 50 per cent. of the aggregate principal amount of the outstanding debt securities in each affected series of Debt Securities Capable of Aggregation (taken individually).

Any Multiple Series Two Limb Written Resolution may be contained in one document or several documents in substantially the same form, each signed or confirmed in writing by or on behalf of one or more Noteholders or one or more holders of each affected series of Debt Securities Capable of Aggregation.

- (d) Any Multiple Series Two Limb Extraordinary Resolution duly passed or Multiple Series Two Limb Written Resolution approved shall be binding on all Noteholders and holders of each other affected series of Debt Securities Capable of Aggregation, whether or not they attended any meeting, whether or not they voted in favour thereof, whether or not any other holder or holders of the same series voted in favour thereof and whether or not they signed or confirmed in writing any such Multiple Series Two Limb Written Resolution, as the case may be, and on all couponholders (where applicable) of each other affected series of Debt Securities Capable of Aggregation.
- (e) Any modification or action proposed under Condition 13.4(a) may be made in respect of some series only of the Debt Securities Capable of Aggregation and, for the avoidance of doubt, the provisions described in this Condition 13.4 may be used for different groups of two or more series of Debt Securities Capable of Aggregation simultaneously.

13.5 **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 majority required to pass an Extraordinary Resolution, a 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, or the definition of "**Extraordinary Resolution**", "**Single Series Extraordinary Resolution**", "**Multiple Series Single Limb Extraordinary Resolution**", "**Multiple Series Two Limb Extraordinary Resolution**", "**Written Resolution**", "**Single Series Written Resolution**", "**Multiple Series Single Limb Written Resolution**" or "**Multiple Series Two Limb Written Resolution**";
- (e) to change the definition of "**debt securities**" or "**Debt Securities Capable of Aggregation**";
- (f) to change the definition of "**Uniformly Applicable**";
- (g) to change the definition of "**outstanding**" or to modify the provisions of Condition 13.9 (*Notes controlled by the Republic*);
- (h) to change the legal ranking of the Notes;
- (i) to change any provision of the Notes describing circumstances in which Notes may be declared due and payable prior to their scheduled maturity date, set out in Condition 10 (*Events of Default*);
- (j) to change the law governing the Notes, the courts to the jurisdiction of which the Republic has submitted in the Notes, any of the arrangements specified in the Notes to enable

proceedings to be taken or the Republic's waiver of immunity, in respect of actions or proceedings brought by any Noteholder, set out in Condition 17 (*Governing Law and Submission to Jurisdiction*);

- (k) to impose any condition on or otherwise change the Republic's obligation to make payments of principal, interest or any other amount in respect of the Notes, including by way of the addition of a call option;
- (l) except as permitted by any related guarantee or security agreement, to release any agreement guaranteeing or securing payments under the Notes or to change the terms of any such guarantee or security; or
- (m) to exchange or substitute all the Notes for, or convert all the Notes into, other obligations or securities of the Republic or any other person, or to modify any provision of these Conditions in connection with 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, which would result in the Conditions as so modified being less favourable to the Noteholders which are subject to the Conditions as so modified than:
 - (i) the provisions of the other obligations or debt securities of the Republic or any other person resulting from the relevant exchange or substitution or conversion; or
 - (ii) if more than one series of other obligations or debt securities results from the relevant exchange or substitution or conversion, the provisions of the resulting series of debt securities having the largest aggregate principal amount.

13.6 Information

Prior to or on the date that the Republic proposes any Extraordinary Resolution or Written Resolution pursuant to Condition 13.2 (*Modification of this Series of Notes only*), Condition 13.3 (*Multiple Series Aggregation – Single limb voting*) or Condition 13.4 (*Multiple Series Aggregation – Two limb voting*), the Republic shall publish in accordance with Condition 14 (*Aggregation Agent; Aggregation Procedures*), and provide the Fiscal Agent with the following information:

- (a) a description of the Republic's economic and financial circumstances which are, in the Republic's opinion, relevant to the request for any potential modification or action, a description of the Republic's existing debts and a description of its broad policy reform programme and provisional macroeconomic outlook;
- (b) if the Republic shall at the time have entered into an arrangement for financial assistance with multilateral and/or other major creditors or creditor groups and/or an agreement with any such creditors regarding debt relief, a description of any such arrangement or agreement. Where permitted under the information disclosure policies of the multilateral or such other creditors, as applicable, copies of the arrangement or agreement shall be provided;
- (c) a description of the Republic's proposed treatment of external debt securities that fall outside the scope of any multiple series aggregation and its intentions with respect to any other debt securities and its other major creditor groups; and
- (d) if any proposed modification or action contemplates debt securities being aggregated in more than one group of debt securities, a description of the proposed treatment of each such group, as required for a notice convening a meeting of the Noteholders in Condition 13.1(d)(vii) (*Convening Meetings of Noteholders; Conduct of Meetings of Noteholders; Written Resolutions*).

13.7 Claims Valuation

For the purpose of calculating the par value of the Notes and any affected series of debt securities which are to be aggregated with the Notes in accordance with Condition 13.3 (*Multiple Series Aggregation – Single limb voting*) and Condition 13.4 (*Multiple Series Aggregation – Two limb voting*), the Republic may appoint a Calculation Agent. The Republic shall, with the approval of

the Aggregation Agent and any appointed Calculation Agent, promulgate the methodology in accordance with which the par value of the Notes and such affected series of debt securities will be calculated. In any such case where a Calculation Agent is appointed, the same person will be appointed as the Calculation Agent for the Notes and each other affected series of debt securities for these purposes, and the same methodology will be promulgated for each affected series of debt securities.

13.8 **Manifest error, etc.**

The Notes, these Conditions and the provisions of the Agency Agreement may be amended by the Republic 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.

13.9 **Notes controlled by the Republic**

For the purposes of (a) determining the right to attend and vote at any meeting of Noteholders, or the right to sign or confirm in writing, or authorise the signature of, any Written Resolution, (b) this Condition 13 (*Meetings of Noteholders; Written Resolutions*) and (c) Condition 10 (*Events of Default*), any Notes which are for the time being 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 shall be disregarded and be deemed not to remain outstanding, where:

- (i) "**public sector instrumentality**" means the Croatian National Bank (Hrvatska Narodna Banka), the Croatian Ministry of Finance (Ministarstvo Financija), any other 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 or any of the foregoing; and
- (ii) "**control**" means the power, directly or indirectly, through the ownership of voting securities or other ownership interests or through contractual control 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.

A Note will also be deemed to be not outstanding if the Note has previously been cancelled or delivered for cancellation or held for reissuance but not reissued, or, where relevant, the Note has previously been called for redemption in accordance with its terms or previously become due and payable at maturity or otherwise and the Republic has previously satisfied its obligations to make all payments due in respect of the Note in accordance with its terms.

In advance of any meeting of Noteholders, or in connection with any Written Resolution, the Republic shall provide to the Fiscal Agent a copy of the certificate prepared pursuant to Condition 14.4 (*Aggregation Agent; Aggregation Procedures – Certificate*), which includes information on the total number of Notes which are for the time being 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 and, as such, such Notes shall be disregarded and deemed not to remain outstanding for the purposes of 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 in respect of any such meeting. 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.

13.10 **Publication**

The Republic shall publish all Extraordinary Resolutions and Written Resolutions which have been determined by the Aggregation Agent to have been duly passed in accordance with Condition 14.7 (*Aggregation Agent; Aggregation Procedures – Manner of Publication*).

13.11 **Exchange and Conversion**

Any Extraordinary Resolutions or Written Resolutions which have been duly passed and which modify any provision of, or action in respect of, the Conditions may be implemented at the Republic's option by way of a mandatory exchange or conversion of the Notes and each other affected series of debt securities, as the case may be, into new debt securities containing the modified terms and conditions if the proposed mandatory exchange or conversion of the Notes is notified to Noteholders at the time notification is given to the Noteholders as to the proposed modification or action. Any such exchange or conversion shall be binding on all Noteholders.

14. **Aggregation Agent; Aggregation Procedures**

14.1 **Appointment**

The Republic will appoint an Aggregation Agent to calculate whether a proposed modification or action has been approved by the required principal amount outstanding of Notes, and, in the case of a multiple series aggregation, by the required principal amount of outstanding debt securities of each affected series of debt securities. In the case of a multiple series aggregation, the same person will be appointed as the Aggregation Agent for the proposed modification of any provision of, or any action in respect of, these Conditions or the Agency Agreement in respect of the Notes and in respect of the terms and conditions or bond documentation in respect of each other affected series of debt securities. The Aggregation Agent shall be independent of the Republic.

14.2 **Extraordinary Resolutions**

If an Extraordinary Resolution has been proposed at a duly convened meeting of Noteholders to modify any provision of, or action in respect of, these Conditions and other affected series of debt securities, as the case may be, the Aggregation Agent will, as soon as practicable after the time the vote is cast, calculate whether holders of a sufficient portion of the aggregate principal amount of the outstanding Notes and, where relevant, each other affected series of debt securities, have voted in favour of the Extraordinary Resolution such that the Extraordinary Resolution is passed. If so, the Aggregation Agent will determine that the Extraordinary Resolution has been duly passed.

14.3 **Written Resolutions**

If a Written Resolution has been proposed under the terms of these Conditions to modify any provision of, or action in respect of, these Conditions and the terms and conditions of other affected series of debt securities, as the case may be, the Aggregation Agent will, as soon as reasonably practicable after the relevant Written Resolution has been signed or confirmed in writing, calculate whether holders of a sufficient portion of the aggregate principal amount of the outstanding Notes and, where relevant, each other affected series of debt securities, have signed or confirmed in writing in favour of the Written Resolution such that the Written Resolution is passed. If so, the Aggregation Agent will determine that the Written Resolution has been duly passed.

14.4 **Certificate**

For the purposes of Condition 14.2 (*– Extraordinary Resolutions*) and Condition 14.3 (*– Written Resolutions*), the Republic will provide a certificate to the Aggregation Agent up to three days prior to, and in any case no later than, with respect to an Extraordinary Resolution, the date of the meeting referred to in Condition 13.2 (*Meetings of Noteholders; Written Resolutions – Modification of this Series of Notes only*), Condition 13.3 (*Meetings of Noteholders; Written Resolutions – Multiple Series Aggregation – Single limb voting*) or Condition 13.4 (*Meetings of Noteholders; Written Resolutions – Multiple Series Aggregation – Two limb voting*), as applicable, and, with respect to a Written Resolution, the date arranged for the signing of the Written Resolution.

The certificate shall:

- (a) list the total principal amount of Notes and, in the case of a multiple series aggregation, the total principal amount of each other affected series of debt securities outstanding on the record date; and

- (b) clearly indicate the Notes and, in the case of a multiple series aggregation, debt securities of each other affected series of debt securities which shall be disregarded and deemed not to remain outstanding as a consequence of Condition 13.9 (*Meetings of Noteholders; Written Resolutions – Notes controlled by the Republic*) on the record date identifying the holders of the Notes and, in the case of a multiple series aggregation, debt securities of each other affected series of debt securities.

The Aggregation Agent may rely upon the terms of any certificate, notice, communication or other document believed by it to be genuine.

14.5 **Notification**

The Aggregation Agent will cause each determination made by it for the purposes of this Condition 14 (*Aggregation Agent; Aggregation Procedures*) to be notified to the Fiscal Agent and the Republic as soon as practicable after such determination. Notice thereof shall also promptly be given to the Noteholders.

14.6 **Binding nature of determinations; no liability**

All notifications, opinions, determinations, certificates, calculations, quotations and decisions given, expressed, made or obtained for the purposes of this Condition 14 (*Aggregation Agent; Aggregation Procedures*) by the Aggregation Agent and any appointed Calculation Agent will (in the absence of manifest error) be binding on the Republic, the Fiscal Agent and the Noteholders and (subject as aforesaid) no liability to any such person will attach to the Aggregation Agent or the Calculation Agent in connection with the exercise or non-exercise by it of its powers, duties and discretions for such purposes.

14.7 **Manner of publication**

The Republic will publish all notices and other matters required to be published pursuant to the Agency Agreement including any matters required to be published pursuant to Condition 10 (*Events of Default*), Condition 13 (*Meetings of Noteholders; Written Resolutions*), this Condition 14 (*Aggregation Agent; Aggregation Procedures*) and Condition 15 (*Noteholders' Committee*):

- (a) on the website of the Croatian Ministry of Finance (Ministarstvo Financija);
- (b) through the systems of Clearstream Banking S.A. and Euroclear Bank SA/NV and/or any other international or domestic clearing system(s) through which the Notes are for the time being cleared;
- (c) in such other places and in such other manner as may be required by applicable law or regulation; and
- (d) in such other places and in such other manner as may be customary.

15. **Noteholders' Committee**

15.1 **Appointment**

- (a) Holders of at least 25 per cent. of the aggregate principal amount of the outstanding debt securities of all series of affected debt securities (taken in aggregate) may, by notice in writing to the Republic (with a copy to the Fiscal Agent), appoint any person or persons as a committee to represent the interests of such holders (as well as the interests of any holders of outstanding debt securities who wish to be represented by such a committee) if any of the following events has occurred:
 - (i) an Event of Default under Condition 10 (*Events 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;

- (iii) any public announcement by the Republic, to the effect that the Republic is seeking or intends to seek a rescheduling or restructuring of the Notes or any other affected series of debt securities (whether by amendment, exchange offer or otherwise); or
 - (iv) with the agreement of the Republic, at a time when the Republic has reasonably reached the conclusion that its debt may no longer be sustainable whilst the Notes or any other affected series of debt securities are outstanding.
- (b) Upon receipt of a written notice that a committee has been appointed in accordance with Condition 15.1(a) (*– Appointment*), and a certificate delivered pursuant to Condition 15.4 (*– Certification*), the Republic shall give notice of the appointment of such a committee to:
 - (i) all Noteholders in accordance with Condition 12 (*Notices*); and
 - (ii) the holders of each affected series of debt securities in accordance with the terms and conditions of such affected series of debt securities,

as soon as practicable after such written notice and such certificate are delivered to the Republic.

15.2 Powers

Such committee in its discretion may, among other things:

- (a) engage legal advisers and financial advisers to assist it in representing the interests of the Noteholders;
- (b) adopt such rules as it considers appropriate regarding its proceedings;
- (c) enter into discussions with the Republic and/or other creditors of the Republic; and
- (d) 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.

Except to the extent provided in this Condition 15.2 (*– Powers*), such committee shall not have the ability to exercise any powers or discretions which the Noteholders could themselves exercise.

15.3 Engagement with the committee and provision of information

- (a) The Republic shall:
 - (i) subject to Condition 15.3(b), engage with the committee in good faith;
 - (ii) provide the committee with information equivalent to that required under Condition 13.6 (*Meetings of Noteholders; Written Resolutions – Information*) and related proposals, if any, in each case as the same become available, subject to any applicable information disclosure policies, rules and regulations; and
 - (iii) pay any reasonable fees and expenses of any such committee as may be agreed with it (including without limitation, the reasonable and documented fees and expenses of the committee's legal and financial advisers, if any) following receipt of reasonably detailed invoices and supporting documentation.
- (b) If more than one committee has been appointed by holders of affected series of debt securities in accordance with the provisions of this Condition 15 (*Noteholders' Committee*) and/or equivalent provisions set out in the terms and conditions of any affected series of debt securities, the Republic shall not be obliged to engage with such committees separately. Such committees may appoint a single steering group (to be comprised of representatives from such committees), whereupon the Republic shall engage with such steering group.

15.4 **Certification**

Upon the appointment of a committee, the person or persons constituting such a committee (the "**Members**") will provide a certificate to the Republic and to the Fiscal Agent signed by the authorised representatives of the Members, and the Republic and the Fiscal Agent may rely upon the terms of such certificate.

The certificate shall certify:

- (a) that the committee has been appointed;
- (b) the identity of the initial Members; and
- (c) that such appointment complies with the terms and conditions of the relevant bond documentation.

Promptly after any change in the identity of the Members, a new certificate which each of the Republic and the Fiscal Agent may rely on conclusively, will be delivered to the Republic and the Fiscal Agent identifying the new Members. Each of the Republic and the Fiscal Agent will assume that the membership of the committee has not changed unless and until it has received a new certificate.

The provisions of this Condition 15.4 (*– Certification*) shall apply, mutatis mutandis, to any steering group appointed in accordance with Condition 15.3(b) (*– Engagement with the committee and provision of information*).

In appointing a person or persons as a committee to represent the interests of the Noteholders, the Noteholders may instruct a representative or representatives of the committee to form a separate committee or to join a steering group with any person or persons appointed for similar purposes by other affected series of debt securities.

16. **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.

17. **Governing Law and Submission to Jurisdiction**

17.1 **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 of the Republic.

17.2 **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. To the extent allowed by law, 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 W1T 6BN 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 17 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.

18. **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.

SUMMARY OF PROVISIONS RELATING TO THE NOTES WHILE IN GLOBAL FORM

The Global Certificate contains provisions which apply to the Notes in respect of which it is issued whilst they are represented by the Global Certificate, some of which modify the effect of the Conditions. Terms defined in the Conditions have the same meaning in paragraphs 1 to 6 below.

1. Form of the Notes

The Notes will be represented on issue by a Global Certificate in registered form without interest coupons (the "**Global Certificate**"), which will be deposited with, and registered in the name of a nominee for the common safekeeper for, Euroclear and Clearstream, Luxembourg. Beneficial interests in the Global Certificate may be held only through Euroclear or Clearstream, Luxembourg or their participants at any time.

Except in the limited circumstances described below, owners of beneficial interests in the Global Certificate 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 Certificate, each person (other than another clearing system) who is for the time being shown in the records of 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 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 of a common safekeeper for Euroclear and Clearstream Luxembourg (the "**Relevant Nominee**") in accordance with and subject to the terms of the Global Certificate. Each Accountholder must look solely to 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 Global Certificate.

4. Payments

Payments of principal and interest in respect of Notes represented by the 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 the 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 Certificate for such purpose.

Distributions of amounts with respect to book entry interests in the Global Certificate 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.

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

All payments in respect of Notes represented by the Global Certificate will be made to, or to the order of, the person whose name is entered on the Register at the close of business on the Clearing System Business Day immediately prior to the date for payment, where "**Clearing System Business Day**" means Monday to Friday inclusive except 25 December and 1 January.

5. Notices

So long as the Notes are represented by the Global Certificate and the 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 any stock exchange, notices shall also be published in accordance with the rules of such exchange. Any such notice shall be deemed to have been given to the Noteholders on the 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 the 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, Euroclear and Clearstream, Luxembourg may approve for this purpose.

5. 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 7 calendar days preceding the due date for any payment of principal, or interest in respect of the Notes.

6. Exchange for Certificates

Exchange

The Global Certificate will be exchangeable, free of charge to the holder, in whole but not in part, for 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; or
- (b) 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.

The Republic will promptly give notice to the Noteholders in accordance with Condition 12 upon the occurrence of an Exchange Event. In the event of an occurrence of an Exchange Event, either Euroclear and/or Clearstream, Luxembourg, as the case may be, acting on the instructions of any holder of an interest in this Global Certificate may give notice to the Registrar requesting exchange or, in the case of an exchange pursuant to (b) above, the holder may give the Registrar notice at its specified office requiring exchange. Any exchange shall occur no later than 30 days after the date of receipt of the first relevant notice by the Registrar.

In exchange for the 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 Global Certificate shall be exchanged in full for Certificates and the Republic will, at the cost of the Republic (but against such indemnity and/or security 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 the Global Certificate must provide the Registrar with a written order containing instructions and such other information as the Republic and the Registrar may require to complete, execute and deliver such Certificates.

Transfers

Transfers of book-entry interests in the Global Certificates will be effected through the records of Euroclear and/or Clearstream, Luxembourg and their respective participants in accordance with the rules and procedures of Euroclear and/or Clearstream, Luxembourg and their respective direct and indirect participants.

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.

USE OF PROCEEDS

The net proceeds of the issue are estimated to amount to approximately €1,471,320,000 and will be utilised for general budgetary government purposes, including refinancing of outstanding debt.

OVERVIEW OF THE REPUBLIC OF CROATIA

Territory and Population

Croatia occupies a total area of 87,661 square kilometres, of which 56,594 square kilometres is land and 31,067 square kilometres is sea. 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 has land borders with 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 and Herzegovina and Hungary, respectively. The Adriatic coastline runs 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.

Croatia is divided into 21 counties (including the City of Zagreb as a separate county), 127 towns/cities and 428 municipalities. The population of Croatia is approximately 4.2 million. The official language of Croatia is Croatian.

History

In the year 626, the Croatian people amalgamated the Roman provinces of Dalmatia, Pannonia and Illyricum and established two independent principalities that were later united into the Croatian Kingdom by its first King Tomislav, who was crowned in 925. Along with the Frankish Kingdom, Adriatic Croatia was the first permanent and organised state in Central Europe.

After the extinction of the native Trpimirović dynasty, the Croatian Parliament (Sabor) (the "**Parliament**") elected rulers of other states as Kings of Croatia, thereby creating a personal union – first between Croatia and Hungary (1102 – 1300 and 1307 – 1526), and then between Croatia and Austria (1527 – 1918). Between the 15th and 18th centuries, the Croatian Kingdom acted as a bulwark for Christian Europe and was crucial in halting the further advance of the Ottoman Empire towards the West, while on the other side the Venetian Republic occupied most of the Croatian coast.

Owing to its special position within the Habsburg Monarchy, the Croatian Kingdom preserved its sovereignty until the collapse of the Monarchy in 1918. After discontinuing constitutional links with Austria and Hungary in 1918, Croatia was included in the newly created Kingdom of Serbs, Croats and Slovenes (later the Kingdom of Yugoslavia), without the consent of the Parliament. As a result, Croatia was for the first time placed within a Balkan political context and, by coercion, ceased to exist as a state.

The autonomous Banovina of Croatia, established in 1939 by the agreement between the Croatian opposition and the Yugoslav Government, lasted until the Axis powers broke up Yugoslavia in 1941. Despite the plebiscitary support of the population for the pro-Western peasant-democratic coalition, the Second World War in Croatia was led between two radical movements – the Ustasha under the auspices of the Axis and the Communists (Partisans) on the side of the Allies, both of which declared their own Croatian state.

From 1945, Croatia was one of the six federal states of Marshal Tito's communist Yugoslavia. The democratic people's movement (known as the Croatian Spring) which sought political rights for Croatia within Yugoslavia and which opposed the forced merging of the Croatian language with Serbian into Serbo-Croatian in 1967, was repressed by the Yugoslav regime in 1971.

Following democratic elections in 1990, the Republic of Croatia declared independence in 1991, as the majority of member states of Yugoslavia did. Using the former federal army and local rebels, Serbia and Montenegro attacked Croatia and Bosnia and Herzegovina in 1991, with the aim of retaining the territories conquered in the rump Yugoslavia. The war ended in 1995 with a victory for Croatia and the liberation of occupied areas, while the simultaneous successes of the Croatian-Bosniak alliance led to the peace process in Bosnia and Herzegovina.

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 Organisation for Security and Co-operation in Europe and became a member of the IMF. In 1996, Croatia became the 40th Member State of the Council of Europe. For a

discussion of the economic programmes and reforms between 1995 and 2000 (see "*The Economy*"). Since 2000, following the reform programme of subsequent Governments, various integration processes with international organisations became a higher priority. In October 2000, Croatia became a member of the World Trade Organisation, while in 2002 it acceded to the Central European Free Trade Area. Croatia is also a member of the International Bank for Reconstruction and Development (the "**IBRD**" or "**World Bank**"), the Multilateral Investment Guarantee Agency, the International Development Association, the International Finance Corporation, the International Centre for Settlement of Investment Disputes, the European Investment Bank (the "**EIB**"), the European Bank for Reconstruction and Development (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. In April 2009, Croatia acceded to NATO. On 1 July 2013, Croatia became the 28th member state of the EU.

The IMF has assisted Croatia in maintaining macroeconomic stability since 1994 (See "*The Economy — Stabilisation of the Economy*"). The IMF conducts routine annual missions to Croatia and issued its last Staff Report on Croatia in June 2016. The IMF conducted its last mission to Croatia during 17 October 2017 to 27 October 2017 and is expected to issue its next Staff Report shortly.

Together with the IMF, the 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's 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 programmes; (vi) continue the process of judicial reform; and (vii) support a process of reform in the road sector (See "*Reform of Croatia's Roads and Motorways*").

Constitution and Government Structure

Croatia's Constitution was adopted on 22 December 1990 and was substantially amended in December 1997, November 2000, April 2001, June 2010 and December 2013 (the latest amendment to the Constitution is related to the definition of marriage). It established a multi-party democracy, with an economy based on market principles and private ownership. Under the Constitution, the President of the Republic (the "**President**") is elected for a five-year term by the popular vote of Croatian citizens 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. The Constitution is based on the separation of powers between the legislature, executive and judiciary. The current President is Kolinda Grabar-Kitarović (elected in January 2015) and the current Prime Minister is Andrej Plenković (appointed in October 2016).

Legislature

Croatia has a single chamber Parliament, which consists of a minimum of 100 and a maximum of 160 elected members who are elected by national general elections for a four-year term. The President promulgates laws validly enacted by the Parliament. If, in the President's view, the law does not conform to the Constitution, the President may initiate proceedings to review the constitutionality of the law before the Constitutional Court.

International agreements ratified in accordance with the Constitution and published in the Official Gazette (the "**OG**") 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 agreement, 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 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 or she 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 at least 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

Once elected, the President mandates 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 and the Government formulate and execute foreign policy. 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 Government cabinet members:

Name	Title
Andrej Plenković	Prime Minister
Tomislav Tolušić	Deputy Prime Minister and Minister of Agriculture
Marija Pejčinović Burić	Deputy Prime Minister and Minister of Foreign and European Affairs
Damir Krstičević	Deputy Prime Minister and Minister of Defence
Predrag Štromar	Deputy Prime Minister and Minister of Construction and Physical Planning
Zdravko Marić	Minister of Finance
Darko Horvat	Minister of Economy, Entrepreneurship and Crafts
Davor Božinović	Minister of the Interior
Marko Pavić	Minister of Labour and Pension System
Dražen Bošnjaković	Minister of Justice
Milan Kujundžić	Minister of Health
Gabrijela Žalac	Minister of Regional Development and EU Funds
Tomo Medved	Minister of War Veterans
Oleg Butković	Minister of the Sea, Transport and Infrastructure
Goran Marić	Minister of State Property
Tomislav Čorić	Minister of Environment and Energy
Gari Cappelli	Minister of Tourism
Lovro Kušćević	Minister of Public Administration
Blaženka Divjak	Minister of Science and Education
Nina Obuljen Koržinek	Minister of Culture
Nada Murganić	Minister of Demography, Families, Youth and Social Politics

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, *inter alia*, decides on ordinary legal remedies (appeals), when so prescribed, under special laws and decides on extraordinary legal remedies against final court judgments, in accordance with special laws. The Supreme Court has the authority to decide on the conflict of jurisdiction between the courts of different types in Croatia. Specialised courts exist to deal with commercial, administrative and misdemeanour law matters. Judges are appointed by the State Judiciary Council of Croatia (the "**Council**"), comprising 11 members, seven of whom are selected from amongst judges, two from amongst university law professors and two from amongst members of the Parliament (among whom one has to be a member of the opposition), for a four-year term and may not serve more than two terms. The Council, according to the Constitution and law, decides independently on the appointment, promotion, transfer, dismissal, immunity 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 on Constitutional Court of the Republic. It has the authority to annul unconstitutional laws or regulations and to decide on jurisdictional questions among the legislature,

executive and judiciary, and on whether or not a President should be impeached. It has jurisdiction to protect the constitutional freedom and rights of citizens.

Judicial Reform

Prior to EU accession, the Government focused its judicial reform efforts on strengthening the rule of law, improving the efficiency and effectiveness of judicial system, shortening the period of time between the commencement and conclusion of legal training, and improving professionalism and ongoing training of staff. Since accession, the Government is focusing on aligning its judiciary with that of the EU along with integration into the EU judicial process.

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.

Past and ongoing corruption cases include investigations against a former Deputy Prime Minister, a former Prime Minister, a 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.

A new Public Procurement Act (OG 120/2016) was passed in December 2016 and entered into force on 1 January 2017 (with exception of certain provisions that entered into force in April 2018 and October 2018, respectively) (the "**Public Procurement Act**"). The Public Procurement Act was adopted with aim to implement new solutions introduced by the public procurement related EU directives from 2014 (Directive 2014/24/EU of 26 February 2014 and Directive 2014/25/EU of 26 February 2014) and to fully align the Croatian public procurement system with the relevant chapters of the EU *acquis communautaire*. Anti-corruption provisions are incorporated in the Public Procurement Act which seeks to prevent conflicts of interest in the area of public procurement. In June 2013, the Government adopted an Ordinance on Internal Organisation of the State Commission for Control of Public Procurement Procedures (OG 84/2013 and 145/2014). The Public Private Partnership Act (OG 78/2012, 152/2014 and 114/2018) was also adopted. The Public Procurement System Directorate of the Ministry of Economy and the State Commission for Control of Public Procurement Procedures supervise the public procurement procedure to ensure that it is transparent and implemented consistently. In June 2017, the Government adopted a new Ordinance on Internal Organisation of the Central State Office for Central Public Procurement (OG 59/2017). In addition, in June 2017, the Parliament adopted a new Concessions Act (OG 69/2017) which entered into force on 22 July 2017.

The Political System

Parliamentary Elections

The major political parties that participated in parliamentary elections on 11 September 2016 were the Croatian Democratic Union ("**HDZ**"), Social Democratic Party ("**SDP**"), The Bridge of Independent Lists ("**MOST**") and Croatian People's Party – Liberal Democrats ("**HNS**"). Together with the Croatian Christian Democratic Party ("**HDS**"), the Social Liberal Party ("**HSLS**"), HRAST – Movement for Successful Croatia and independent MP Branko Hrg., HDZ won 61 out of 151 seats in the Parliament. HDZ and MOST, which won 13 seats in the Parliament, together with partners formed a coalition with the cooperation of the other political parties. The new members of Parliament took office on 14 October 2016. The HDZ's leader, Andrej Plenković, was appointed as Croatia's Prime Minister on 19 October 2016. Following disagreements

between HDZ, the major coalition partner, and MOST, the junior coalition partner, the coalition was dissolved. HDZ found a new junior partner in HNS and after negotiations, HDZ and HNS appointed new cabinet ministers. HNS experienced internal difficulties as some of the more vocal members of the party decided to leave the party and to form a new one, namely the Civic Liberal Alliance (“GLAS”).

The following table sets out the current composition of the Parliament:

	Seats	Per cent.
Croatian Democratic Union (HDZ).....	55	36.67
Social Democratic Party of Croatia (SDP).....	36	24.00
Bridge of the Independent Lists (MOST)	12	8.00
Croatian People's Party - Liberal Democrats (HNS)	5	3.33
Croatian Peasant Party (HSS).....	5	3.33
Civic Liberal Alliance (GLAS)	4	2.67
Istrian Democratic Assembly (IDS).....	3	2.00
Independent Democratic Serbian Party (SDSS)	3	2.00
Human Blockade	3	2.00
Croatian Demochristian Party (HDS)	2	1.33
Let's Change Croatia (PH).....	2	1.33
Croatian Democratic Alliance of Slavonia and Baranja (HDSSB)	1	0.67
Croatian Pensioners Party (HSU).....	1	0.67
Croatian Social Liberal Party (HSL).....	1	0.67
People's Party – Reformists.....	1	0.67
HRAST - Movement for Successful Croatia	1	0.67
Power - People's and Civic Engagement Party (SNAGA).....	1	0.67
Party of Croatian Intergenerational Solidarity (SMŠH)	1	0.67
Independent MPs	8	5.33
National Minorities MPs	5	3.33
TOTAL	150	100.00

Source: Internet Editorial Staff of the Croatian Parliament, Members of the 9th Term on 1 October 2017

Presidential Elections

On 28 December 2014, a first round of presidential elections was held and Mr. Ivo Josipović, the acting President since 2010, won 38.46 per cent. of votes, which was not sufficient to win the elections outright. A second round of presidential elections was held on 11 January 2015 between first-round winner Mr. Ivo Josipović and first-round runner-up Ms. Kolinda Grabar-Kitarović, nominated by the HDZ, and Ms. Grabar-Kitarović won 50.74 per cent. of votes, becoming newly elected president for a 5-year term starting in February 2015.

Local Elections

The most recent elections for the local and regional governments took place in May 2017. The next elections for the local and regional governments are expected to take place in 2021.

Croatia is divided into 21 counties containing 127 towns/cities and 428 municipalities. The Croatian Constitution reserves certain functions, including police services, education and other local services, for the county and local governments.

Cooperation with the ICTY and Domestic War Crime Trials

Croatia has cooperated with the International Criminal Tribunal for the Former Yugoslavia (the "ICTY") in connection with the prosecution of crimes committed during the 1991 War. According to the first instance verdict in 2011, two former generals of the armed forces of Croatia were sentenced to 18 and 24 years in prison, respectively. In 2012, the ICTY's Appeals Chamber acquitted them. Croatia's domestic courts continue to hear war crimes cases brought by the State Prosecutor's Office related to the 1991 War. There have been no significant prosecutions since 2012.

General Information

The address of the Ministry of Finance of Croatia is Katančičeva 5, HR-10000 Zagreb, Croatia and the telephone number is +385 1 45 91 333.

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 CBS, the HNB and the Ministry of Finance of Croatia.

Economic Reform Policy

The Republic has shown progress in important structural reforms, and the significant decrease of public debt during the last three years, by as much as 10 percentage points from 2015 to 2018, is of particular importance. At the beginning of 2019, the third round of tax reform was initiated resulting in, among other things, the reduction of the value-added tax on certain products. This measure is expected to increase disposable income, whereas the reduction of labour costs for employers might incentivise investment activity. The economy is growing steadily since recession ended in 2015 as a result of, among other things, strong growth of the tourism sector. Manufacturing and service activities, such as transport, also contribute significantly to GDP, and personal consumption is expected to stay strong due to the growth in employment and salaries, as well as further tax relief. Investments are expected to increase, owing to an increased absorption of EU funds, particularly investments in public infrastructure.

Main objectives, reform priorities and measures of the economic policy

The Government's policy is based on: continuing fiscal consolidation (a prerequisite of sound economic growth); implementing structural reforms (in order to improve the public administration system, the judicial system, education, social welfare, healthcare and state property management); and increasing investments.

The reform priorities have been established with regard to three objectives: strengthening the competitiveness of the economy, connecting education with the labour market, and sustainability of public finances. The Republic will aim to advance these specified objectives during 2019 by implementing 30 economic policy measures categorised into 10 reform priorities, as set out below.

Strengthening the Competitiveness of the Economy

1. Improving the business environment

The regulatory reform for the purpose of improving the business environment by means of relieving the business sector in terms of administration and various non-tax payments will be continued. The liberalisation of the services market and digitisation of starting a business will facilitate access to the market for new entrepreneurs and market competition. Emphasis will be also put on improving the regulatory framework in order to incentivise investments by economically activating inactive state-owned property and investing in new technologies. Considering the importance of the transport system on the TEN-T network in the Republic for the development of the Croatian economy, special attention will be dedicated to the development and integration of infrastructure intended for certain types of transport. Efforts will also be directed towards improving the results in the area of high-speed and ultra-high-speed broadband network coverage in order to achieve the objectives of the European digital agenda. The water utility sector reform aims to enable efficient business activities of public water service suppliers, which reflect positively on the price of water services.

2. Increase in investments

The existing programmes for investment incentivisation will be incorporated into new technologies and the capacities of the counties for attracting and incentivising investments will be improved in order to increase the number of investments and ensure equitable regional development.

3. Improvement of the management and disposition of state property

This will continue through the activation of state property and the reduction of the state portfolio, as well as through ensuring more responsible management and more successful business operations of state-owned enterprises. The financial restructuring of state-owned road and railway system enterprises is of particular importance.

4. *Improving public administration*

This focuses on more efficient human resources management, along with revising the salary setting system, as well as a more efficient performance of state administration activities which will be ensured through digitisation projects, introduction of quality control systems and further professionalisation. An integrated system of strategic planning and development management will be introduced as a foundation for channelling budgetary resources, monitoring achieved results and systematic assessment of the implementation of strategies, plans, programmes, activities and projects for the purposes of increasing the quality of formulation and implementation of public policies. For the purpose of strengthening the normative framework in the area of anti-corruption, there are plans for improving the accountability and integrity of public officials, the organisation of the system and the legislative framework.

5. *Improvement of the efficiency of the judicial system*

This will be continued through further development of electronic communication between courts and other participants of judicial proceedings. The efforts regarding the functional improvement of the system, acceleration and shortening of the duration of judicial proceedings will be continued, as well as the activities of tracking the resolution of old unresolved court cases.

Aligning education with labour market needs

6. *Education and training in accordance with labour market needs*

This involves the reform of general and vocational education, lifelong learning and efficient and relevant higher education. The curricular reform will establish a harmonised and efficient education system. The establishment of the system of developing digitally advanced schools within the education process will enable the integration of modern learning and teaching methods. The development of vocational education and training is headed towards changes and adaptations focused on quality and efficiency, a greater connectedness with the labour market and more learning methods focused on work-based learning. The instruments for improving the quality and relevance of adult education and lifelong learning programmes, as well as study programmes, will be strengthened in order to ensure their compliance with the real needs of the economy and society as a whole.

Sustainability of public finances

7. *Strengthening the framework for public financial management and implementation of fiscal consolidation*

This includes strengthening fiscal responsibility, budgetary spending control and collection of revenue, as well as increasing the efficiency of the process of collecting data regarding the execution of financial plans. Emphasis will also be placed on the implementation of ex-post evaluation of effects of select programmes, activities or projects and the establishment of a more efficient system of financial and statistical planning and reporting by extra-budgetary users from the transport sector.

8. *Stimulation of demographic renewal*

This will be continued through the implementation of a measure aimed at increasing social security of families with children. In more sparsely inhabited and rural areas of the Republic, this process includes ensuring the availability of institutions and programmes of early childhood and preschool education in order to meet the needs of families with children and to create an incentivising environment for them to remain in the community. In order to incentivise employed parents to use parental leave and improve the material status of families with new-born children, plans are underway to increase the amount of monetary allowance during parental leave.

9. *Improving the social welfare system*

This focuses on a transparent social security benefits system with comprehensive records on social security benefits that citizens receive or can receive on a national or local level, which will serve as a foundation for better channelling of benefits and programmes, reducing regional disparities, as well as creating more efficient social policies. Further development of e-services in the social

welfare system will contribute to a greater accessibility of its services, and a uniform approach to financing for all social service providers will enable equal availability of the services for all users.

10. *Ensuring financial stability, sustainability and quality of the healthcare system*

The aim is to achieve this through the improvement of human resources management in the healthcare sector and the optimisation of other hospital healthcare system resources, the application of information and communications technologies for the purpose of ensuring efficient organisation, planning and control of healthcare costs, as well as increasing the availability and quality of healthcare services. Structural and organisational measures in the area of prevention, diagnostics and treatment of malignant diseases will also be initiated. For the period 2016-2020, which coincides with the mandate of the current Government, economic policy is focused on the creation of a stimulating, transparent and safe business environment where the private sector is the generator of economic development, while the state guarantees the implementation of principles grounded on social solidarity, partnership and protection.

EU Structural Funds

Croatia is able to apply for and receive EU structural funds pursuant to the EU Cohesion Policy (the "**Cohesion Policy**"). The Cohesion Policy aims to achieve a balanced development within the EU and to strengthen the global competitiveness of the European economy. Funds pursuant to the Cohesion Policy are made available to Member States that need additional investment in order to achieve balanced and sustainable economic and social development. Those funds include the European Social Fund (engaged in programmes relating to employment and labour market participation), the European Regional Development Fund (supporting job creation, competitiveness, economic growth, improved quality of life and sustainable development) and the Cohesion Fund (available to Member States with GDP of less than 90 per cent. of the EU average and aiming to boost economic development). In order to receive disbursements pursuant to these EU programmes, Croatia must propose suitable projects, meet certain initial criteria and comply with ongoing monitoring obligations relating to transparency and the proper use of funds. In addition, the receipt of funds under these EU programmes is subject to a co-financing requirement by Croatia.

EU funds and programmes contribute to addressing structural challenges and to fostering growth and competitiveness in Croatia. Croatia is one of the largest beneficiaries of EU solidarity funds. The financial allocation from EU funds amounts to up to EUR 10.7 billion for 2014-2020, potentially equivalent to above 3 per cent. of GDP annually. The additional national co-financing is expected to be approximately EUR 2 billion, so the national budget amounts to almost EUR 12.6 billion. As of the end of 2018 approximately EUR 6.8 billion (around 64 per cent. of the total EU funds received) had been allocated to specific projects. In addition to European Structural and Investment Funds, EUR 424 million was allocated to specific projects on strategic transport networks through a dedicated EU funding instrument, the Connecting Europe Facility. Furthermore, numerous Croatian research institutions, innovative firms and individual researchers benefited from other EU funding instruments, notably Horizon 2020 which provided EUR 62 million.

Plans for Adoption of the Euro

As a member state of the EU, Croatia is committed to adopt the euro once it fulfils the necessary conditions, and will seek to enter the ERM II. Under ERM II, the exchange rate of a non-euro area Member State is fixed against the euro and is only allowed to fluctuate within set limits. Entry into ERM II is based on an agreement between the ministers and central bank governors of the non-euro area Member State and the euro area Member States, and the European Central Bank. On 27 May 2019, the Republic of Croatia submitted a request to the ECB for the establishment of a close cooperation between the ECB and the Croatian National Bank in the exercise of supervisory tasks over credit institutions within the SSM. This step is part of the procedure for the entry of the Republic of Croatia to ERM II and, subsequently, to the euro area, in line with Croatia's commitment pursuant to the Accession Treaty. The Republic of Croatia intends to concurrently establish close cooperation with the ECB for entry into the ERM II. Croatia is a highly euroised economy (both on the asset and liabilities side) and the benefits of adopting the euro are believed by the Government to outweigh the possible disadvantages of eurozone membership. Croatia's date of entry into ERM II and, subsequently, into the eurozone (though not expected in the short term) are dependent on Croatia's ability to fulfil the relevant membership criteria (See "*Risk Factors* —

The further proliferation of the euro in the Croatian economy may adversely affect the HNB's ability to implement its monetary policies"). In May 2018, the government adopted the Strategy for the introduction of the euro as the official currency in the Republic of Croatia. The Government of the Republic of Croatia and the Croatian National Bank have jointly prepared this strategy document for the purpose of acquainting the public with the process and the effects of the adoption of the euro as the official currency in Croatia. The document provides an analysis of economic costs and benefits of euro adoption, which may serve as a starting point for public debate and for reaching a consensus on whether Croatia should introduce the euro as soon as possible. In addition, it describes procedures and required adjustments necessary for meeting conditions for the adoption of the common currency and successful participation in the monetary union in the future. The document, although not stating the target date for the introduction of the euro, presents some of the strategic determinants of economic policy in the upcoming period, which will, in addition to the direct contribution to the effort of meeting the criteria for the introduction of the euro, contribute to the creation of conditions for sustainable economic convergence.

The request put forward by the Republic of Croatia to the ECB in May 2019 referred to above is based on Article 7 of Council Regulation (EU) No 1024/2013 and on the Decision of the European Central Bank of 31 January 2014 on the close cooperation with the national competent authorities of participating Member States whose currency is not the euro (ECB/2014/5). Close cooperation is established by a decision of the ECB, upon the request of a Member State. The procedure for the establishment of close cooperation with the ECB consists of two steps: the harmonisation of the regulatory framework and the comprehensive assessment of credit institutions. The first step involves the preparation and adoption of the relevant national legislation enabling the ECB to exercise supervisory tasks pursuant to the mentioned regulations on a close cooperation and to assess this legislation. The second step comprises the comprehensive assessment of banks in the Member State wishing to establish a close cooperation with the ECB, which consists of evaluating their asset quality and testing their resilience to shocks. The assessment procedure begins after the harmonisation of the applicable national legislation and lasts from six to twelve months. Once both steps have been completed, the ECB adopts a decision establishing how supervisory tasks will be transferred to the ECB and when close cooperation will start, including, identification of significant credit institutions in the Republic. The remaining less significant credit institutions remain under the supervision of the Croatian National Bank on behalf of the ECB.

World Bank Country Partnership Strategy

In May 2019, the World Bank Group's Board endorsed the Country Partnership Framework ("CPF") for the Republic of Croatia for the period 2019-2024, replacing the previous Country Partnership Strategy for 2014-2017 whose goal was to support Croatia's convergence with the EU, prioritising aspects of the Europe 2020 "smart, sustainable, and inclusive growth" strategy and the Government's reform agenda. The 2019-2024 CPF is aligned with the Government's plan for Croatia's future development focusing on accelerating growth and convergence to EU income levels as well as reducing vulnerabilities and regional disparities. The CPF focuses on the following three areas:

- enhancing public sector performance and institutions
- preserving and leveraging natural capital to ensure low carbon growth
- strengthening market institutions to enable a dynamic enterprise sector

In the selection and structuring of projects to be supported, primary consideration is given to projects that contribute to the progress towards more sustainable and resilient economic and social convergence. The CPF indicatively envisages interventions aimed at improving the quality and efficiency of education; strengthening efficiency in the justice sector and market institutions to improve business environment; and enhancing access to finance in lagging regions. It also prioritizes engagements across key industries, particularly with a view to mobilizing private investments that support regionally competitive and innovative local firms; target innovative capital market instruments; and promote public private partnerships in renewable energy and transport infrastructure. A number of reimbursable advisory services is envisaged as well, to support improvement of EU resources utilization.

The World Bank's current total active lending portfolio with respect to Croatia consists of 4 projects and 1 programme, in the total value of approximately U.S.\$ 370 million in the sectors of education, health, roads, land administration and railways. In addition, the International Finance Corporation's active portfolio of investments in Croatia amounts to approximately U.S.\$ 153 million.

Economic Incentives Reform

The Agency for Investment and Competitiveness ("**AIK**") was established by the Government in April 2012. It provided assistance in removing administrative barriers and conducted post-investment supervision as well as advisory services in relation to investment and promotion of Croatia as a desired investment destination. In December 2018, AIK was adjoined to the Ministry of Economy, Entrepreneurship and Crafts which is in charge of investments processes in Croatia and all activities and employees of the AIK. In order to help stimulate new investment, the Ministry of Economy has prepared the Catalogue of Investments (the "**Catalogue**") comprising all investment projects related to energy, tourism and infrastructure.

In addition, the Government adopted several new acts aimed at improving competitiveness and growth. The Act on Investment Incentives and Improvement of Business Environment came into force in October 2012 and was subsequently replaced by the Act on Promotion of Investments (OG 102/2015, 25/2018 and 114/2018) (the "**Act on Promotion of Investments**"), which came into force in October 2015. The Act on Promotion of Investments regulates incentives for investment projects in production and manufacturing activities, development and innovation activities, business support activities, high added value service activities and activities in tourism. Investors in production and manufacturing activities, technological development and innovation activities, or strategic activities related to business support have various tax benefits. Several types of non-refundable financial support for job creation and professional improvement of employees are also available to investors. Furthermore, the Republic of Croatia offers additional non-refundable financial support for investments in development and innovation of products via high technology. Official guidance has not yet been published.

The Strategic Investment Projects Act (the "**Strategic Investment Projects Act**") (OG 29/2018 and 114/2018) that entered into force in April 2018 aims to support investment by accelerating the implementation of large projects of strategic interest for the Government (i.e. legal ownership issues, granting of licences). The Strategic Investment Projects Act *inter alia* applies to public and private capital projects with a value of at least HRK 75 million or capital projects fulfilling certain criteria such as employment of a considerable number of persons, contribution to development of tourism, economy, exports, technology, implementation of projects in undeveloped parts of the country, development of the infrastructure network, rises the overall level of safety and quality of life of citizens, and contributes to competitiveness of the Croatian economy. Strategic projects are selected by Government committee.

The Croatian Bank for Reconstruction and Development (Hrvatska Banka za obnovu i razvitak) ("**HBOR**") engages in activities to stimulate the Croatian economy including (among other things): reduced interest rates for loans; loans without foreign exchange clauses; risk sharing and support to exporters. Interest rates have effectively been reduced by 1 per cent. for loans to support investments in agriculture, fisheries, tourism, energy efficiency and renewable energy resources. All loans approved prior to the end of 2012 were allowed to be executed without foreign exchange clauses except those approved with interest rates linked to EURIBOR. HBOR has developed new models of risk sharing. For instance, HBOR shares risks with commercial banks in the financing of new projects for small and medium-size enterprises. Projects valued at greater than HRK 9 million can also be financed via a new model of risk sharing where commercial banks and HBOR share the risk equally.

Reform of Croatia's Roads and Motorways

Overview

The roads and motorways of Croatia are among the largest infrastructure assets of Croatia, and their development over recent years has supported increased modernisation and network expansion as well as greater connectivity and integration with the European network.

Beginning in 2001, Croatia undertook a large road and motorway network expansion, with investments in motorways exceeding EUR 7.7 billion from 2001 to 2008 and decreasing afterwards. This expansion was aimed at spurring industry growth and tourism, and integrating the Croatian network into the broader European network. This has supported a substantial growth in freight and passenger traffic over this period of time, which today accounts respectively for 73 per cent. and 71 per cent. of total traffic in Croatia.

The roads and motorways network of Croatia is primarily managed by three companies, each of which is fully owned by the State:

- Hrvatske Autoceste d.o.o. ("**HAC**"), established in 2001 and in charge of the management, construction and maintenance of 926 km of motorways, including A1, A3, A4, A5, A10, A11 and DC532⁽ⁱ⁾.
- Autocesta Rijeka-Zagreb d.d. ("**ARZ**"), established in 1998 and in charge of the management, construction and maintenance of 187 km of motorways, including A1, A6, A7 and DC102⁽ⁱ⁾.
- Hrvatske Ceste d.o.o. ("**HC**"), established in 2001 and in charge of the management, construction and maintenance of 7,098 km of roads.

(i) The operation and maintenance activities have been assigned to HAC-ONC.

There are also privately operated companies in Croatia that manage certain motorways, most notably BINA-ISTRA d.d. and Autocesta Zagreb Macelj d.o.o.. The size of their road networks (141 km and 60 km respectively) are relatively small when compared with those of HAC, ARZ and HC (together, the "**Road Companies**").

Ongoing road sector reform

In 2015, the Government launched a review of actions necessary to improve the institutional capacity, operational efficiency and debt profile of the roads and motorways sector.

The transformations that comprise the Road Sector Reform are reflected in a letter of sector policy, which was designed by Croatia towards the end of 2016 and approved by the Government on 16 March 2017 (the "**Letter of Sector Policy**"), and includes certain reforms to the roads and motorways network, primarily focused on the Road Companies. These reforms are supported by multilateral institutions, particularly the IBRD and EBRD. The IBRD Board has approved a project with Croatia relating to the Road Sector Reform (the "**IBRD Project**"), which is consistent with the IBRD's CPS with Croatia for financial years 2014 to 2017. In support of the IBRD Project and the Road Sector Reform, the IBRD has made available a EUR 22m loan to Croatia.

As set out in the Letter of Sector Policy, the proposed reforms that form part of the Road Sector Reform include the following:

- An increase in the toll rate on HAC and ARZ motorways, as well as the harmonisation of certain other existing toll rates and the implementation of fully automated electronic tolling systems.
- The merger of Hrvatske autoceste održavanje i naplata cestarine d.o.o. ("**HAC-ONC**") (which was a subsidiary of both HAC and ARZ) into HAC, and the transfer of certain operational activities of ARZ, related to the motorway sector and currently performed by HAC ONC, to HAC through future service contracts between HAC and ARZ.
- The standardisation of road classification, maintenance and management criteria within Croatia, and the development of a Road Asset Management System covering the motorways, state roads and county roads in Croatia.
- The approval by the Government of a Public Roads Construction and Maintenance Programme covering the years 2017 to 2020, and the implementation of road and traffic safety-related initiatives on Croatia's TEN-T road network, in accordance with EU Directives.
- The adoption by the Road Companies of updated corporate governance plans based on OECD principles.
- A debt optimisation exercise in respect of the existing debt of each of the Road Companies.

To date, the following reforms have been completed:

- The toll rates on HAC and ARZ motorways have been increased.

- In terms of the merger of HAC and HAC-ONC, HAC has acquired the equity capital of HAC-ONC that was previously owned by ARZ (at market value following a determination of the fair market value of such equity capital by an independent expert). The effective date of the acquisition was 4 October 2017.
- An investment plan for the road sector for 2017 to 2020, with clear prioritisation criteria, has been approved.
- Other measures on cost reduction, tolling, standards and improvement in sector monitoring have started and will fully materialise in relation to activities carried out with the support of IBRD.

Debt optimisation exercise in respect of the Road Companies

On 19 January 2017, the Ministry of Sea, Transport and Infrastructure ("MSTI") appointed a consortium led by Lazard Frères to advise it on the design and implementation of the debt optimisation exercise. This included a review of the Road Companies' current situation, debt profile and prospects. Following this review, MSTI determined that a debt optimisation exercise for each of the Road Companies needed to be explored in order to enable a smooth implementation of the Proposed Sector Reforms, permit the operational improvement of the Road Companies, and enhance the debt sustainability of the Road Companies in the short, medium and long term.

The financial restructuring of the road sector was conducted in two phases. For the first phase, in November 2017, the Ministry of Finance issued a bond of EUR 1.275 billion (HRK 9.5 billion) in cooperation with the MSTI, due in 2030, with a yield of 2.95 per cent. and a coupon of 2.75 per cent. All the proceeds of the issuance were on-lent by Croatia to the Road Companies pursuant to downstream agreements entered into between Croatia and each Road Company. Each Road Company used the proceeds from the applicable downstream agreement to prepay or refinance certain of its indebtedness on 20 December 2017. The first phase resulted in minimum future savings on interest payments of EUR 21 million per year. The second phase involved the refinancing of approximately EUR 1.8 billion of debt through issuance of "Jumbo loans" (i.e. existing loans for each Road Company were closed by a single large loan with much more favourable terms). The second phase resulted in an average interest rate reduction from 3.77 per cent. to 1.95 per cent., which represents minimum future savings on interest payments of EUR 29 million per year. The savings on interest payments of both phases amount to a minimum of EUR 50 million per year. These measures help maintain the financial stability and liquidity of the road sector and ensure the stable settlement of road sector's annual servicing loan obligations.

Gross Domestic Product

The following table sets forth real and nominal GDP amounts for the periods indicated:

	Year ended 31 December				
	2014	2015	2016	2017 ⁽¹⁾	2018 ⁽¹⁾
Nominal GDP (HRK millions).....	331,570	339,616	351,349	365,643	381,799
Real GDP (HRK millions) ⁽²⁾	318,622	326,271	337,808	347,677	356,820
Nominal GDP (EUR millions).....	43,456	44,630	46,664	49,013	51,496
Nominal GDP per capita (EUR).....	10,254	10,616	11,180	11,882	12,594
Real GDP growth (per cent.).....	(0.1)	2.4	3.5	2.9	2.6

Source: CBS and HNB

⁽¹⁾ Preliminary data for 2017 and 2018.

⁽²⁾ Constant previous year prices, reference year 2010.

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

	Year ended 31 December				
	2014	2015	2016	2017	2018 ⁽¹⁾
	(per cent.)				
Households	(1.6)	1.0	3.4	3.6	3.5
NPISH	1.0	10.5	6.8	2.6	3.3
Government	1.8	(1.0)	0.7	2.7	2.9

	Year ended 31 December				
	2014	2015	2016	2017	2018 ⁽¹⁾
	<i>(per cent.)</i>				
Gross fixed capital formation	(2.8)	3.8	6.5	3.8	4.1
Exports of goods and services	6.0	9.4	5.6	6.4	2.8
Imports of goods and services	3.1	9.2	6.2	8.1	5.5
Change in overall GDP for the period.....	(0.1)	2.4	3.5	2.9	2.6

Source: CBS

⁽¹⁾ Preliminary data for 2017 and 2018.

The following table sets forth the quarterly GDP change by expenditure for the periods indicated:

	Final consumption expenditure						Gross domestic product (market price)
	Households	NPISH	Government	Gross fixed capital formation	Exports of goods and services	Imports of goods and services	
	<i>(per cent.)</i>						
2014							
First quarter.....	(1.5)	0.7	0.8	(1.6)	9.5	6.4	(1.0)
Second quarter.....	(1.6)	2.5	0.4	(3.4)	7.7	3.0	(0.4)
Third quarter	(2.2)	0.2	2.9	(2.9)	4.6	3.6	0.1
Fourth quarter.....	(1.3)	0.7	3.0	(3.0)	4.3	(0.3)	0.8
2015							
First quarter.....	(0.1)	8.4	0.4	1.5	9.5	9.3	1.5
Second quarter.....	0.3	10.0	(1.0)	2.4	11.7	6.8	1.8
Third quarter	1.1	11.3	(1.6)	5.0	7.1	7.8	3.8
Fourth quarter.....	2.4	12.3	(2.0)	6.3	10.8	13.1	2.3
2016							
First quarter.....	3.1	5.9	(1.2)	6.4	7.0	5.9	3.3
Second quarter.....	3.1	6.5	1.3	8.0	3.8	7.7	3.2
Third quarter	3.7	7.3	1.2	4.9	5.5	5.5	3.7
Fourth quarter.....	3.6	7.1	1.3	6.5	6.5	5.7	4.0
2017							
First quarter.....	3.5	3.2	2.0	6.1	10.6	11.7	2.9
Second quarter.....	3.8	3.1	2.3	3.7	7.0	6.1	3.2
Third quarter	3.7	2.5	3.1	3.7	5.6	8.3	3.4
Fourth quarter.....	3.5	1.6	3.4	1.9	3.8	6.8	2.2
2018							
First quarter.....	3.9	4.3	2.8	3.6	(0.5)	5.5	2.5
Second quarter.....	3.6	2.7	2.5	3.1	5.6	4.7	2.9
Third quarter	2.7	3.7	3.9	3.7	3.7	5.1	2.8
Fourth quarter.....	3.9	2.5	2.3	6.1	1.3	6.6	2.3

Source: CBS

⁽¹⁾ The data are harmonised with the data series according to the annual GDP calculation for the period from 2000 to 2016, while data for the period from the first quarter of 2017 to the fourth quarter of 2018 are provisional.

After six years of negative growth, in 2015 real GDP rose by 2.4 per cent. compared to the previous year. The largest positive contribution to the GDP growth came from an increase in exports of goods and services of 9.4 per cent. Household consumption, including Non-profit Institutions Serving Households ("NPISH") increased in real terms by 1.1 per cent. and gross fixed capital formation recorded a real increase of 3.8 per cent., while government consumption decreased by 1.0 per cent., imports of goods and services contributed negatively to the GDP growth, increasing by 9.2 per cent. in 2015.

Positive developments continued in 2016 and real GDP increased by 3.5 per cent., year-on-year. The biggest positive contribution to GDP growth came from exports of goods and services, which recorded a growth of 5.6 per cent., year-on-year. Household consumption (including NPISH) increased by 3.5 per cent., gross fixed capital formation by 6.5 per cent. and government consumption by 0.7 per cent. year-on-year. Imports of goods and services, which recorded a growth of 6.2 per cent., year-on-year caused a negative contribution to GDP growth.

In 2017 GDP increased by 2.9 per cent. in real terms, year-on-year. The biggest positive contribution to GDP growth came from exports of goods and services which increased by 6.4 per cent. and household consumption (including NPISH) with a real growth of 3.6 per cent. year-on-year. Gross fixed capital formation increased by 3.8 per cent., government consumption by 2.7 per cent. and imports of goods and services by 8.1 per cent. in real terms, year-on-year.

In May 2018 CBS published a press release on revised annual GDP data for the period 2000 to 2016. The data for 2017 and 2018 is provisional.

Positive developments continued in 2018 and real GDP increased by 2.6 per cent., year-on-year, according to provisional data. The largest positive contribution to GDP growth came from household consumption (including NPISH), which recorded a growth rate of 3.5 per cent., year-on-year. Exports of goods and services increased by 2.8 per cent., gross fixed capital formation by 4.1 per cent. and government consumption by 2.9 per cent. year-on-year. Imports of goods and services, which recorded a growth rate of 5.5 per cent. year-on-year, contributed negatively to GDP growth.

Gross Value Added ("GVA")

In 2014, real GVA recorded a stagnation in comparison to the previous year. The most positive contribution to GVA change in 2014 came from manufacturing, mining and quarrying, and other industries, but was offset by a negative contribution from agriculture. In 2015, total GVA growth amounted to 2.3 per cent. This increase was primarily a result of an increase by 4.5 per cent. in wholesale and retail trade, transportation, storage, accommodation and food service activities and an increase by 2.9 per cent. in manufacturing, mining and quarrying, and other industries. In 2016 real GVA recorded an increase of 3.5 per cent., year-on-year, which was primarily the consequence of growth of GVA in industry (5.9 per cent.) wholesale and retail trade, transportation, storage, accommodation and food service activities (5.0 per cent.). In 2017, real GVA recorded an increase of 2.1 per cent. (and amounted to EUR 40.4 billion), year-on-year, which was again primarily the consequence of growth of GVA in wholesale and retail trade, transportation, storage, accommodation and food service activities (4.5 per cent.). All other categories, with the exception of agriculture, forestry and fishing, had a positive contribution to real GVA growth. In 2018, according to provisional data, GVA recorded a growth rate of 2.1 per cent. in real terms, year-on-year, which was again primarily due to the growth of GVA in wholesale and retail trade, transportation, storage, accommodation and food service activities (4.4 per cent.). All other categories, with the exception of manufacturing, mining and quarrying, and other industries, had a positive contribution to GVA growth in real terms.

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

	Year ended 31 December							
	2014		2015		2016		2017	
	(HRK millions)	(per cent. of total)	(HRK millions)	(per cent. of total)	(HRK millions)	(per cent. of total)	(HRK millions)	(per to
Agriculture, forestry and fishing	9,784	3.5	10,243	3.6	11,018	3.8	11,022	
Manufacturing, mining and quarrying and other industries.....	59,514	21.5	60,317	21.4	62,250	21.4	63,383	
Construction.....	14,771	5.3	15,105	5.4	15,365	5.3	15,767	
Wholesale and retail trade, transportation, storage, accommodation and food service activities	58,559	21.1	61,081	21.7	64,216	22.0	68,219	
Information and communication	12,151	4.4	12,651	4.5	13,145	4.5	13,754	
Financial and insurance activities	18,554	6.7	18,219	6.5	18,377	6.3	18,657	
Real estate activities	28,979	10.5	29,069	10.3	29,237	10.0	29,623	
Other ⁽¹⁾	74,639	27.0	75,221	26.7	77,750	26.7	81,132	
Total	276,951	100.0	281,905	100.0	291,358	100.0	301,557	

Source: CBS

(1) Category contains professional, scientific, technical, administrative and support service activities as well as public administration and defence, education, human health activities

* The data are harmonised with the data series according to the annual GDP calculation for the period from 2000 to 2016, while data for 2017 and 2018 are provisional.

The following table sets forth real GVA, reference year 2010, for the periods indicated:

	Year ended 31 December							
	2014		2015		2016		2017	
	(HRK millions)	(per cent. of total)	(HRK millions)	(per cent. of total)	(HRK millions)	(per cent. of total)	(HRK millions)	(per cent. of total)
Agriculture, forestry and fishing	8,977	3.3	9,317	3.4	9,997	3.5	9,785	
Manufacturing, mining and quarrying and other industries.....	53,554	20.0	55,095	20.1	58,322	20.5	59,108	
Construction.....	14,243	5.3	14,521	5.3	14,795	5.2	14,987	
Wholesale and retail trade, transportation, storage, accommodation and food service activities.....	54,858	20.4	57,306	20.9	60,179	21.2	62,901	
Information and communication	13,187	4.9	13,797	5.0	14,316	5.0	14,886	
Financial and insurance activities	19,207	7.2	19,160	7.0	19,340	6.8	19,524	
Real estate activities	27,409	10.2	27,359	10.0	27,439	9.7	27,493	
Other ⁽¹⁾	76,937	28.7	77,753	28.3	79,258	27.9	81,001	
Total	268,288	100.0	274,336	100.0	283,904	100.0	289,912	

Source: CBS

(1) Category contains professional, scientific, technical, administrative and support service activities as well as public administration and defence, education, human health activities

* The data are harmonised with the data series according to the annual GDP calculation for the period from 2000 to 2016, while data for 2017 and 2018 are provisional.

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

	Year ended 31 December				
	2014	2015	2016	2017	2018
Agriculture, forestry and fishing	(12.8)	3.8	7.3	(2.1)	2.0
Manufacturing, mining and quarrying and other industries	2.6	2.9	5.9	1.3	(0.9)
Construction.....	(2.9)	2.0	1.9	1.3	4.7
Wholesale and retail trade, transportation, storage, accommodation and food service activities	0.2	4.5	5.0	4.5	4.4
Information and communication	(2.4)	4.6	3.8	4.0	4.6
Financial and insurance activities.....	1.6	(0.2)	0.9	0.9	0.3
Real estate activities	(0.2)	(0.2)	0.3	0.2	0.6
Other ⁽¹⁾	0.5	1.1	1.9	2.2	2.7
Total GVA	0.0	2.3	3.5	2.1	2.1

Source: CBS

(1) Category contains professional, scientific, technical, administrative and support service activities as well as public administration and defence, education, human health and social work activities and other service activities

The data are harmonised with the data series according to the annual GDP calculation for the period from 2000 to 2016, while data for 2017 and 2018 are provisional.

Agriculture, forestry and fishing

In 2014, GVA in the agriculture, forestry and fishing sectors decreased by 12.8 per cent. in comparison to 2013. However, in 2015, GVA in this sector recorded a positive trend, increasing by 3.8 per cent., year-on-year. In 2016, GVA increased again by 7.3 per cent. in comparison to 2015. However, in 2017, the trend reversed as GVA declined by 2.1 per cent in comparison to 2016. In 2018, GVA in this sector increased by 2 per cent., year-on-year.

Manufacturing, mining, quarrying, and other industries

In 2014 and 2015, the GVA in this sector grew by 2.6 and 2.9 per cent., respectively. Positive developments continued in 2016 and 2017, when GVA in this sector recorded a real year-on-year growth of 5.9 and 1.3 per cent., respectively. In 2018, GVA in this sector declined by 0.9 per cent., year-on-year.

Construction

In 2014, the GVA in this sector continued to decline by 2.9 per cent. However, in 2015 and afterwards, real year-on-year growth of GVA was recorded, for the first time after six years, amounting to 2.0 per cent. in 2015, 1.9 per cent. in 2016 and 1.3 per cent. in 2017. In 2018, GVA in this sector increased by 4.7 per cent., year-on-year.

Wholesale and retail trade, transportation, storage, accommodation and food service activities

The real growth rate of the GVA in the wholesale and retail trade, transportation, storage, accommodation and food service was 0.2 per cent. in 2014 and 4.5 per cent. in 2015. In 2016 and 2017, real year-on-year growth of GVA in this sector was 5.0 and 4.5 per cent., respectively. In 2018, GVA in this sector increased by 4.4 per cent., year-on-year.

Information and communication

The information and communication sector has recorded negative real growth rates from 2009 onwards. In 2014, GVA in this sector decreased by 2.4 per cent. In 2015, 2016 and 2017, GVA finally recorded a positive trend, increasing by 4.6, 3.8 and 4.0 per cent., respectively. In 2018, GVA in this sector increased by 4.6 per cent., year-on-year.

Financial and insurance activities

In 2014, GVA in this sector increased by 1.6 per cent. in real terms. The real growth rate of GVA was, again, negative in 2015, amounting to 0.2 per cent. In 2016 and 2017 the real growth rate of GVA was positive, amounting to 0.9 per cent. in each year. In 2018, GVA in this sector increased by 0.3 per cent., year-on-year.

Real estate activities

GVA in the real estate activities sector declined by 0.2 per cent in both 2014 and 2015. In 2016, real year-on-year growth of 0.3 per cent. was recorded. In 2017, real year-on-year growth of 0.2 per cent. was recorded. In 2018, GVA in this sector increased by 0.6 per cent., year-on-year.

Other Sectors

In 2014, GVA in the other sectors, a category which contains professional, scientific, technical, administrative and support service activities as well as public administration and defence, education, human health and social work activities and other service activities, experienced a real growth rate of 0.5 per cent. In 2015, GVA in the other sectors experienced a real increase of 1.1 per cent. In 2016 and 2017, real year-on-year growth of 1.9 and 2.2 per cent., respectively, was recorded. In 2018, GVA in this sector increased by 2.7 per cent., year-on-year.

Inflation and Trends in Prices

Inflation in Croatia is measured according to a consumer price index ("CPI") and a producer price index ("PPI"). The CPI is based on the price of a basket of approximately 890 goods and services weighted according to the Household Budget Survey and by available administrative data. Approximately 38,000 product prices are collected each month in a fixed panel of outlets in nine geographical locations. The PPI on the domestic market is based on a sample of 2,093 industrial product prices for 2019. Unlike the CPI, the PPI does not take into account services. Standards for calculating the CPI and the PPI in Croatia are materially in line with the standards used for calculating the CPI and the PPI in the EU.

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

Overview of Inflation

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

	2014	2015	2016	2017	2018
CPI (period average).....	-0.2	-0.5	-1.1	1.1	1.5
PPI (domestic market, period average).....	-2.7	-3.9	-4.0	2.1	2.3
CPI (end of period).....	-0.5	-0.6	0.2	1.2	0.8
PPI (domestic market, end of period).....	-3.3	-4.1	0.1	2.1	0.5

Due to significantly lower prices of crude oil and other commodities (mainly food products) in the world market, low inflation in the eurozone and subdued domestic inflationary pressures (both from the demand and the cost side), there was a continued decline in inflation and the average annual CPI inflation rate in Croatia in 2015 stood at -0.5 per cent. and the annual CPI inflation rate stood at -0.6 per cent. in December 2015. The negative contribution to inflation originated largely from energy prices. Separately, the average annual core inflation rate (calculated excluding volatile prices, such as agricultural and energy prices), as well as administratively regulated prices, was positive in 2015 but at a low of 0.2 per cent. Furthermore, the inflation diffusion index, which shows the share of the number of products whose prices increased in a given month in the total number of products in the harmonised CPI basket, proves that the negative inflation rate is not diffused to the largest number of products. In 2015, the share of products, whose price rose at a monthly level, reached approximately 56 per cent.

Developments in industrial producer prices on the domestic market in 2014 and in 2015 were strongly affected by the fall in commodities prices in the global market, weak domestic demand and stagnant unit labour costs. The annual drop in domestic producer prices amounted to -2.8 per cent. in 2014 and -3.8 per cent. in 2015, largely reflecting the annual fall in energy prices. The annual rate of decrease in

producer prices excluding energy was less pronounced and stood at –1.4 per cent. in 2014 and at –0.4 per cent. in 2015. The downward pressure on consumer prices also stemmed from reduced producer prices of nondurable consumer goods, most notably food products. In 2016 the annual rate of change in industrial producer prices on the domestic market remained negative, but improved in the second half of 2016, mostly due to energy price developments.

The average annual CPI inflation rate decreased to –1.1 per cent. in 2016 (from –0.5 per cent. in 2015), mostly due to the deflationary impact of external factors, especially the fall in crude oil prices, but also to some extent due to weak domestic inflationary pressure and low inflation in the euro area. The largest negative contribution to the average annual CPI inflation rate in 2016 came from energy prices (approximately 1 per cent.) due to a decrease in the administrative price of natural gas and decrease in prices of refined petroleum products. Inflation rebounded significantly in the second half of 2016, from –1.6 per cent. in June to 0.2 per cent. in December, mainly due to the increase in the annual rate of change in energy prices (refined petroleum products). This mostly reflected an upward base effect (resulting from a strong decline in crude oil prices on the world market in the second half of 2015) and to a lesser extent the increase in petroleum prices in the second half of 2016. Food price inflation also rebounded, mostly due to the increase in the annual rate of change in meat and milk prices, reflecting an upward base effect resulting from a drop in those prices in the second half of 2015. Tobacco prices also increased due to the increase in excise duties on tobacco products in December 2016. Core inflation (which excludes agricultural, energy and administered prices) also rebounded reaching 0.5 per cent. in December 2016, from –0.9 per cent. in June, mostly due to the increase in the annual rate of change in the prices of meat, milk, tobacco, recreational and sporting services and prices of footwear.

The average annual CPI inflation rate increased to 1.1 per cent. in 2017 (from –1.1 per cent. in 2016), reflecting a strengthening in inflationary pressure, notably due to an increase in crude oil and certain food prices (milk, butter and meat). To a lesser extent, inflation also increased due to a rise in euro area inflation. Vegetable prices also increased due to unfavourable weather conditions. Domestic inflationary pressure, driven by economic recovery, also contributed mildly to the rise in inflation. The average annual growth rate in CPI, excluding food and energy prices, increased mildly, and reflects to a large extent the effects of tax reform (an increase in the VAT rate on catering services and came from food prices increase in excise duty on cigarettes). The largest negative contribution to the overall average annual inflation rate in 2017 came from food prices (approximately 0.8 per cent.). Industrial producer prices on the domestic market increased by 2.1 per cent. in 2017.

The average annual CPI inflation rate slightly accelerated to 1.5 per cent. in 2018. Looking at individual components of the CPI, the main contribution to higher overall inflation came from energy prices and in particular, electricity (with the VAT decline occurring in the prior period). The contribution of services prices to the average annual inflation rate increased as well, albeit to a much smaller extent compared to energy prices, while the contribution of other components of the CPI declined in 2018. Unlike total CPI, the average annual growth rate of core inflation (excluding the prices of agricultural product prices, energy prices and administered prices) slowed to 0.8 per cent. in 2018, down from 1.4 per cent. in the previous year. This was driven by a decline in the annual growth rate of food prices (especially prices of meat and prices of milk, cheese and eggs) and non-food industrial goods without energy (mainly prices of clothing and footwear as well as prices of motor vehicles). Average annual rate of growth of industrial producer prices on the domestic market slightly accelerated to 2.3 per cent. in 2018. The base effect of the increase in electricity prices from September 2017 made a positive contribution to inflation growth in 2018 of 0.2 percentage points. In addition, the increase of excise duties on tobacco (+0.1 percentage points), growth of refuse collection prices (+0.1 percentage points) and water supply prices (+0.1 percentage points) also made positive contributions to CPI growth, while changes in the taxation system of personal cars aided in the reduction of consumer prices (–0.1 percentage points).

Looking at historical trends it can be concluded that producer price inflation is more volatile than consumer price inflation and that its trends reflect world market developments more closely. The industrial producer price index is an important short-term indicator of the business cycle that shows price changes in the industrial sector. It may also indicate inflationary changes before they reach consumers. Nevertheless, from the viewpoint of monetary policy, relatively greater importance is given to CPI which measures changes in prices of goods and services acquired, used or paid over time by reference to population (private households) for consumption purposes.

Inflation Outlook for 2019

The average annual CPI inflation rate is estimated to decline from 1.5 per cent. in 2018 to below 1 per cent. in 2019. This is the result of a slower annual increase in energy prices (mainly due to lower expected contribution of petroleum products) and food prices (mainly due to the impact of the reduction in the VAT rate from 25 per cent. to 13 per cent. on fresh meat, fish, fruits, vegetables and eggs at the beginning of 2019). The average annual growth rate of the CPI excluding food and energy could remain at the same level as in the previous year. Inflationary pressures from the external environment are subdued, given, for example, the expected slight drop in crude oil prices on the world market and the ECB's downward revision of euro area core inflation projection in March 2019. On the other hand, domestic inflationary pressures pertain to the growth of domestic demand, as well as the cost pressures stemming from the growth of unit labor costs.

Government Subsidies

The Government maintains a direct subsidy programme for certain large industries such as the agriculture and Croatian railway industry. The following table sets out government subsidies in real prices for the periods indicated:

	Twelve months ended 31 December	
	2016 ⁽³⁾	2017 ⁽⁴⁾
	<i>(HRK thousands)</i>	
Industry		
Croatian railways	464,740	453,749
Agriculture	3,608,463	3,788,197
Shipyards and shipbuilding ⁽¹⁾	312,632	222,590
HBOR.....	28,256	14,510
Other industries ⁽²⁾	437,790	896,386
Total subsidies	4,851,881	5,375,432

Source: Ministry of Finance

⁽¹⁾ "Shipyards and shipbuilding" includes subsidies for factoring.

⁽²⁾ "Other industries" includes subsidies to air transport, water transport, road transport and tourism.

⁽³⁾ Data presented in the Annual Report on State Aid for 2016.

⁽⁴⁾ Data presented in the Annual Report on State Aid for 2017.

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

	Twelve months ended 31 December	
	2016	2017
	<i>(per cent.)</i>	
Industry		
Croatian railways	0.13	0.12
Agriculture	1.03	1.04
Shipyards and shipbuilding.....	0.09	0.06
HBOR.....	0.01	0.00
Other industries ⁽¹⁾	0.12	0.25
Total subsidies	1.38	1.47

Source: Ministry of Finance

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

Subsidies given to the Croatian railways include amounts provided to maintain and expand the railways network.

It should be noted that after the Croatian accession to the European Union on 1 July 2013, the approval, monitoring and recovery of state aid is under the jurisdiction of the European Commission. Data for 2016 was published in the Annual Report on State Aid for 2016. Data for 2017 was published in the Annual Report on State Aid for 2017.

The Government submitted the Annual Report for 2017 to Parliament for approval. The approval was granted in autumn 2018. The Annual Report for 2017 was published on the website of the Ministry of Finance.

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. Within the framework of its activities, aside from lending, HBOR performs foreign currency payment transactions and 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 the Republic, the Environment and Energy Efficiency Fund, Vodovod i kanalizacija d.o.o., Split (a 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 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 the German development bank, KfW, the EBRD, the IBRD, the Council of Europe Development Bank (the "CEB") and the EIB.

Employment

The data presented in this section is according to International Labour Organisation ("ILO") methodology.

According to ILO methodology, the average number of unemployed persons amounted to 317,721 in 2013 and the average unemployment rate amounted to 17.3 per cent. (an increase of 1.3 per cent. compared to 2012). While the average number of unemployed persons further increased by 3.0 per cent. in 2014, the average unemployment rate remained unchanged, compared to 2013. In 2015 both the average number of unemployed and the unemployment rate recorded a decrease, amounting to 305,900 and 16.2 per cent., respectively. In 2016, the average number of unemployed continued to decline and amounted to 240,112, while the average unemployment rate decreased to 13.1 per cent. In 2017, the average number of unemployed persons recorded a decrease of 14.6 per cent., amounting to 205,131, while the average unemployment rate recorded the lowest level since 2009, amounting to 11.2 per cent.. In 2018, the average number of unemployed persons recorded a decline of 25.7 per cent., amounting to 152,250, while the average unemployment rate stood at 8.4 per cent., the lowest ever level.

The following table sets forth the unemployment rate calculated under International Labour Organisation ("ILO") methodology for the periods indicated:

	Year ended 31 December				
	2014	2015	2016	2017	2018
	<i>(average for the period, in per cent.)</i>				
ILO unemployment rate	17.3	16.2	13.1	11.2	8.4

Source: CBS

The following table sets forth the unemployment rate calculated under the registered unemployment methodology for the periods indicated.

	Year ended 31 December				
	2014	2015	2016	2017	2018
	<i>(average for the period, in per cent.)</i>				
Registered unemployment rate.....	19.6	17.0	14.8	12.1	9.7

Source: CBS

* From the beginning of 2016, data on administrative employment (needed to calculate unemployment rate) are gathered from different sources and are not comparable to previously published data.

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 (for example, in seasonal or shadow-economy jobs) but have registered as unemployed.

The table below shows the state of the labour market (according to survey data, ILO methodology data) in Croatia for the periods indicated:

	Year ended 31 December				
	2014	2015	2016	2017	2018
	<i>(average for the period)</i>				
Total employed persons.....	1,565,677	1,585,267	1,589,943	1,625,069	1,655,000
Total unemployed.....	327,287	305,900	240,112	205,131	152,250
Rate of unemployment (per cent.)	17.3	16.2	13.1	11.2	8.4
GDP per person employed (HRK)					
.....	211,774	214,233	220,982	225,002	230,695
GDP per person employed (EUR)					
.....	27,755	28,153	29,349	30,161	31,115

Source: CBS

The data presented in this section does not reflect the EU system of national and regional accounts ("ESA 2010").

According to survey data, in 2014, the number of employed persons increased to an average of 1,565,677, which represents an increase of 41,655 (or an increase of 2.7 per cent. year-on-year) compared to 2013.¹ The average number of total employed persons continued to increase in 2015 and 2016, increasing by 1.3 per cent. and 0.3 per cent., respectively. There were 35,126 (or an increase of 2.2 per cent.) more employed persons in 2017 compared to the previous year, amounting to 1,625,069. The number of employed persons further increased in 2018 by 29,968 (or an increase of 1.8 per cent.) and reached 1,655,037 persons.

¹ From the beginning of 2014, labour force survey data have been estimated according to the results of the Census of Population, Households and Dwellings in 2011 which resulted in break in the series from 2014.

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

	Year ended 31 December				
	2014	2015	2016	2017	2018
	<i>(average for the period, in 000)</i>				
Public administration and defence, compulsory social security	110	110	104	117	111
Education	118	118	118	122	131
Human health and social work activities.....	106	104	107	100	107
Total	334	332	329	339	349

Source: CBS

In 2014, an average of 333,800 people were employed in the public sector, representing 21.3 per cent. of all employed persons, while in 2015, 332,900 people were employed in the public sector, representing an average of 21.0 per cent. of all employed persons. An average of 329,200 people were employed in the public sector in 2016, representing 20.7 per cent. of all employed persons, while in 2017 an average of 338,700 people were employed in the public sector, representing 20.8 per cent. of all employed persons. In 2018, the average number of employed in the public sector amounted to 348,900 persons, representing 21.1 per cent. of all employed persons.

Croatia's labour laws are aligned with the relevant EU legislation. Trade and labour unions are active in Croatia. Collective bargaining agreements are normally entered into 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.

Labour market

The Law on Criteria for Participation in Tripartite Bodies and Representativeness for Collective Bargaining, which entered into force on 28 July 2012, enabled the start of collective negotiations among private and public companies and public institutions. This Law was subsequently replaced by the Law on Representativeness of Employer's Associations and Unions (OG 93/2014 and 26/2015), which came into force on 7 August 2014.

A Collective Bargaining Agreement for Civil Service was signed on 3 August 2013. Two Annexes of the Collective Agreement were also signed and contained further decreases of the wage bill on 3 August 2013. Changes included cancellation of Christmas bonuses, cancellation of the holiday bonus, reduction of per diems from HRK 170.00 to HRK 150.00 and reduction of jubilee bonuses (basis for calculation is reduced from HRK 1,800 to HRK 500). The Collective Bargaining Agreement was effective until 1 August 2016, when it expired. In the case of a positive GDP growth during three consecutive quarters and a budget deficit under 3 per cent. of GDP, the restrictions will be repealed. The Basic Collective Agreement for Public Service Employees was dated 12 December 2012 and entered into force on 1 January 2013 and expired on 12 December 2016. The public servant trade union and the Government negotiated the new temporary Basic Collective Agreement for Public Service Employees, which was valid until November 2017. The Basic Collective Agreement provided for a wage increase to public sector employees. The temporary agreement retained the rights of public sector employees from the previous agreement. The most recent Collective Bargaining Agreement for Civil Service and Public Service which was signed in November 2017 (and further amended in February and December 2018) replaces its previous agreements and retains the rights of public sector employees from the previous agreements. Amendments to the Employment Incentive Act were adopted in September 2012. The purpose of the legislation is to mitigate the consequences of the economic crisis. The Amendments to the Employment Incentive Act: (i) applied to unemployed persons regardless of their previous working experience unless they had less than a year of working experience in the vocation they were trained for; (ii) enabled the Croatian Employment Service (the "CES") to pay health contributions for workers with previous working experience during the first 12 months of their occupational training; and (iii) sought to provide incentives for the employment of seasonal workers in agriculture up to 90 days within a calendar year. Further amendments to the Employment Incentive Act were adopted in February 2017. The Employment Incentive Act ceased to apply as of 1 January 2019.

The implementation of active labour market policy measures ("ALMM") is targeted towards the inclusion of youth in the labour market, self-employment, training, occupational training and participation in public work programmes of specific target groups, enhancing employability and improving the participation rate

of persons in an unfavourable position in the labour market, as well as support for employers facing labour market difficulties and employment in the tourism sector. The priorities and objectives of the active labour market policy are laid down in the Guidelines for the Development and Implementation of Active Labour Market Policy for the period 2015 – 2017. Its aims are to increase employment rates of disadvantaged groups in the labour market, improve the competitiveness of employers, increase the professional, geographical and educational mobility of the labour force and ensure a good match between demand and supply in the labour market. By the end of August 2017 there were 25,267 active participants in the active labour market policy programmes. In December 2017, the Government adopted the Guidelines for the Development and Implementation of Active Labour Market Policy for the period 2018 – 2020. Its aims are to increase the employment rate to 68 per cent. by 2020, to align the supply and demand in the labour market, and to increase the level of awareness of the labour market participants.

The 2013 and 2014 labour market reforms have significantly reduced the gap with other EU economies in terms of employment protection legislation and positively impacted employment growth, but have also led to a significant increase in the use of temporary contracts.

Wages and labour costs

During 2013, there was a continued trend of a nominal increase but a real decrease in wages. In 2013, the average monthly net earnings per person in paid employment in legal entities was HRK 5,515, which is a 0.7 per cent. increase in nominal terms and a 1.5 per cent. decrease in real terms, compared to 2012. Average monthly gross earnings per person in paid employment in legal entities were HRK 7,939 in 2013, representing a 0.8 per cent. increase in nominal terms, or a 1.4 per cent. decrease in real terms. In 2014, average salaries recorded only a mild nominal increase, as well as a mild real increase due to a negative inflation rate. The average monthly net earnings amounted to HRK 5,533 in 2014, increasing by 0.3 and 0.5 per cent. in nominal and real terms, respectively. On the other hand, average monthly gross earning amounted to HRK 7,953 in 2014, increasing by 0.2 per cent. in nominal terms and 0.4 per cent. in real terms. According to the data from the monthly survey RAD-1, the average monthly net earnings for 2015 was HRK 5,711, which represented an increase of 3.2 per cent. in nominal terms, or an increase of 3.7 per cent. in real terms compared to 2014. Average monthly gross earnings per person in 2015 were HRK 8,055, representing a 1.3 per cent. increase in nominal terms and a 1.8 per cent. increase in real terms.

From 2016, the CBS published data on employment and wages according to a new methodology, where data for 2015 is available according to both old and new methodology. A former monthly survey (RAD-1) that covered 70 per cent. of employees in legal entities, and an annual survey (RAD-1G) which included full coverage, were replaced with the JOPPD form (a form regarding taxes, local taxes and contributions for submitting data on total receipts per individual taxpayer for specified types of receipts). Due to changes in methodology, the data from the JOPPD form from January 2015 is not comparable with previously published data.

According to the data from the JOPPD form, the average monthly net earnings per person in paid employment in legal entities in 2016 was HRK 5,685, representing a 1.6 per cent. increase in nominal terms and 2.8 per cent. increase in real terms compared to 2015². In 2016, the average monthly gross earnings amounted to HRK 7,752, increasing by 1.9 per cent. in nominal terms and 3.0 per cent. in real terms, compared to 2015. In 2017, the average monthly net earnings recorded a 5.3 per cent. increase in nominal terms and 4.2 per cent. increase compared to 2016, amounting to HRK 5,985, while the average monthly gross earnings amounted to HRK 8,055, increasing by 3.9 and 2.8 per cent. in nominal and real terms, respectively. In 2018, the average monthly net earnings recorded a 4.3 per cent. increase in nominal terms and 2.8 per cent. increase in real terms, amounting to HRK 6,242, while the average monthly gross earnings amounted to HRK 8,447, increasing by 4.9 and 3.3 per cent. in nominal and in real terms, respectively.

The following table shows average nominal monthly wages in Croatia per person in paid employment in legal entities for the periods indicated:

	Year ended 31 December				
	2014	2015	2016	2017	2018
Average monthly gross wages and salaries in	7,953	8,055	7,752	8,055	8,448

² Data for 2015 according to new methodology (JOPPD form).

	Year ended 31 December				
	2014	2015	2016	2017	2018
HRK.					
Average monthly net wages and salaries in HRK	5,533	5,711	5,685	5,985	6,242
Net wages and salaries in EUR (average exchange rate).....	725	750	755	802	842

Source: CBS, HNB

Social Security System

Unemployment

The social security system in Croatia consists of the Croatian Health Insurance Fund (the "HZZO"), 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 addition, Croatian legislation 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.

Healthcare

In September 2012, the Parliament adopted the National Strategy of the Development of the Croatian Health Care System 2012 – 2020. The document presents an in-depth quantitative and qualitative analysis of the current status and future trends in health care, and sets out principal priorities for its development until 2020

From a healthcare system perspective, demographic changes have a significant impact on the demand for healthcare protection services. According to the EC 2018 Ageing Report total healthcare spending in the Republic of Croatia amounted to 5.2 per cent. of GDP in 2016, 1.6 percentage points lower than the EU average, of 6.8 per cent.. By comparing changes in spending over the period up to 2070, the share of planned healthcare expenditures in GDP at the level of the Republic of Croatia is expected to increase by 13 per cent., which equals the increase at the EU level.

The key challenge in the healthcare sector of the Republic of Croatia is the adjustment in the ways of providing healthcare protection in the face of unfavourable demographic trends. In order to sustain the healthcare system, the aim is to raise the quality of healthcare protection, resource optimisation and financial stability of the system. The same is planned to be achieved through greater availability of healthcare services, reduction of multiple scheduled appointments and medical procedures, reduction of waiting lists, consolidated procurement of medicines and medical equipment. Furthermore, the aim is also to standardise and optimise the criteria and the procedure of diagnostics, treatment and patient monitoring, as well as to functionally integrate hospitals and to establish centres of excellence in individual hospitals at both the regional and the national level. The aim is also to improve primary healthcare protection, to improve access to specialist-conciliar healthcare protection, daily hospital treatments and acute and chronic care beds in hospitals as well as palliative care. These aims are also defined by the key strategic document for the development of the healthcare system in the Republic of Croatia, i.e. by the National Strategy of the Healthcare Development 2012-2020 and the Decision on the adoption of the National Plan for the Development of Clinical Hospital Centres, Clinical Hospitals, Clinics and General Hospital in the Republic of Croatia for the period 2018 - 2020.

In order to ensure financial sustainability of the system, as many healthcare institutions as possible will be included in the model of consolidated public procurement and the number of public procurement categories will be expanded. This should ensure better control through the central place of joint public procurement management, i.e. the reduction of expenditures and the achievement of savings on an annual basis.

Pension System

Croatia has a three-pillar pension system. 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, the first pillar of a pension, and 5 per cent. to the mandatory pension fund at the choice of the insured person, or the 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). In August 2014, three categories of pension funds were introduced within the existing system (A, B and C funds), differing according to the limits of investments and the investment strategy, with C funds being the most conservative. The third pillar is a voluntary private system, fully funded by voluntary employee or employer contributions.

In December 2018, the parliament adopted an important package of pension system reforms that entered into force in 2019. The purpose of the reforms is multifaceted and can be summarised under three main objectives: first, addressing structural design inconsistencies, which resulted in an unfair treatment of certain cohorts of pensioners; second, improving pension system adequacy through longer working lives; and third, strengthening the institutional setup and performance of the second pillar. On the first objective, the government proposes to extend the 27 per cent. supplement of the pension entitlement (that is currently paid out to individuals receiving a pension from the first pillar only) to all pensioners in a proportional way, while retaining the possibility for all to opt-out of the second pillar and shift savings to the first pillar at retirement. The aim of the authorities was to find an equitable solution that would avoid severely undermining the first pillar. According to government estimates, mainly low-wage earners would find it convenient to move back to the first pillar, as well as workers that have a short contributory period under the second pillar. The authorities also plan to increase the minimum pension by 3.13 per cent. from mid-2019 and enable the accumulation of a supplementary contribution period of six months per child for the calculation of the pension entitlement of the parent. On the second objective, the reform proposal includes: (i) accelerating the planned increase in the statutory retirement age to 67, bringing it forward from 2038 to 2033; (ii) accelerating the equalisation of retirement age for men and women, bringing it forward to 2027; (iii) increasing penalties for early-retirement and bonuses for deferred retirement, while retaining the relatively large gap of five years between early and statutory retirement age; (v) widening the possibility to work part-time while receiving a pension; and (vi) streamlining the list of arduous and hazardous professions benefitting from more favourable pension entitlements, while preserving a number of special pension schemes (e.g. for military personnel and police). Certain of the proposed reforms are designed to implement this objective ((i) accelerating the planned increase in the statutory retirement age to 67, bringing it forward from 2038 to 2033; (ii) accelerating the equalisation of the retirement age for men and women, bringing it forward to 2027; and (iii) increasing penalties for early-retirement and bonuses for deferred retirement) are being challenged by unions.

A dedicated set of measures addresses the design of the mandatory funded second pillar. The measures aim at increasing the efficiency and performance of the mandatory funded second pillar, as well as the voluntary third pillar. The legislative acts introduce more stringent rules to tackle potential conflict of interest arising in the private funds and lower caps on membership management fees paid by second pillar members. The amended legislative acts also modify some of the investment rules, introducing a new investment category, which allows pension funds to invest in infrastructural projects in Croatia within prescribed limits. Furthermore, all second pillar members can choose the risk profile of their pension fund, though a new default option is foreseen for those who do not express their choice upon first employment. The amended legislative acts enable the Croatian Pension Insurance Institute to establish a public pension insurance company that would be in charge of the payout of annuities from the second and third pillar. On pension insurance companies, the proposed legislation also introduces new governance rules for cross-border transactions and for managers (in terms of fitness and probity), new requirements in terms of capital shares and technical reserves, a cap on certain administrative costs and the obligation for the insurance companies to adjust the annuity payments to the consumer inflation rate twice a year. The new legislation allows life insurance companies to pay out third pillar annuities (under certain conditions of compliance with the relevant legislative rules). Furthermore, among other measures, second pillar pensioners can request a lump-sum payment of 15 per cent. of their second pillar savings upon retirement, provided their pension is at least 15 per cent. higher than the first pillar minimum pension.

Pension funds in Croatia are under the supervision of the Croatian Financial Services Supervisory Agency ("CFSSA").

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 after tax and surtax		Number of people receiving child allowance		Unemployment benefit recipients	
	Number of recipients	Year-on-year per cent. change	HRK	Year-on-year per cent. change	Number of recipients	Year-on-year per cent. change	Number of recipients	Year-on-year per cent. change
<i>(end of the period)</i>								
2013	1,182,464	(2.9)	2,486	4.3	208,836	(1.4)	74,597	(14.2)
2014	1,223,160	3.3	2,417	(2.8)	200,929	(3.9)	60,735	(18.6)
2015	1,225,701	0.2	2,425	0.3	192,282	(4.3)	51,016	(16.0)
2016	1,232,959	0.6	2,434	0.4	171,740	(12.0)	45,921	(10.0)
2017	1,231,858	(0.1)	2,526	3.8	153,150	(10.8)	39,123	(14.8)
2018	1,235,642	0.3	2,619	3.7	158,014	3.2	34,771	(11.1)

Source: Croatian Pension Insurance Institute, Croatian Employment Service

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

The following table sets forth the value of the net assets 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				
	2014	2015	2016	2017	2018
<i>(end of the period, HRK thousands)</i>					
Mandatory funds ⁽¹⁾	66,281,554	74,004,667	84,179,365	91,924,545	98,126,194
Open voluntary funds ⁽²⁾	2,651,987	3,044,842	3,548,401	3,895,569	4,231,346
Closed voluntary funds ⁽³⁾	596,188	681,211	777,088	849,556	908,054
Total	69,529,728	77,730,720	88,504,853	96,669,670	103,265,593

Source: Croatian Financial Services Supervisory Agency

⁽¹⁾ Mandatory Funds: Raiffeisen (A, B, C), PBZ-Co (A, B, C), AZ (A, B, C) and Erste Plavi (A, B, C).

⁽²⁾ Open Voluntary Funds: AZ Benefit, AZ Profit, Croatia Osiguranje, Croatia Osiguranje 1000 A, Croatia Osiguranje 1000 C, Raiffeisen, Erste Plavi Expert and Erste Plavi Protect.

⁽³⁾ Closed Voluntary Funds: NOVINAR, AZ VIP, Croatia Osiguranje, Hrvatski Liječnicki Sindikat, AZ Dalekovod, Ericsson Nikola Tesla, AZ HKZP, HEP Grupa, T-HT, AZ Zagreb, Cestarski, HAC and Sindikat hrvatskih željeznica- Raiffeisen, Raiffeisen, Auto Hrvatska, AZ Zaba, AZ Treći horizont, Nestle, Erste Policijski and Posta

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. In 2012, pension expenditure amounted to HRK 35.1 billion. HRK 19.3 billion was covered by pension contributions while the remainder (HRK 15.8 billion) was covered by tax revenues. In 2013, pension expenditure amounted to HRK 36.1 billion, of which HRK 19.2 billion referred to pension contributions and the remainder (HRK 16.9 billion) was covered by tax revenues. In 2014, pension expenditure amounted to HRK 36.4 billion, of which HRK 22.3 billion referred to pension contributions and the remainder (HRK 14.1 billion) was covered by tax revenues. In 2015, total pension expenditure amounted to HRK 36.7 billion, of which HRK 20.8 billion referred to pension contributions and the remainder (HRK 15.9 billion) was covered by tax revenues. In 2016, total pension expenditure amounted to HRK 36.8 billion, of which HRK 20.3 billion referred to pension contributions and the remainder (HRK 16.5 billion) was covered by tax revenues. In 2017, total pension expenditure amounted to HRK 37.7 billion, of which HRK 21.2 billion referred to pension contributions and the remainder (HRK 16.5 billion) was covered by tax revenues. In 2018, total pension expenditure amounted to HRK 39.3 billion, of which HRK 22.8 billion referred to pension contributions and the remainder (HRK 16.5 billion) was covered by tax revenues.

The reform of the social welfare system continues to focus on improving distribution of social benefits to the most vulnerable beneficiaries as well as system transparency, fairness in exercising the rights to benefits, prevention of rights abuse and achieving equal social protection. A Social Welfare Act (OG 157/2013, 152/2014, 99/2015, 52/2016, 16/2017 and 130/2017) was adopted in December 2013 and entered into force on 1 January 2014. The Social Welfare Act was designed to unify social benefits from various systems with the common purpose of protecting the most vulnerable population and introduced a unified means test with

the purpose of identifying the most vulnerable groups of citizens with a view to rationalising the entire system of social cash benefits to increase its effectiveness.

In order to achieve adequate support of, and to simplify the procedure for exercising the rights of persons with disabilities, the Social Welfare Act unified disabled persons' rights exercised through various systems prior to adoption thereof and ensured the necessary support for disabled persons and children with difficulties. The amount of personal disability compensation is intended to provide equal opportunities for persons with disabilities in social inclusion. The Social Welfare Act was further amended in December 2014, September 2015, June 2016, February 2017 and December 2017.

Pending International Arbitrations

The Republic of Croatia appears as a respondent in nine arbitrations at the International Centre for the Settlement of Investment Disputes ("ICSID"). In chronological order, the material proceedings are:

1. *MOL Hungarian Oil and Gas Company Plc v. Republic of Croatia (ARB/13/32)*

This arbitration was instituted on the basis of the Energy Charter Treaty. The claimant asserts that the Republic of Croatia breached its obligations arising from the Energy Charter Treaty in connection with the claimant's investments in the Croatian company INA-Industrija nafte d.d. The Republic of Croatia argues that the agreements underlying the claimant's investments were procured through corruption, i.e. bribery of the then Prime Minister of the Republic of Croatia by the CEO of MOL Hungarian Oil and Gas Company Plc. The claimant is asking for damages in the amount of approximately EUR 860 million.

2. *A series of proceedings relating to Swiss Franc Loans:*

• *UniCredit Bank Austria AG and Zagrebačka Banka d.d. v. Republic of Croatia (ARB/16/31)*

This arbitration was instituted on the basis of the Agreement between the Republic of Austria and the Republic of Croatia for the Promotion and Protection of Investments. The claimants assert that they incurred damages because in 2015 the Republic of Croatia amended its Consumer Credit Act and Credit Institutions Act so that consumers were given the right and credit institutions were put under an obligation to retroactively convert individual loans denominated in Swiss Francs into loans denominated in Euros. The claimants assert that they incurred damages because the exchange rate used in this conversion was the exchange rate at the time when these loans were signed, so that the entire cost of the difference in exchange rates, as well as the cost of conversion had to be borne by the credit institutions. The claimants ask for damages in the amount of EUR 127 million. The claimants withheld the right to subsequently modify their claim for compensation.

• *Raiffeisen Bank International AG and Raiffeisenbank Austria d.d. v. Republic of Croatia (ARB/17/34)*

This arbitration was instituted on the basis of the Agreement between the Republic of Austria and the Republic of Croatia for the Promotion and Protection of Investments. The claimants assert that they incurred damages because in 2015 the Republic of Croatia amended its Consumer Credit Act and Credit Institutions Act so that consumers were given the right and credit institutions were put under an obligation to retroactively convert individual loans denominated in Swiss Francs into loans denominated in Euros. The claimants assert that they incurred damages because the exchange rate used in this conversion was the exchange rate at the time when these loans were signed, so that the entire cost of the difference in exchange rates, as well as the cost of conversion had to be borne by the credit institutions. The claimants have not yet specified their claim for damages.

• *Addiko Bank AG and Addiko Bank d.d. v. Republic of Croatia (ARB/17/37)*

This arbitration was instituted on the basis of the Agreement between the Republic of Austria and the Republic of Croatia for the Promotion and Protection of Investments. The claimants assert that they incurred damages because in 2015 the Republic of Croatia amended its Consumer Credit Act and Credit Institutions Act so that consumers were given the right and credit institutions were put under an obligation to retroactively convert individual loans denominated in Swiss Francs into loans denominated in Euros. The claimants assert that they incurred damages because the exchange rate used in this conversion was the exchange rate at the time when these loans were signed, so that the entire cost of the difference in exchange

rates, as well as the cost of conversion had to be borne by the credit institutions. The claimants have not yet specified their claim for damages.

- *Erste Group Bank AG and others v. Republic of Croatia (ARB/17/49)*

This arbitration was instituted on the basis of the Agreement between the Republic of Austria and the Republic of Croatia for the Promotion and Protection of Investments. The claimants assert that they incurred damages because in 2015 the Republic of Croatia amended its Consumer Credit Act and Credit Institutions Act so that consumers were given the right and credit institutions were put under an obligation to retroactively convert individual loans denominated in Swiss Francs into loans denominated in Euros. The claimants assert that they incurred damages because the exchange rate used in this conversion was the exchange rate at the time when these loans were signed, so that the entire cost of the difference in exchange rates, as well as the cost of conversion had to be borne by the credit institutions. The claimants' request for arbitration, submitted on 29 December 2017, asks for damages in the amount of EUR 150 million. The claimants withheld the right to subsequently modify their claim for compensation.

Further public details about these cases can be found on the website of the International Centre for the Settlement of Investment Disputes.

FOREIGN TRADE AND INTERNATIONAL BALANCE OF PAYMENTS

Current Account Balance

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

	Year ended 31 December				
	2014	2015	2016	2017	2018*
Current account balance in EUR (millions)	857.9	2,019.5	1,205.1	1,794.9	1,354.4
Current account (as a percentage of nominal GDP)	2.0	4.5	2.6	3.7	2.6

* Based on preliminary data

Source: Croatian National Bank, Central Bureau of Statistics

In 2015, the current account balance increased compared to the previous year and amounted to EUR 2.0 billion or 4.5 per cent. of GDP. This increase was mostly due to an increase in net exports of services. In addition, an improvement in the primary income account was recorded, resulting from the effect of the conversion of loans in Swiss francs on banks' business results (estimated to be approximately 2 per cent. of GDP). On the other hand, secondary income account net revenues increased.

In 2016, the current account balance decreased compared to the previous year and amounted to EUR 1.2 billion or 2.6 per cent. of GDP. This reduction was mostly due to a deterioration in the primary income account, resulting from the disappearance of the effect of the conversion of loans in Swiss francs on banks' business results, and a widening merchandise trade deficit. On the other hand, net exports of services and secondary income account net revenues continued to increase.

In 2017, the current account balance increased compared to the previous year and amounted to EUR 1.8 billion or 3.7 per cent. of GDP, as a result of improvements in the services, primary and secondary income accounts. Net exports of services increased primarily due to an increase in revenues from tourism. The secondary income account improved as significantly more funds from the EU were distributed to end users in comparison with the previous year. The primary income account also improved, mostly as a result of the effects of provisioning for Agrokor Group and connected companies. On the other hand, the goods account saw the deficit widen further with both export and import growth increasing significantly.

In 2018, the current account balance decreased compared to the previous year and amounted to EUR 1.4 billion or 2.6 per cent. of GDP. This reduction was mostly due to a widening merchandise trade deficit and deterioration in the primary income account, resulting from the disappearance of the effect of provisioning for Agrokor Group and connected companies. On the other hand, net exports of services and secondary income account net revenues continued to increase.

Goods Account and Recent Trade in Goods Developments

Trade in Goods Deficit

According to CBS data, in 2015, trade in goods was marked by faster growth in exports than imports in relative terms. However, the increase in imports in absolute terms outpaced the increase in exports. This led to a widening of the trade in goods deficit by 2.9 per cent. compared to 2014. As the absolute increase in goods imports was higher than in exports in 2016, the goods trade deficit increased by 6.3 per cent. compared to 2015. In 2017, trade in goods was marked by faster growth in exports than imports in relative terms. However, the increase in imports in absolute terms outpaced the increase in exports. This led to a widening of the trade in goods deficit by 6.5 per cent. compared to 2016. CBS data for 2018 showed much stronger slowdown in goods exports than goods imports, which led to further widening of the trade in goods deficit by 16.1 per cent. In the first two months of 2019 the trade in goods deficit rose by 13.4 per cent. relative to the same period previous year due to stronger growth in imports than in exports.

As a result of BPM6 (Balance of Payments and International Investment Position Manual, 6th ed.) implementation, differences between the goods account in the balance of payments and merchandise trade account according to foreign trade statistics of the CBS increased (reasons are explained in methodological notes). The following two sections (*Exports and Imports*) describe detailed merchandise trade developments according to CBS data.

Exports

The following table sets forth Croatia's exports of goods by sector for the periods indicated prepared in accordance with the Standard International Trade Classification ("SITC") methodology:

	Year ended 31 December					Two months ended 28 February
	2014	2015	2016	2017	2018	2019*
	(EUR millions)					
Food and live animals.....	1,029.9	1,215.3	1,377.2	1,397.9	1,516.7	258.6
Beverages and tobacco	172.4	176.4	194.1	250.5	298.8	43.4
Crude materials, except fuels.....	827.7	895.7	917.0	1,070.2	1,096.4	179.0
Mineral fuels and lubricants	1,393.5	1,259.5	1,165.0	1,488.8	1,542.4	199.0
Animal and vegetable oils and fats	25.8	27.6	49.8	60.3	65.1	9.0
Chemical products.....	1,105.7	1,362.3	1,631.8	1,977.6	1,840.7	315.9
Manufactured goods classified chiefly by material.....	1,666.8	1,812.3	1,927.5	2,265.5	2,452.5	409.9
Machinery and transport equipment	2,279.9	2,783.1	2,897.1	3,274.2	3,404.5	559.3
Miscellaneous manufactured articles	1,697.3	1,860.8	2,084.2	2,172.6	2,203.6	323.9
Commodities and transactions, n. e	105.8	93.8	45.8	33.5	38.3	8.2
Not classified	63.9	41.2	27.1	25.8	58.2	2.3
Total	10,368.8	11,527.9	12,316.6	14,016.9	14,517.3	2,308.3

(1) After joining EU merchandise trade statistics is based on Intrastat (for trade between EU Member States) and Extrastat (for trade with non-EU countries).

Source: Central Bureau of Statistics

After strong growth in 2014, exports continued to increase in 2015 at an even faster pace. Moreover, total exports increased by 11.2 per cent. compared to the previous year and amounted to EUR 11.5 billion. Exports of the narrow aggregate (i.e. export of goods excluding energy) grew by 14.4 per cent. as exports of other goods grew considerably, including for exports of ships, medical and pharmaceutical products, road vehicles, leather and metal. On the other hand, energy exports declined as a result of a decrease in exports of petroleum and petroleum products, despite the rise in export quantities, due to the continued decline in crude oil prices in the world market.

In 2016, exports continued to grow by 6.8 per cent. compared to the previous year. The key growth contributor was stronger exports of the narrow aggregate (excluding energy), mostly as a result of larger exports of medical and pharmaceutical products, miscellaneous manufactured articles, road vehicles and sugar. Also, exports of some capital goods increased, in particular, electrical machinery, apparatus and appliances, telecommunications and sound-recording and general industrial machinery and equipment. On the other hand, exports of energy decreased.

In 2017, goods exports increased by 13.8 per cent. compared to the previous year. Strong growth was propped up by a significant rise in exports of the narrow aggregate, which grew by 12.3 per cent., with the biggest contribution from the exports of medical and pharmaceutical products, metal industry products (non-ferrous metals and other metal products), professional, electrical machinery, apparatus and appliances, scientific and controlling instruments, road vehicles and ships. Exports of energy (in particular, exports of petroleum and petroleum products) increased as well.

The slight increase in total goods exports in 2018 (by 3.6 per cent. compared to 2017) was primarily driven by growth in the narrow aggregate, mostly as a result of increased exports of road vehicles, metal industry products (non-ferrous metals and other metal products) as well as food products. At the same time exports of energy also slightly increased, but its contribution was small since growth of exports of petroleum and petroleum products was offset by a sharp fall in exports of electric current.

During the first two months of 2019, according to CBS data, goods exports sharply increased by 9.6 per cent. compared to the same period of 2018. Exports of energy declined by 2.0 per cent. as an increase in exports of electric current was outpaced by a large decrease in exports of petroleum and petroleum products and gas, each as compared to the same period in 2018. On the other hand, exports of the narrow aggregate (excluding energy) grew by 10.9 per cent. The growth of the narrow aggregate was broad based, while the strongest contribution came from the exports of road vehicles, metal industry products, food products and medicinal and pharmaceutical products.

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					Two months ended 28 February
	2014	2015	2016	2017	2018	2019*
	(EUR millions)					
Food and live animals.....	1,916.7	2,111.5	2,195.1	2,408.3	2,473.3	408.2
Beverages and tobacco.....	194.9	218.0	233.0	298.0	337.4	50.4
Crude materials, except fuels.....	296.0	337.0	334.3	391.1	457.4	75.2
Mineral fuels and lubricants	3,179.4	2,808.6	2,424.6	2,896.8	3,220.5	440.1
Animal and vegetable oils and fats	96.9	94.3	98.5	99.2	94.9	15.2
Chemical products.....	2,264.9	2,607.4	3,011.9	3,034.3	3,301.7	604.9
Manufactured goods classified chiefly by material.....	3,033.7	3,341.2	3,512.5	3,912.1	4,116.8	717.1
Machinery and transport equipment	3,852.9	4,431.5	5,050.5	5,623.3	6,245.0	978.4
Miscellaneous manufactured articles	2,264.4	2,522.0	2,839.2	3,208.7	3,389.8	521.6
Commodities and transactions, n. e	24.4	6.5	7.4	14.3	16.3	2.9
Not classified	5.2	4.9	4.8	3.1	4.4	0.2
Total	17,129.4	18,482.9	19,711.9	21,891.6	23,657.7	3,814.1

* The data for 2018 and 2019 is provisional

(1) After joining EU merchandise trade statistics is based on Intrastat (for trade between EU Member States) and Extrastat (for trade with non-EU countries).

Source: Central Bureau of Statistics

Total imports of goods increased from 2015, as a result of the recovery in domestic demand and labour market conditions, but was also highly connected to export performance (due to import dependence of exports and intensifying transit trade). Total imports grew by 7.9 per cent. as compared to 2014 and amounted to EUR 18.5 billion. Excluding energy, import growth was more significant, primarily as a result of an increase in imports of capital goods, including for imports of electrical machinery, apparatus and appliances, general industrial machinery and telecommunications and sound-recording, road vehicles and medical and pharmaceutical products. For the same period, imports of energy declined primarily as a result of a decrease in imports of petroleum and petroleum products due to drop in crude oil prices in the world market.

According to CBS data, imports continued to increase in 2016 by 6.6 per cent. compared to in 2015, especially due to higher imports of medical and pharmaceutical products, road vehicles and capital goods (in particular, general industrial machinery and equipment and machinery specialised for particular industries). In contrast, energy imports declined.

The increase in total goods imports in 2017 (11.1 per cent.) was mostly fueled by the narrow aggregate (i.e. import of goods excluding energy). The biggest contribution to the growth of imports of the narrow aggregate came from an increase in imports of road vehicles, professional, scientific and controlling instruments, metal industry products, as well as capital products, in particular, electrical machinery and apparatus and appliances. After four consecutive years of decline, imports of energy grew as imports of petroleum and petroleum products increased considerably.

Total goods imports continued to increase in 2018 (by 8.1 per cent. compared to the previous year), mainly due to growth in the imports of the narrow aggregate. Major contributors to the narrow aggregate imports growth were larger imports of road vehicles, electrical machinery, apparatus and appliances, medicinal and pharmaceutical products and metal industry products. Meanwhile, imports of energy increased significantly, due to rise in imports of petroleum and petroleum products.

The increase in total goods imports during the first two months of 2019 (11.1 per cent.) compared to the same period of 2018 was primarily influenced by the narrow aggregate (which grew by 11.3 per cent.), with capital products (in particular industrial machinery and equipment and electrical machinery, apparatus and appliances), food products, medicinal and pharmaceutical products, as well as metal industry products being the largest single contributors. Imports of energy increased as a decline in imports of petroleum and petroleum products (by 7.4 per cent) was mitigated by a sharp growth in

imports of electric current (which increased by 49.2 per cent.) and gas (which increased by 23.8 per cent.).

Geographical Distribution of Croatia's Trade in Goods

The following table sets forth the geographical distribution of Croatia's exports, calculated from EUR values:

	Year ended 31 December					Two months ended 28 February
	2014	2015	2016	2017	2018	2019*
	<i>(per cent)</i>					
EU 27	63.9	66.7	66.4	64.8	69.7	69.2
Slovenia	11.4	12.3	12.5	10.9	11.0	11.4
Hungary	3.5	3.6	3.8	3.2	3.6	3.3
EU 15	42.2	43.7	43.6	42.9	47.8	47.6
Austria.....	6.1	6.5	6.4	6.4	7.1	6.2
Italy.....	13.9	13.4	13.7	13.8	14.4	14.8
Germany	11.2	11.3	11.8	12.3	14.4	14.6
CEFTA.....	20.2	17.9	16.4	17.0	15.6	17.1
Bosnia and Herzegovina.....	11.8	9.7	9.1	9.4	8.7	9.7
Serbia.....	4.9	4.9	4.2	4.7	4.3	4.7
EFTA ⁽¹⁾	1.7	1.6	1.6	1.5	1.8	1.9
Other ⁽²⁾	14.2	13.9	15.6	16.8	12.9	11.8
Russia.....	2.6	1.7	1.5	1.4	1.0	1.2
China.....	0.5	0.6	0.6	0.8	0.8	1.1

* The data for 2018 and 2019 is provisional

⁽¹⁾ European Free Trade Association.

⁽²⁾ Excluding EU 27, CEFTA and EFTA.

Source: Central Bureau of Statistics

The geographical distribution of the total goods exported in 2015 shows that the share of Croatian exports to all Member States (the "EU 27") continued to increase, accounting for two-thirds of total exports. Among the "EU 15" (Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, and the United Kingdom), most notable increases were recorded in exports of capital products, prefabricated buildings and road vehicles to Germany and leather and other transport equipment to Austria. In addition, the share of Croatian exports to 12 new Member States also improved, mostly boosted by increased exports of electricity, general industrial machinery, road vehicles and meat and meat preparations to Slovenia. In contrast, exports to the EFTA countries did not change significantly, while exports to the CEFTA countries decreased. The latter was a result of a reduction of exports to Bosnia and Herzegovina (mainly petroleum and petroleum products), while exports to Serbia continued to grow.

In 2016, exports to Member States grew notably, but were below the aggregate average. Exports to Luxembourg and the United Kingdom dropped noticeably (mostly in other transport equipment), while exports to most other Member States continued to grow at a relatively strong rate. Favourable trends were most noticeable in exports of road vehicles, capital products and medical and pharmaceutical products to Germany, as well as capital goods and metals to Slovenia. The share of exports to CEFTA countries also declined relative to 2015, mostly due to fewer exports to Serbia, Albania and Kosovo (petroleum and agricultural products). The share of exports to EFTA countries remained unchanged. In relation to other countries, their share increased primarily due to the growth in exports of medical and pharmaceutical products to the US.

In 2017, the share of exports to Member States declined, mostly as a result of lower exports to the Netherlands (medical and pharmaceutical products). Nevertheless, exports to Italy (petroleum and petroleum products, metal industry products and cereals) and Germany (non-ferrous metals, electrical machinery, apparatus and appliances and road vehicles) strengthened. Unlike Member States, the share of Croatian exports to CEFTA recovered in 2017, mostly due to stronger exports to Bosnia and Herzegovina (petroleum products and electric current).

After two years of declining, the share of exports to Member States increased in 2018, despite somewhat slower growth rate of exports compared to the previous year. The share of exports to Member States increased predominantly due to stronger exports to the main trading partners – Italy (petroleum and petroleum products) and Germany (road vehicles, manufactures of metals and other transport equipment). On the other hand, the share of exports to CEFTA fell due to lower exports to Bosnia and Herzegovina and Serbia, while the share of exports to countries other than EU, CEFTA and EFTA fell sharply, mostly a result of large decrease in exports to USA (medical and pharmaceutical products).

During the first two months of 2019, the share of exports to Member States continued to increase (reaching 69.2 per cent. of total goods exports), mostly as a result of higher exports to Italy (wide range of products), Germany (road vehicles) and Slovenia (non-ferrous metals). During the same period, the share of Croatian exports to CEFTA slightly increased, predominantly due to higher exports to Bosnia and Herzegovina (electric current). The share of exports to other countries continued to decline further, as a result of a decrease in exports to Canada (other transport equipment).

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

	Year ended 31 December					Two months ended 28 February
	2014	2015	2016	2017	2018	2019*
	(per cent)					
EU 27	76.4	78.0	77.2	78.1	78.0	82.2
Slovenia	10.8	10.7	10.9	10.7	11.1	11.2
Hungary	6.6	7.8	7.1	7.6	7.7	10.0
EU 15	50.8	51.2	50.5	50.2	48.9	50.6
Austria.....	8.7	9.1	8.0	7.6	6.9	6.6
Italy.....	14.3	13.1	12.6	12.8	13.2	14.2
Germany	15.1	15.5	16.1	15.4	15.2	15.7
CEFTA.....	5.3	5.5	5.9	6.2	6.1	5.7
Bosnia and Herzegovina.....	2.7	2.7	2.9	3.1	3.1	2.9
Serbia	2.1	2.3	2.5	2.6	2.5	2.5
EFTA ⁽¹⁾	1.2	1.0	1.0	0.9	1.0	0.6
Other ⁽²⁾	17.2	15.5	15.9	14.9	14.9	11.6
Russia.....	5.0	2.3	1.5	1.4	1.6	1.6
China.....	2.6	2.8	2.9	3.2	3.4	3.5

* The data for 2017 is provisional

⁽¹⁾ European Free Trade Association.

⁽²⁾ Excluding EU 27, CEFTA and EFTA.

⁽³⁾ After joining EU merchandise trade statistics is based on Intrastat (for trade between Member States) and Extrastat (for trade with non-EU countries).

Source: Central Bureau of Statistics

In 2015, imports from Member States increased from 2014 and amounted to 78.0 per cent of total goods imports. Such developments were mainly the result of an increase of imports from the new member states, primarily from Hungary (mainly electricity and telecommunications and sound recording instruments) and Slovenia (road vehicles and capital products). Imports from the EU 15 also increased noticeably, due to stronger imports from Germany, Austria, Netherlands and Spain. The share of imports from CEFTA countries also increased, as a result of growth in imports of electricity from Serbia and Bosnia and Herzegovina. Separately, the share of imports from EFTA countries decreased slightly, mainly due to lower imports from Switzerland. In addition, the share of other countries in total merchandise imports continued to decline mostly due to an extreme reduction in the value of imports of petroleum and petroleum products from Russia.

Data for 2016 indicates a slight decrease in the share of imports from Member States. This mostly reflects lower imports from Austria (mostly natural gas and leather manufactures). Road vehicle and capital goods imports from Germany and Slovenia were among the biggest contributors to total import growth. The share of CEFTA countries saw a minor increase relative to 2015, mostly due to a growth in imports of electric current from Bosnia and Herzegovina, as well as non-ferrous metals, food and live animals from Serbia. Notwithstanding this, the share of EFTA countries remained unchanged, whilst the share of non-EFTA countries increased with relatively strong imports of medical and pharmaceutical products from Korea and petroleum products from Kazakhstan.

After a temporary drop in 2016, the proportion of Croatian imports from Member States recovered in 2017 mainly due to an increase in imports from Italy (petroleum and organic chemicals), Germany (road vehicles and capital goods), Hungary (electric current and road vehicles) and Slovenia (road vehicles, electrical machinery, apparatus and appliances). The proportion of imports from CEFTA also increased slightly due to an increase in imports from Bosnia and Serbia (electric current and nonferrous metals). Since the growth of imports from other countries weakened, their proportion of total imports declined mildly.

In 2018, the geographical distribution of Croatian imports remained almost unchanged. The growth of total imports was to a large extent driven by stronger imports from Italy (petroleum and petroleum products), Slovenia (road vehicles and non-ferrous metals) and Germany (medical and pharmaceutical products and road vehicles). On the other hand, imports from Serbia (non-ferrous metals) declined. During the first two months of 2019, the proportion of Croatian imports from Member States increased strongly, mainly due to larger imports from Hungary (electric current and petroleum and petroleum products), Germany (industrial machinery and equipment) and Italy (petroleum and petroleum products). The proportion of imports from CEFTA declined slightly due to a slower growth than total imports growth, while imports from other countries declined strongly, mainly as a result of reduced imports of petroleum and petroleum products from Azerbaijan and Iraq.

In 2015, net exports of services increased by 9.1 per cent. compared to 2014, with the largest positive contribution from tourism services. Tourism revenues in 2015 increased by 7.6 per cent. compared to 2014, in line with favourable physical indicators. Foreign tourist arrivals grew by 9.6 per cent. and overnight stays by 7.5 per cent. Tourists from Germany, Austria, Slovenia, Hungary and Italy mainly accounted for the increase in the number of nights stayed. The greatest decrease recorded in overnight stays was in Russian tourists, as a result of new stricter visa rules introduced after the Croatian accession to the EU, and also due to the unfavourable economic situation in Russia. In addition, after being in deficit, other services recorded a surplus, especially due to favourable results in trade in computer services, construction services, repairs on goods and personal, cultural and recreational services.

In 2016, net exports of services further increased by 8.9 per cent. compared to the previous year mainly owing to positive developments in tourism services. Tourism revenues increased by 8.5 per cent., in line with the growth of volume indicators showing that the number of arrivals and nights spent by foreign tourists in commercial accommodation facilities grew by 9.3 per cent. and 9.7 per cent. respectively. The major contributors were tourists from Germany, Austria, Poland, Great Britain and Slovenia. At the same time, travel expenditures increased as well due to larger tourism consumption of residents abroad. In addition, net revenues from other services (especially telecommunication, computer and other business services), as well as transportation increased.

Net exports of services increased further in 2017 by 7.1 per cent. compared to the previous year. The biggest contributor was the tourism sector with an annual growth rate of revenues at 9.9 per cent. Such growth is in line with the significant increase in the number of arrivals and number of nights spent by foreign tourists in commercial accommodation in Croatia (by 13.7 per cent. and 11.3 per cent. respectively). The total number of nights spent by foreign tourists in commercial accommodation in Croatia in 2017 was 80.2 million as compared to 72.1 million in 2016. The total amount of nights spent by foreign and domestic tourists in commercial accommodation in Croatia increased in 2017 by 9.0 per cent. compared to the previous year. Tourists from Germany, Poland and the UK accounted for the greatest increase in the number of nights spent. Favourable trends were also seen in the trade of other services, especially in financial and telecommunications and computer services, whilst net exports of transportation services and manufacturing services on physical inputs owned by others experienced a slight decline.

In 2018, the growth of net exports of services slightly decelerated to 5.3 per cent. compared to the previous year. The biggest contributor was again the tourism sector, although tourism revenues growth was somewhat slower than in 2017 with an annual growth rate of 6.4 per cent. Growth dynamics of tourism physical indicators decelerated as well. Foreign tourist arrivals grew by 6.7 per cent. and overnight stays by only 3.7 per cent., with tourists from Germany, United Kingdom, United States and Hungary accounting for the strongest increase in the number of nights spent. In addition, net revenues from other services (especially telecommunications, computer and information services and construction services), as well as transportation increased.

The table below shows the revenues from tourism and their proportion of GDP, along with the overnight stays for the years indicated.

	2014	2015	2016	2017	2018
Tourism Revenue (EUR billions)	7.4	8.0	8.6	9.5	10.1
Per cent. GDP	17.0	17.8	18.5	19.4	19.6
Overnight stays (EUR millions)					
Domestic	5.1	5.7	5.8	6.0	6.5
Foreign	61.2	65.7	72.1	80.2	83.2
Total	66.3	71.4	77.9	86.2	89.7

Details of the International Balance of Payments

Croatia's balance of payments 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 Government institutions (CBS and Croatian Health Insurance Fund), special reports of the HNB (external debt relations, monetary statistics and reserve assets), and estimates and statistical research carried out by the HNB.

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, (2) trade in services, (3) primary income and (4) secondary income. The capital account primarily comprises net capital transfers from international institutions. The financial account is made up of: (1) direct investment (equity, reinvested earnings, debt instruments), (2) portfolio investments (equity and debt instruments), (3) financial derivatives, (4) other investments (other equity, currency and deposits, loans, trade credits, other accounts receivable/payable) and (5) changes in the official reserves.

Croatia's balance of payments data is reported in three currencies: in euro, U.S. dollar and kuna. 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 following table sets forth the balance of payments for the periods indicated:

	Year ended 31 December				
	2014	2015	2016	2017	2018*
CURRENT ACCOUNT	857.9	2,019.5	1,205.1	1,794.9	1,354.4
Goods, services, and primary income	(36.2)	734.0	(168.7)	203.6	(371.1)
Credit	20,500.4	22,412.2	23,993.2	26,673.3	28,324.3
Debit	20,536.6	21,678.1	24,161.9	26,469.6	28,695.4
Goods and services	822.3	1,025.0	1,322.5	1,073.3	552.0
Credit	19,676.9	21,473.1	22,784.6	25,143.1	26,590.3
Debit	18,854.7	20,448.2	21,462.1	24,069.8	26,038.2
Goods	(6,512.2)	(6,974.5)	(7,385.0)	(8,254.0)	(9,273.9)
Credit	9,439.5	10,193.5	10,510.6	11,712.1	12,215.4
Debit	15,951.7	17,167.9	17,895.7	19,966.2	21,489.2
Services	7,334.5	7,999.4	8,707.5	9,327.4	9,825.9
Credit	10,237.4	11,279.7	12,274.0	13,431.0	14,374.9
Debit	2,903.0	3,280.2	3,566.4	4,103.6	4,549.0
Manufacturing services on physical inputs owned by others	229.9	251.3	264.4	255.2	243.3
Credit	251.3	277.0	300.9	299.0	292.3
Debit	21.3	25.6	36.6	43.9	49.0
Transport	434.6	442.0	514.6	508.2	555.1
Credit	999.1	1,018.2	1,077.5	1,147.0	1,219.7
Debit	564.5	576.2	562.9	638.8	664.6
Travel	6,767.6	7,280.2	7,781.5	8,291.0	8,686.5
Credit	7,402.3	7,962.0	8,635.0	9,492.9	10,096.5
Debit	634.6	681.8	853.5	1,201.9	1,410.1
Other services	(97.7)	25.9	147.1	273.0	341.1
Credit	1,584.8	2,022.6	2,260.5	2,492.1	2,766.4
Debit	1,682.5	1,996.6	2,113.4	2,219.1	2,425.3
Primary income	(858.5)	(291.0)	(1,491.2)	(869.7)	(923.1)
Credit	823.5	939.0	1,208.6	1,530.2	1,734.1
Debit	1,681.9	1,230.0	2,699.8	2,399.8	2,657.2
Secondary income	894.1	1,285.5	1,373.7	1,591.2	1,725.5
Credit	1,922.4	2,286.5	2,437.9	2,667.2	2,864.4
Debit	1,028.3	1,001.0	1,064.2	1,076.0	1,138.9
CAPITAL ACCOUNT	165.6	321.2	667.2	501.6	710.8
FINANCIAL ACCOUNT	422.2	1,902.5	1,356.0	1,639.0	1,426.0
Direct investment	(691.2)	(232.8)	(1,939.5)	(1,196.7)	(682.1)
Assets	1,608.5	(41.0)	(176.9)	585.1	375.7
Liabilities	2,299.7	191.8	1,762.6	1,781.9	1,057.8
Portfolio investment	717.9	(115.2)	1,299.9	125.1	698.0
Assets	404.7	184.3	(183.2)	157.7	171.3
Liabilities	(313.2)	299.5	(1,483.1)	32.6	(526.7)
Financial derivatives	35.8	(15.7)	(81.7)	(317.1)	(9.1)
Other investment	889.6	1,521.0	2,342.1	434.6	(125.8)
Assets	940.0	(132.3)	256.1	(77.1)	(707.4)
Liabilities	50.5	(1,653.3)	(2,086.0)	(511.7)	(581.6)
Reserve Assets	(529.9)	745.3	(264.7)	2,593.1	1,545.0
NET ERRORS AND OMISSIONS ⁽¹⁾	(601.3)	(438.2)	(516.3)	(657.5)	(639.3)

Balance of payments for the periods indicated (EUR millions)

* Preliminary data

Source: Croatian National Bank

⁽¹⁾ 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.

The negative balance on the primary income account declined by 66.1 per cent. in 2015 compared to 2014, primarily as a result of lower expenditures on direct equity investments due to bank losses associated with the cost of expected conversion of the Swiss franc-indexed loans. Strong growth in revenues from remittance of employees working abroad contributed additionally to primary income account balance improvement. Interest expenditures increased very mildly because rising government financing costs were to a large extent offset by falling expenditures in the banking sector and other domestic sectors. After three consecutive years of improvement, the primary income account balance in 2016 significantly deteriorated from the previous year, mainly due to the base effect related to the conversion of the Swiss franc-indexed loans (recorded in September 2015). In addition to the fall in provisioning due to the write-off Swiss franc-indexed loans, the pronounced growth in profitability of foreign-owned banks was spurred by one-off revenue from the sale of the shares of Visa Europe Ltd., the increase in operating profit and the sale of non-performing loans at a price higher than their net value.). Excluding the financial sector, the profitability of other foreign-owned companies also improved, mostly in the manufacture of refined petroleum products,

trade and pharmaceutical sector. In contrast, the balance on portfolio and other investment income accounts improved, spurred by decreasing interest expenditures on foreign liabilities across all domestic sectors. Rising revenues from the compensation of employees working abroad also contributed to the improvement in the primary income account balance. In 2017 the negative balance on the primary income account declined by 41.7 per cent. compared to 2016, driven by the negative effect of provisions for loans related to Agrokor Group on banks' profits. In addition, improved profitability of foreign firms owned by residents, falling interest expenditures of domestic sectors, as well as the rising compensation of employees working abroad contributed positively to the primary income account balance. In contrast, growth in banks' profits from regular activities as well as improved profitability of foreign-owned firms, in particular in the construction, manufacture of refined petroleum products and real estate sectors, were recorded. In 2018 the negative balance on the primary income account slightly deteriorated by 6.1 per cent. compared to the previous year, spurred by the increasing expenditures from equity investments. More specifically, bank profits increased strongly after negative one-off credit impairments in the previous year as well as profitability of other foreign-owned companies, mostly in real estate, information and communication activities and trade. On the other hand, unfavorable developments were offset by the improvement of the balance on portfolio and other investment income accounts due to decreasing interest expenditures on foreign liabilities as well as strong increase in revenues from the compensation of employees working abroad.

Net revenues on the secondary income account increased noticeably (by 43.8 per cent.) in 2015 compared to previous year, primarily due to higher use of EU funds. The positive balance in the secondary income account continued to increase in 2016 (by 6.9 per cent) driven by a rise in transfers unrelated to the EU budget. During 2017 net revenues on the secondary income account increased further, by 15.8 per cent., due to an increase in the withdrawal of funds from the EU budget. Positive trends continued in 2018 when net revenues in the secondary account increased by 8.4 per cent.

Capital Account

In the 2014-2016 period on the capital account a positive balance was recorded, reaching EUR 0.7 billion in 2016. On the other hand, in 2017 the value of net capital transfers dropped to EUR 0.5 billion due to a substantial decrease in the inflow of EU funds related to fixed capital formation, but this reversed in 2018 when capital transfers from EU funds rose sharply and the overall positive balance on the capital account reached EUR 0.7 billion. In relation to EU funds, it is important to keep in mind that the revenues on the current and capital account only show the funds paid out to end beneficiaries, while the funds received but not yet allocated are only recorded on the financial account.

Net value of total transfers with the EU budget, calculated as the sum of current and capital transfers of EU funds allocated to end beneficiaries in Croatia minus the current transfers from Croatia to the EU related to payments to the EU budget, was negative in 2014. This changed in 2015, when Croatia's payments to the EU budget were lower than the payments to end beneficiaries, which rose substantially. Positive net value of transfers with the EU budget continued to grow, reaching 1.2 per cent. of GDP in 2016 and 2017 and 1.8 per cent of GDP in 2018.

Financial Account

In 2015, net capital outflow (financial account excluding the net international reserves³) increased to EUR 2.3 billion. Net inflow from foreign direct investment declined further compared to the previous year. Capital outflows were strongly affected by a pronounced deleveraging of credit institutions, which was partly related to the adjustment of their currency position to the effects of a write-off of the part of Swiss franc-indexed loans governed by the Law on Amendments to the Law on Consumer Credit. Foreign liabilities of the Government declined as well, while liabilities of other domestic sectors increased mildly. Strong deleveraging towards affiliated creditors mostly referred to de facto debt-equity transactions. The stock of gross external debt declined by EUR 1.0 billion (as the unfavourable impact of cross-currency changes and other adjustments was EUR 1.1 billion) and stood at EUR 45.4 billion or 101.7 per cent. of GDP at the end of 2015.

Notwithstanding the domestic economic activity growth and improvement in financing conditions, capital outflows from Croatia continued into 2016 with net capital outflow (the financial account, excluding the

³ Net international reserves are defined as the difference between gross international reserves and CNB's foreign liabilities.

net international reserves) amounting to EUR 1.3 billion. Net inflow of foreign direct investment intensified compared to the 2015, mainly driven by a considerable improvement of the reinvested earnings in the financial sector. However, capital outflows are related to a pronounced deleveraging, most notably of the Government and credit institutions, and to a lesser extent of the other domestic sectors. As a result, the stock of gross external debt declined by EUR 3.7 billion and stood at EUR 41.7 billion or 89.3 per cent. of GDP at the end of 2016.

Unlike the previous year, in 2017, the financial account, excluding net international reserves, recorded a small inflow of capital of EUR 0.3 billion. Net inflow of foreign direct investment was somewhat lower compared to 2016 due to higher investments abroad, accompanied with lower retained earnings and equity investments in Croatia. During the same period, the deleveraging of domestic sectors slowed down. While the banks and non-financial corporates continued deleveraging, the Government increased its foreign debt by issuing a bond on a foreign market to refinance the debt of public companies in the road sector. Despite the slower intensity of deleveraging, and as a result a favourable effect of cross-currency changes and other adjustments in the amount of EUR 1.4 billion, the stock of gross external debt declined by EUR 1.4 billion and stood at EUR 40.2 billion or 82.1 per cent of GDP at the end of 2017.

In 2018, net capital inflow (financial account excluding the net international reserves) increased to EUR 0.5 billion, mostly as a result of stronger net equity flows compared to 2017 due to higher retained earnings, mostly driven by a rise in banks' profitability after absorbing one-off credit impairments in the previous year and, as well as lower investments abroad. At the same time, the deleveraging of domestic sectors slightly intensified as a result of strong deleveraging by the government sector and other domestic sectors (due to strong deleveraging towards affiliated creditors), while net foreign position of banks remained almost unchanged after several years of strong improvements. Accordingly, while the impact of cross-currency changes and other adjustments was unfavourable and rather small (EUR 0.1 billion), the stock of gross external debt declined by EUR 1.4 billion and stood at EUR 38.8 billion or 75.4 per cent of GDP. In January 2019 the stock of gross external debt increased sharply by EUR 0.8 billion, almost entirely due to the investment of international reserves in reverse repo agreements that results in simultaneous, same-amount increase in assets and liabilities of the HNB. Gross international reserves stood at EUR 18.8 billion as at 30 April 2019, representing an increase of EUR 1.3 bn compared to 31 December 2018, this was mostly the result of higher stock of repo operations. As at 30 April 2019, international reserves were sufficient to cover 138 per cent. of base money (MO) and 116 per cent. of money supply (M1).

Foreign Direct Investment

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

	Year ended 31 December				
	2014	2015	2016	2017	2018
	<i>(EUR millions)</i>				
Assets	1,608.5	(41.0)	(176.9)	585.1	375.7
Liabilities	2,299.7	191.8	1,762.6	1,781.9	1,057.8
Direct Investment	(691.2)	(232.8)	(1,939.5)	(1,196.7)	(682.1)
Direct Investment as a percentage of GDP	(1.6)	(0.5)	(4.2)	(2.4)	(1.3)

Source: Croatian National Bank

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

Net foreign direct investment inflow in Croatia declined substantially in 2015, amounting to only EUR 0.2 billion (0.5 per cent. of GDP). This was mainly the result of high negative reinvested earnings on the liabilities side due to the negative effects of the conversion of Swiss franc-indexed loans on banks' profitability and, to a lesser extent, valuation adjustments. In relation to equity investments, the growth in liabilities (excluding round-tripping in 2014) intensified in 2015. However, most of the equity investments referred to de facto debt-equity swap transactions and one significant investment in the tobacco industry. Other equity investments were mainly recorded in the real estate activities.

Net foreign direct investment inflow in Croatia increased significantly in 2016 and amounted to EUR 1.9 billion (4.2 per cent. of GDP), driven by relatively large reinvested earnings on the liabilities side, particularly in financial intermediation activity. This is the result of the much higher profitability for domestic banks that was accompanied by much smaller dividend payments, following last year's losses associated with the cost of the expected conversion of Swiss franc-indexed loans. At the same time, new foreign direct equity investments in Croatia were modest and mostly took place in the real estate, trade and financial sectors.

Net foreign direct investment inflow in Croatia declined in 2017 and amounted to EUR 1.3 billion (2.4 per cent. of GDP), mostly due to a recovery of foreign direct investment abroad, while on the liability side, both equity investment and reinvested earnings were lower compared to the previous year. New foreign equity investments mostly took place in the real estate and trade sectors. The reduction in reinvested earnings was largely the outcome of lower profits in the banking sector (due to higher provisions for loans related to the Agrokor Group. On the other hand, in other sectors, retained earnings increased, particularly in construction, oil industry, trade and real estate.

Net foreign direct investment inflow dropped from 2.4 per cent. of GDP to 1.3 per cent. in 2018 mostly due to strong fall in affiliated borrowing on the liabilities side as a result of significant deleveraging of corporate sector. On the other hand, reinvested earnings were higher compared to the last year, primarily as a result of larger bank earnings in 2018 after the negative impact of provisioning for Agrokor group companies on the profitability of banking sector a year earlier. In other sectors retained earnings also increased (in particular in ICT sector and trade). Equity investment excluding debt to equity swaps were somewhat lower compared to the last year and were mostly recorded in the real estate sector.

Exchange Rates

The following table sets forth for the periods indicated, the average monthly rates published by the Croatian National Bank (Hrvatska narodna banka) (the "HNB"), expressed as kuna per Euro.

	2014	2015	2016	2017	2018	2019
				(HRK/EUR)		
January.....	7.629820	7.679826	7.652777	7.534989	7.440202	7.424741
February.....	7.654972	7.709544	7.636668	7.450718	7.434137	7.411951
March.....	7.654440	7.648124	7.566498	7.419710	7.436512	7.416254
April.....	7.627459	7.594858	7.494619	7.441166	7.418312	7.426090
May.....	7.593665	7.553892	7.494223	7.433633	7.388816	
June.....	7.573554	7.565026	7.511915	7.405667	7.376993	
July.....	7.599809	7.579293	7.489517	7.405674	7.388817	
August.....	7.626000	7.554396	7.477713	7.398765	7.412997	
September.....	7.618519	7.574467	7.490070	7.450196	7.422715	
October.....	7.650459	7.622835	7.502932	7.501332	7.418863	
November.....	7.663895	7.598376	7.513263	7.544639	7.425220	
December.....	7.667075	7.634682	7.534257	7.543915	7.401281	
Yearly average.....	7.630014	7.609601	7.529383	7.460100	7.414111	

Source: HNB

Croatia has a managed floating exchange rate regime, 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 HNB does not predetermine the floor or the ceiling level of the exchange rate that it attempts to maintain or the level at which it will necessarily intervene. However, the HNB attempts to prevent excessive exchange rate volatility by occasional market interventions or by other monetary policy instruments that influence the foreign exchange market or money market conditions such as open market operations and reserve requirements, among others. The HNB aims to maintain the stability of the EUR/HRK exchange rate in order to meet its primary objective of maintaining price stability 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 significantly impact household inflationary expectations. The effect of this is augmented by the population's sensitivity to inflation as a result of hyperinflation episodes in the former Yugoslavia and in the early 1990s.

In 2015, the nominal EUR/HRK exchange rate appreciated mildly. The daily kuna/euro exchange rate moved within a rather narrow range from –1.1 per cent. to 1.5 per cent. around an average annual exchange rate of HRK 7.61 to EUR 1, appreciating by 0.3 per cent. from 2014. At the beginning of 2015, depreciation pressures appeared on the EUR/HRK exchange rate. This was due to the adjustment of bank currency positions as a result of the Government's decision to fix the CHF/HRK exchange rate for Swiss franc indexed loans. In order to prevent further depreciation of the EUR/HRK exchange rate, the HNB intervened twice on the foreign exchange market during January 2015 and February 2015 by selling EUR 498.9 million worth of foreign currency to banks. Depreciation pressures appeared again during September 2015, mainly as a result of the adopted amendments to the Consumer Credit Act and the Credit Institutions Acts that enabled conversion of the Swiss franc indexed loans to euro loans. The HNB intervened on the foreign exchange market to prevent further depreciation of the EUR/HRK exchange rate at the end of September 2015, by selling EUR 268.3 million worth of foreign currency to banks. The daily kuna/euro exchange rate was stable during the last quarter of 2015. At the end of December 2015 it stood at HRK 7.64 to EUR 1, an appreciation of only 0.3 per cent. from the end of 2014.

In 2015, the HNB intervened three times on the foreign exchange market by selling a total amount of EUR 767.2 million worth of foreign currency to banks. When transactions with the European Commission and the central Government are included (net foreign purchase of EUR 935.1 million), total foreign exchange transactions of the HNB resulted in a net foreign exchange purchase in the amount of EUR 167.9 million and the creation of HRK 1.2 billion.

In 2016, appreciation of the nominal EUR/HRK exchange rate continued. The daily kuna/euro exchange rate moved within a range from –0.9 per cent. to 1.8 per cent. around an average annual exchange rate of

HRK 7.53 to EUR 1, appreciating by 1.1 per cent. from 2015. This was mostly attributable to the continuation of the surplus in the current account of the balance of payments, stronger inflows of EU funds, increase in demand for kuna denominated loans (mostly from households) and a slowdown in credit institutions' deleveraging.

The HNB intervened on the foreign exchange market several times in 2016 to prevent stronger appreciation of the EUR/HRK exchange rate by buying a total amount of EUR 1,018.8 million worth of foreign currency from banks. It purchased EUR 83.5 million in May 2016, EUR 69.0 million in September 2016 and EUR 866.3 million in December 2016 (EUR 716.3 million in two foreign exchange auctions and EUR 150.0 million out of auction).

Total foreign exchange transactions of the HNB in 2016 resulted in a net foreign exchange purchase in the amount of EUR 866.6 million (creating HRK 6.5 billion of reserve money). The HNB purchased EUR 1,018.8 million from banks and EUR 125.6 million from the central Government and sold EUR 277.8 million to the European Commission.

During the first eight months of 2017, appreciation of the nominal EUR/HRK exchange rate continued. This trend reversed in September when the nominal EUR/HRK exchange rate started to depreciate. By the end of 2017 it returned to a level similar to the one observed at the beginning of the year. The daily kuna/euro exchange rate moved within a range from -1.0 per cent. to 1.5 per cent. around an average exchange rate of HRK 7.46 to EUR 1. By 31 December 2017, the EUR/HRK exchange rate appreciated by 0.6 per cent., from HRK 7.56 to EUR 1 at the end of 2016 to HRK 7.51 to EUR 1.

The HNB intervened in the foreign exchange market several times in 2017 to alleviate appreciation pressures on the EUR/HRK exchange rate by buying a total amount of EUR 1,757.0 million worth of foreign currency from banks. It purchased EUR 424.0 million in June 2017 (EUR 374.0 million in two foreign exchange auctions and EUR 50.0 million out of auction), EUR 101.5 million in July 2017, EUR 126.0 million in August 2017, EUR 120.0 million out of auction in September 2017, EUR 80.0 million out of auction in October, EUR 40.0 million out of auction in November 2017 and EUR 765.5 million in December 2017 (EUR 345.5 million in a foreign exchange auction and EUR 420.0 million out of auction). Data for 2017 also includes a direct purchase of foreign exchange from banks outside auctions of EUR 100.0 million on 29 December 2016, as the value date of that transaction was 2 January 2017.

Total foreign exchange transactions of the HNB during 2017 resulted in a net foreign exchange purchase of EUR 1,787.6 million (creating HRK 13.4 billion of reserve money). The HNB purchased EUR 1,757.0 million from banks and EUR 30.6 million from the central Government. There were no transactions done with the European Commission.

In 2018, appreciation of the nominal EUR/HRK exchange rate continued. The nominal daily kuna/euro exchange rate moved within a rather narrow range from -0.6 per cent. to 1.3 per cent., with an average annual exchange rate of around HRK 7.41 to EUR 1, appreciating by 0.6 per cent. from 2017. In 2018, HNB intervened on the foreign exchange market by buying a total amount of EUR 1,808.9 million worth of foreign currency from banks and EUR 30.4 million worth of foreign currency from the central Government (creating HRK 13.6 billion of reserve money). There were no transactions done with the European Commission.

During the first four months of 2019, the nominal EUR/HRK exchange rate appreciated mildly, from HRK 7.42 to EUR 1 at the end of 2018 to HRK 7.41 to EUR 1 at the end of April 2019. At the beginning of February, somewhat stronger appreciation pressures appeared so the HNB intervened in the foreign exchange market by buying a total amount of EUR 450.3 million worth of foreign currency from banks. During the first four months of 2019, the HNB also sold EUR 452.0 million worth of foreign currency to central Government. There were no transactions done with the European Commission.

The following table sets forth the period end, average, high and low official mid-point rates, expressed as kuna per U.S. dollar:

	Period End	Average ⁽¹⁾	High	Low
		(HRK/USD)		
2014.....	6.302107	5.749322	6.302107	5.44043
2015.....	6.991801	6.862262	7.258268	6.299529
2016.....	7.168536	6.803718	7.247732	6.479354
2017.....	6.269733	6.622397	7.260492	6.154188
2018.....	6.469192	6.278406	6.604879	5.948045
January 2019.....	6.496932	6.503106	6.556329	6.439358
February 2019.....	6.517828	6.527974	6.569177	6.467111
March 2019.....	6.610040	6.554411	6.614007	6.503872
April 2019.....	6.641671	6.606620	6.663806	6.568564

Source: HNB

Note: Calculations based on mid exchange rate.

⁽¹⁾ Average of daily rates.

The kuna depreciated significantly against the U.S. dollar in 2014, mainly reflecting movements in the global foreign exchange markets during the second half of the year, due to the strengthening of the U.S. dollar against the euro. The U.S.\$/HRK exchange rate depreciated by 13.6 per cent. in 2014, from U.S.\$/HRK 5.55 at the end of 2013 to U.S.\$/HRK 6.30 at the end of 2014. In 2015, depreciation of the kuna against the U.S. dollar continued, mainly as a result of the strengthening of the U.S. dollar against the euro on the global foreign exchange markets. At 31 December 2015, the exchange rate stood at U.S.\$/HRK 6.99, depreciating by 10.9 per cent. from the end of 2014. Depreciation of the kuna against the U.S. dollar continued in 2016, reflecting the strengthening of the U.S. dollar against the euro on the global foreign exchange markets. In such an environment, the U.S.\$/HRK exchange rate depreciated by 2.5 per cent. in 2016 and stood at U.S.\$/HRK 6.99 at the end of 2015 to U.S.\$/HRK 7.17 at the end of 2016.

In 2017, the kuna appreciated significantly against the U.S. dollar, mainly reflecting movements in the global foreign exchange markets, due to the weakening of the U.S. dollar against the euro. By 31 December 2017, the U.S.\$/HRK exchange rate appreciated by 12.5 per cent., from U.S.\$/HRK 7.17 at the end of 2016 to U.S.\$/HRK 6.27 at the end of 2017. In 2018, the U.S.\$/HRK exchange rate depreciated by 3.2 per cent., from U.S.\$/HRK 6.27 at the end of 2017 to U.S.\$/HRK 6.47 at the end of 2018. During the first four months of 2019, depreciation of the kuna against the U.S. dollar continued, as a result of the strengthening of the U.S. dollar against the euro on the global foreign exchange markets. At 30 April 2019, the exchange rate stood at U.S.\$/HRK 6.64, depreciating by 2.7 per cent compared to the level observed at the end of 2018.

After unfavourable trends in 2013, the indicators of Croatian export price competitiveness improved again in 2014. The average real effective kuna exchange rate deflated by producer prices continued to depreciate at a broadly similar pace compared to the previous year. In 2015, depreciation continued at its fastest pace since 2010 (by 3.8 per cent.), mostly due to the nominal effective depreciation of the kuna. In contrast, after appreciating during 2013, the average real effective kuna exchange rate deflated by consumer prices depreciated in 2014. This mainly reflected price developments in Croatia relative to Croatia's main trading partners, thus returning to its 2012 level. In 2015, a combination of the kuna nominal effective depreciation and favourable price developments in Croatia relative to its main trading partners contributed to further depreciation of the real effective kuna exchange rate deflated by consumer prices (by 4.3 per cent.). Overall, the indicators of Croatian export price competitiveness reveal mixed developments in 2016. The average real effective kuna exchange rate deflated by producer prices was broadly stable during 2016, with more favourable domestic price developments (relative to main trading partners) offsetting nominal effective appreciation of the kuna. In contrast, the average real effective kuna exchange rate deflated by consumer prices, appreciated mildly. Both indicators of Croatian export price competitiveness deteriorated slightly during 2017. This was due to the appreciation of the kuna's nominal effective exchange rate, which was only partly alleviated by the relatively favourable domestic price trends. In 2018, the real effective exchange rates of the kuna, deflated by consumer and producer prices, depreciated slightly, due to the appreciation of the kuna's nominal effective exchange rate, which was only partly alleviated by the relatively favourable domestic price trends. In the years before the crisis, the kuna real effective exchange rate indices, deflated by unit labour costs in the whole economy and in industry, were signalling deterioration of cost competitiveness due to the nominal effective appreciation of the kuna as well as due to faster growth of unit labour costs in Croatia than in its main trading partners. These negative trends reversed in 2009, 2010, 2011 and 2012 when kuna real effective exchange rate indices, deflated by unit labour costs, depreciated. The real effective kuna exchange rate, deflated by unit labour costs, in the whole economy continued to depreciate

in 2013 and 2014 but at a much slower pace compared to 2012. In 2015, the real effective kuna exchange rate deflated by unit labour costs in the whole economy and in industry depreciated further, with the former depreciating even faster than the year before. In 2016, depreciation of the real effective kuna exchange rate, deflated by unit labour costs, continued, both in the whole economy and in industry, although at a slower pace. In 2017, depreciation of the real effective kuna exchange rate deflated by unit labour costs in the whole economy continued, at a similar pace. At the same time, the real effective kuna exchange rate deflated by unit labour costs in industry appreciated slightly, due to the nominal effective exchange rate appreciation of the kuna, which was only partly mitigated by relatively favourable domestic costs trends.

In 2018, the real effective kuna exchange rate, deflated by unit labour costs in the whole economy, was broadly stable, with more favourable domestic cost developments (relative to main trading partners) offsetting nominal effective appreciation of the kuna. At the same time, the real effective kuna exchange rate deflated by unit labour costs in industry appreciated, due to the nominal effective exchange rate appreciation of the kuna and relatively unfavourable domestic costs trends.

MONETARY DEVELOPMENTS, INTERNATIONAL RESERVES AND FINANCIAL SYSTEM

Monetary Policy and Instruments

Despite the negative effects of the global financial crisis on the domestic economy since 2008, the HNB has successfully maintained the stability of the euro/kuna exchange rate, a key aspect of achieving domestic price stability as well as the stability of the financial sector as a whole. The HNB seeks to maintain the stability of the euro/kuna exchange rate through a variety of instruments, including reserve and foreign currency requirements, foreign exchange interventions and reverse operations to manage banking sector liquidity. For an overview of recent interventions, see *"Monetary Policy Developments January 2014 – April 2019"*.

Monetary Policy Developments January 2014 – April 2019

The HNB continued to implement the expansionary monetary policy together with maintaining the stable nominal euro/kuna (EUR/HRK) exchange rate. The expansionary monetary policy stance was conducted in an environment marked by the delayed recovery of lending activity, risk aversion of banks and economic entities, low level of business and consumer optimism and subdued inflationary pressures. An accommodative monetary policy was reflected in the maintenance of high levels of liquidity created in previous years. The average surplus kuna liquidity on credit institutions' accounts increased from HRK 6.4 billion in 2014 to HRK 6.7 billion in 2015 and further to HRK 7.6 billion in 2016. In 2017 liquidity surplus reached HRK 15.1 billion, while in 2018 it further increased up to HRK 24.9 billion. During the first four months of 2019 liquidity continued to grow reaching a historically high level of HRK 33.3 billion which contributed to the lowering and maintaining of overnight interest rates on the interbank market at exceptionally low levels (only 0.11 per cent. on average in 2018). After eight months without the turnover on the domestic overnight interbank market, turnover was finally recorded in April, with the average interest rate dropping to a negative area for the first time and amounting to -0.24%. Indirectly, ample liquidity also contributed to more favourable short-term Government borrowing on T-bills ("**T-bills**") market. For example, yield on 1-year kuna T-bills stood at 0.08 per cent. in April 2019, which makes it lower than an average of 0.10 per cent in 2018 and even more than four times lower compared to an average of 0.45 per cent. recorded in 2017.

Reserve money creation in 2014 was mainly driven by the foreign currency transactions. In 2014, due to seasonal depreciation pressures the HNB intervened in the foreign exchange market only on 31 January 2014 by selling EUR 240.2 million since there was no significant pressure on the exchange rate in the remaining part of 2014. Meanwhile, the HNB continued conducting foreign currency transactions with the Ministry of Finance and European Commission. In the period from January to December 2014, the HNB sold EUR 392.2 million to the European Commission. These transactions refer to the conversion of kuna funds allocated by the Government to the European Commission's account with the central bank as payments to the EU budget. Transactions with the Government resulted in the net purchase of EUR 420.6 million. Similarly to previous years, those purchases were generated from the Government's foreign borrowing. Therefore, in the environment of subdued capital inflows, Government foreign borrowing remained the main source of foreign currency inflows.

As of November 2014, the HNB cut the foreign currency reserve requirement allocation rate on funds received from connected clients from 100 per cent. to 60 per cent. The share of the foreign currency reserve set aside to the account with the HNB was thus equalised for all foreign currency sources. As a result, the foreign currency reserve requirement set aside to the government foreign currency account with the HNB decreased by approximately EUR 80 million, and the part of reserve requirement maintained by banks in foreign assets increased by the same amount.

In 2015, the monetary policy stance was additionally loosened. The HNB continued with an accommodative monetary policy while keeping the exchange rate stable. The HNB purchased a net total of EUR 167.9 million and created HRK 1.2 billion. In 2015, the net purchase of foreign currency from the Government exceeded the sale of foreign currency to the banks and the European Commission. The HNB purchased from the Government a net total of EUR 1,364 million and created HRK 10.4 billion, which is associated with the conversion of a part of the funds received in the Government foreign currency account with the HNB, following the issue of foreign currency T-bills on the domestic market and eurobonds in the international market. Separately, the sale of foreign currency to the European Commission in 2015 amounted to EUR 428.9 million.

In 2015, depreciation pressures on the exchange rate were triggered by the banks' need to adjust their foreign currency positions. The HNB intervened three times in 2015 by selling foreign currency to banks. The first two interventions (amounting to EUR 498.9 million) in January and February 2015, were to mitigate depreciation pressures caused by adjusting the foreign currency positions of banks due to the Government's decision to fix the exchange rate of the Swiss franc for the repayment of loans in the following year. In late September 2015, the HNB again intervened by selling EUR 268.3 million due to the need to harmonise the foreign currency position of banks, which was associated with the adoption of the Law on Amendments to the Law on Consumer Credit governing conversion loans indexed to the Swiss franc. The main intention was to use a conversion procedure to place borrowers with loans linked to the Swiss franc in the same position they would have been if their loans had been initially indexed to the euro. This resulted in a reduction of the remaining principal of the prospective loan and in the refund of overpayments related to past loan instalments. The overpayment was intended to be used to settle future instalments, with a caveat that up to one half of each future instalment may be settled using the overpayment. The cost associated with the conversion of Swiss franc-indexed loans was initially recorded in September 2015 as HRK 6.8 billion of expenses on provisions. This cost was borne by banks in 2015 and did not affect their profit and loss accounts in 2016. As a result, losses before taxes of the banking sector in 2015 amounted to HRK 5.0 billion as opposed to HRK 2.1 billion profit before taxes in the previous year. According to the Ministry of Finance data, the total cost of the conversion process, including principal write-offs and the refund of overpayments through the reduction of future instalments, amounted to HRK 7.3 billion. The conversion procedure and the associated recognition of losses caused the opening of banks' foreign exchange ("FX") positions, and the need to reduce their FX exposure. Through interventions, the HNB sold EUR 767.2 million, thus withdrawing HRK 5.9 billion. Moreover, the banks' increased demand for foreign currency spurred demand for liquid kuna assets needed for purchasing the foreign currency, and temporarily pushed the intrabank overnight interest rate up from below 0.5 per cent. in early September to almost 2 per cent. in the second half of the month.

In order to enable smooth implementation of the conversion operation while maintaining stable exchange rates and favourable liquidity conditions, the HNB implemented a set of monetary policy measures in September and October 2015. Firstly, in order to alleviate depreciation pressures on the kuna, the HNB intervened on the FX market by selling EUR 268.3 million on September 30 2015, thus withdrawing HRK 2 billion. The HNB also provided additional kuna liquidity by resuming weekly reverse repurchase operations. Additionally, the HNB abolished the mandatory holding of HNB bills and repurchased the remaining amounts held by banks, thus releasing HRK 3.4 billion in October. Due to these measures, in early October the EUR/HRK exchange rate stabilised and the overnight interest rate returned to below 0.5 per cent. By mid-October, excess liquidity exceeded HRK 8 billion. In order to facilitate the use of regular standing facilities, the HNB widened the list of securities eligible for collateral and reduced the HNB discount rate from 7 per cent. to 3 per cent. and the lending rate on lombard loans from 5 per cent. to 2.5 per cent.

In December 2015, the HNB abolished the requirement to allocate the foreign exchange component of the reserve requirement to a separate account with the HNB and instead decided that the total foreign exchange component of the reserve requirement is to be maintained by the average daily balances of liquid foreign exchange claims. The decision was applied as of the reserve requirement calculation in mid-January 2016.

After the implementation of a set of monetary policy measures in September and October 2015 that successfully alleviated the pressures on the exchange rate and domestic money market, there was no need for further measures. The conversion process began in late November 2015, and proceeded smoothly on the FX market. Debtors that account for 94.0 per cent. of the total number of Swiss franc loans accepted the conversion. From the end of November 2015, banks have written off a total of HRK 6.0 billion of Swiss franc-indexed loans, while the total amount of bank claims to households of the Swiss franc indexed loans fell to HRK 0.7 billion in March 2019 (which comprises 0.6 per cent. of total placements to households), down from HRK 21.7 billion (or 17.2 per cent. of total placements to households) prior to the conversion.

The expansionary monetary policy of the HNB continued in 2016, and was further strengthened with the introduction of structural repurchase operations in February 2016. The purpose of these operations was to provide banks with longer-term sources of kuna liquidity at an interest rate competitive to interest rates on other banks' kuna liquidity sources. The room for the introduction of structural repurchase operations arose from the growth of the current account surplus, coupled with the strengthening of banks' external positions and accelerated domestic economic recovery which spurred demand for new loans. Furthermore, the lending structure changed in favour of kuna loans and since April 2015, the amount of newly granted household kuna loans has continuously exceeded the amount of foreign currency loans. As a result, the stock of household kuna loans at the end of March 2019 was greater than the stock of foreign currency loans. Such developments

support the stability of the kuna exchange rate and minimise the risks that structural operations might pose to its stability. Structural operations could also contribute to lowering the level of euroisation in the banking system and, in turn, of the currency risk exposure of the economy and consumers. However, a more pronounced reduction of euroisation is conditional on changing the currency structure of bank deposits in favour of kuna deposits.

Foreign exchange transactions of the HNB in 2016 also contributed to the rise in excess kuna liquidity, notably the purchase of foreign currency from banks due to the appreciation pressures on the domestic currency. After two interventions in May and September 2016, the HNB further intervened in December 2016, twice in foreign exchange auctions and twice out of auction. In 2016 as a whole, the HNB purchased EUR 1,018.8 million from banks and EUR 125.6 million from the Ministry of Finance and sold EUR 277.8 million to the European Commission. Altogether, HNB's foreign exchange transactions in 2016 resulted in a net purchase of foreign currency of EUR 866.6 million, thus creating HRK 6.5 billion of reserve money.

In 2017, to alleviate appreciation pressures on the kuna, the HNB conducted a number of FX purchases from banks (both through auctions and outside of auctions). In 2017, the HNB purchased a total of EUR 1,757.0 million from banks, thus creating HRK 13.2 billion of reserve money (in June EUR 424.0 million were purchased, in July EUR 101.5 million, in August EUR 126.0 million, in September EUR 120.0 million, in October EUR 80.0 million, in November EUR 40.0 million and in December EUR 765.5 million.). An additional EUR 30.6 million was purchased from the Ministry of Finance in 2017. In all of the FX transactions during 2017, HNB net purchased EUR 1,787.6 million. This created HRK 13.4 billion of reserve money (note that the EUR 100.0 million out of auction FX purchase from banks conducted on 29 December 2016 was settled in January 2017 and is therefore included in the data for 2017).

During 2018, due to appreciation pressures on the domestic currency (driven by changes in the current account, lower foreign government debt requirements and other factors), the HNB conducted a number of FX purchases from banks that contributed to the further rise in excess kuna liquidity. After two interventions in January (EUR 405.5 million) and May (EUR 320.5 million), three further FX transactions were conducted in December 2018 (EUR 1.1 billion in total). In total in 2018, the HNB purchased EUR 1.8 billion from banks, while an additional EUR 30.4 million was net purchased from the Ministry of Finance, which resulted in the creation of HRK 13.6 billion of reserve money.

Since the beginning of 2019 to end-April, the HNB continued to conduct FX purchases from banks to alleviate appreciation pressures on the kuna. In an auction in February, the HNB purchased EUR 450.3 million from banks. During the same period the HNB net sold EUR 452.0 million to the Ministry of Finance. In all of the FX transactions during the first four months of 2019, the HNB net sold EUR 1.7 million, thus withdrawing HRK 20.2 million of reserve money. As of April 2019, the HNB had approximately HRK 100.7 billion of reserve money compared to approximately HRK 101.8 billion at the end of 2018.

Reserve Requirements and Credit Schemes

At the end of 2013, the HNB adopted new measures to encourage bank lending to the corporate sector and boost economic recovery. In December 2013, the reserve requirement rate was reduced from 13.5 per cent. to 12 per cent. and remained at that level. Following this reduction, banks were obliged to purchase compulsory HNB bills from the released funds of a total amount of HRK 3.9 billion. On a monthly basis, the HNB redeems compulsory bills in the amount of half of the increase in a banks placements to domestic non-financial corporations in the previous month. From 31 December 2013 to 31 December 2014, the HNB repurchased HRK 758 million of compulsory bills or 19 per cent. of the total amount of bills initially held by banks. As this programme did not prove efficient due to subdued developments in the credit market and numerous factors beyond the scope of monetary policy, the HNB abolished it in 2015 and repurchased the remaining amounts held by banks, thus releasing HRK 3.4 billion in October 2015.

Foreign Currency Liquidity and Reverse Operations

At the beginning of 2011, the HNB improved foreign currency liquidity conditions in the banking system. In early March 2011, it reduced the rate of minimum required foreign currency assets of banks relative to their foreign currency liabilities by three per cent. (from 20 to 17 per cent.). As a result of this change, it released approximately EUR 850 million (HRK 6.3 billion) for further use by banks to finance domestic lending activity. As a result of this measure, the HNB reduced regulatory costs for banks. In early 2012, the HNB again changed the minimum amount required for foreign currency claims in order to facilitate Government financing. By way of exception, in the period from 16 February 2012 to 15 August 2013, the nominal amount

of T-bills of the Ministry of Finance issued in euro at an auction held on 14 February 2012 and paid in on 16 February 2012 (EUR 763.9 million) are included in foreign currency claims. In June 2012, the HNB issued a decision under which the calculation of minimum required foreign currency claims also includes 50 per cent. of the amount of bank loans granted to economic entities. This, together with the reduction of the reserve requirement rate from 15 per cent. to 13.5 per cent., and the exclusion of funds received from multilateral development banks from the calculation base, had a positive impact on banks' regulatory indicators of foreign currency liquidity during 2012. The Ministry of Finance issued T-bills in euros with a one-and-a-half-year maturity and a 5.00 per cent. yield at an auction held on 13 August 2013 and paid in on 14 August 2013 (EUR 700.0 million), through which it almost completely refinanced the maturing T-bills in euros. Banks subscribed EUR 582.75 million of the EUR 700.0 million issue and the HNB continued to include those T-bills in the minimum required liquid foreign currency claims of banks. With the T-bills in euros maturing in February 2015, the Ministry of Finance again issued T-bills in euros with a one-and-a-half-year maturity and a 1.95 per cent. yield at an auction held on 10 February 2015 and paid in on 12 February 2015 (EUR 1,225.4 million). Banks subscribed EUR 1,017.45 million of the EUR 1,225.4 million issue and the HNB again continued to include those T-bills in the minimum required liquid foreign currency claims of banks. As the T-bills in euros matured in August 2016, the Ministry of Finance again issued T-bills in euros with a 15-month maturity and a 0.70 per cent. yield at an auction held on 9 August 2016 and settled on 11 August 2016 (EUR 1,500.0 million). Banks subscribed for EUR 1,237.2 million of the EUR 1,500.0 million issue and the HNB again continued to include those T-bills in the minimum required liquid foreign currency claims of banks. With the T-bills in euros maturing in November 2017, the Ministry of Finance again issued T-bills in euros with a 15-month maturity and a 0.10 per cent. yield at an auction held on 6 November 2017 and settled on 9 November 2017 (EUR 1,500.0 million). Banks subscribed for EUR 1,376.7 million of the EUR 1,500.0 million issue and the HNB again continued to include those T-bills in the minimum required liquid foreign currency claims of banks. 455-day EUR-linked T-bills issued in November 2017 were refinanced at the end of January 2019 with the 455-day EUR-linked T-bills in the amount of EUR 1.1 billion at 0.00 per cent. Banks subscribed for EUR 1,026.1 million and the HNB continued to include it in the minimum required liquid foreign currency claims of banks.

In an environment of high kuna liquidity, the need to create reserve money by means of regular reverse repurchase operations was significantly reduced. Thus, the turnover at the regular repurchase auctions (held at a fixed rate of 6.0 per cent. since December 2008) gradually decreased through 2009 and since mid-2009 no auctions were held until September 2015, when the HNB resumed weekly reverse repurchase operations. The aim was to stabilise interest rates and ensure greater kuna liquidity for banks during Swiss franc-loan conversion period. The first repurchase auction in six years was held on 30 September 2015, on which the HNB provided HRK 1.2 billion at the rate of 0.80 per cent. The HNB continued with regular weekly reverse repurchase operations during 2016 with the average daily value at HRK 0.2 billion. The repurchase rate was reduced to 0.50 per cent. in November 2015 (down from 0.80 per cent.), and further to 0.30 per cent. as of 14 September 2016. With the fixed repurchase rate of 0.30 per cent, average daily value of reverse repurchase operations amounted to HRK 30 million in 2017. However, during 2018 and the first four months of 2019, the HNB did not place any funds through regular weekly reverse operations because there was no demand by banks in an environment of historically high excess of kuna liquidity.

Introduction of structural repurchase operations in February 2016 enabled banks to increase lending in the domestic currency and under more favourable conditions. Through four structural repo auctions in 2016 (held in February, May, July and November), the HNB placed a total of HRK 1.0 billion in the banking sector with a four-year maturity. The interest rate on the first two auctions was 1.8 per cent., and this was reduced to 1.4 per cent. on latter two auctions in 2016. In a structural operation auction held in November 2017, the first after November 2016, the HNB placed HRK 530.0 million with the fixed interest rate reduced to 1.2 per cent. and maturity prolonged to five years. In December 2018, the HNB held an additional structural operation through which it placed HRK 1,397.0 million at fixed interest rate of 1.2 per cent. and maturity of five years. The collateral accepted by the HNB for structural operations includes debt securities of issuers from Croatia, in all currencies, maturing after the repurchase date, under the condition that the issuer or the issue has been assigned a credit rating that is at least equal to the rating of the Republic by one of the following international rating agencies: Standard & Poor's, Fitch Ratings or Moody's. A single 5 per cent. reduction applies, for now, to all securities included in the HNB's list of eligible collateral. The introduction of structural repurchase operations expectedly lowered the kuna yield curve. The HNB held no additional auctions for the long-term funding through the structural operations after the last auction held in December 2018.

In September 2017 the HNB introduced the new collateral pooling arrangement for all liquidity provision facilities which can be placed via open market operations. Prior to this new regulation, the maturity of eligible collateral for the HNB's liquidity provision facilities had to be equivalent to or longer than the

maturity of the provided liquidity. However, as of September 2017 banks are now able to form and manage their pool of collateral with various maturities, change the composition of the portfolio in the pool, withdraw securities from the pool and add new ones to the pool etc. Collateral pooling applies to all facilities for which the HNB accepts collateral.

Legal Framework

Pursuant to the Law on the HNB (OG 75/2008 and 54/2013) and the Decision on Reserve Requirements (OG 136/2015 and 55/2016) (the "**Reserve Requirement Decision**"), credit institutions are required to maintain with the HNB certain reserves in the settlement account, or in a separate account with the HNB. Reserve requirements apply to banks founded in Croatia and branches of foreign banks in Croatia and do not apply to special purpose saving banks (housing saving banks), banks that are regulated by a special law or 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 HNB and HBOR, funds received from financial institutions which calculate reserve requirements pursuant to the Reserve Requirement Decision, relief funds received in connection with natural disasters including emergency funds for recovery of war damage and funds received from IBRD, IFC, Council of Europe Development Bank, the EBRD and the EIB, the European Investment Fund, the European Fund for Southeast Europe and the Green for Growth Fund, Southeast Europe. The foreign exchange base for calculating reserve requirements consists of the foreign exchange sources of funds, including received foreign exchange deposits and loans, issued foreign exchange-denominated debt 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 the HNB and HBOR, foreign exchange funds received from financial institutions which calculate reserve requirements pursuant to the Reserve Requirement Decision, foreign exchange relief funds received in connection with natural disasters including emergency funds for recovery of war damage and foreign exchange funds received from one of the following multilateral development banks: IBRD, IFC, Council of Europe Development Bank, EBRD and EIB. 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.

Pursuant to the Law on the HNB, the HNB's Council in September 2017 introduced the Decision on monetary policy implementation (OG 94/2017) with intentions to: (a) recast in a single act the national legislation on monetary policy operations; (b) introduce a pooling collateral management system for all of HNB's credit operations; and (c) introduce discretionary measures that HNB is authorised to take regarding eligibility and the obligations of HNB's counterparties. The Decision on monetary policy implementation sets out, in particular: (a) an overview of the operations and instruments of HNB's monetary policy and rules for their implementation; (b) the conditions for participation in monetary policy operations, including eligible counterparties (banks and savings banks with head offices in the Republic of Croatia, branches of credit institutions of other Member States whose establishment has been notified to HNB by the competent authorities and branches of third country credit institutions that have been authorised by HNB), eligible assets, eligible securities, valuation and risk control and HNB's eligible assets pooling system for collateralisation of HNB's credit operations; (c) the discretionary measures which HNB is authorised to take on the grounds of prudence, risk protection and in the case of breach by a counterparty of its obligations arising from transactions conducted on the basis of the draft decision, together with the consequences in the case of a breach of obligations and the expiry of the validity of a banks authorisation by HNB; and (d) additional rules for conducting the monetary policy operations of HNB, including reporting obligations and the protection of confidential data.

In order to align the terminology and regulations introduced by the Decision on monetary policy implementation with other monetary policy-related decisions, the HNB's Council introduced the following Decisions in September 2017: (i) the Decision on the interest rates, the discount rate and remunerations of the Croatian National Bank (OG 94/2017); (ii) the Decision on the method of calculating, charging and paying interest and remuneration of the Croatian National Bank (OG 94/2017); (iii) the Decision on the abolishment of the Decision on intraday loans (OG 94/2017); and (iv) the Decision on the abolishment of the Decision on the general conditions of foreign currency purchase and sale for the purpose of interventions in the foreign exchange market. On the date of the entry into force of the Decision on monetary policy implementation, the following also ceased to have effect: (i) the Decision on the deposit facility with the Croatian National Bank (OG 34/2005, 133/2010 and 121/2016); (ii) the Decision on

Lombard loans (OG 71/2013 and 98/2015); and (iii) the Decision on the Croatian National Bank Bills (OG 203/2003, 133/2010 and 100/2016).

In December 2017 the HNB introduced a new Decision on the minimum required amount of foreign currency claims (OG 132/2017 and 12/2019) which stipulates changes to banks' reporting requirements starting from 2018. Specifically, data must no longer be gathered using accounting categories but through instruments as defined in the Instruction for statistical and prudential reporting, which constitutes an integral part of the Decision on statistical and prudential reporting. As a result, banks are no longer obliged to report FX liabilities and liabilities with a currency clause separately as they are all now reported as FX liabilities. On the date of the entry into force of the Decision on the minimum required amount of foreign currency claims (OG 132/2017), the Decision on the minimum required amount of foreign currency claims (OG 100/2016 and 108/2017) ceased to have effect.

Monetary Developments

The ratio of nominal GDP to total liquid assets (M4), which measures the money supply, is broadly stable since 2014 as shown by the table below:

	Twelve months ended 31 December					Three months ended 31 March
	2014	2015	2016	2017	2018	2019 ⁽¹⁾
Ratio of Nominal GDP/M4	1.2	1.2	1.2	1.2	1.2	1.2

⁽¹⁾ Nominal GDP data refers to 2018.

Sources: CBS and HNB

The following table sets forth the Republic of Croatia's money supply (per million kuna) at the dates indicated:

	Twelve months ended 31 December					Three months ended 31 March
	2014	2015	2016	2017	2018	2019
	(HRK millions)					
Reserve money (M0) ⁽¹⁾	63,318.0	63,748.5	73,263.6	86,397.9	101,817.6	103,034.2
Money (M1) ⁽²⁾	63,412.3	70,623.3	83,468.6	99,436.3	119,994.8	119,555.5
Broad money (M4) ⁽³⁾	273,248.6	287,328.4	300,897.3	307,243.8	324,030.2	317,208.4
Net domestic assets ⁽⁴⁾	198,127.0	194,176.8	196,243.0	185,408.3	194,082.3	191,642.1
Domestic credit ⁽⁵⁾	237,004.6	230,005.1	221,511.0	218,933.3	223,237.0	226,585.4

Source: HNB

⁽¹⁾ Reserve money (M0) consists of currency outside credit institutions, cash in credit institutions' vaults, credit institutions' deposits with the HNB, other banking institutions' deposits and other domestic sectors' deposits with the HNB.

⁽²⁾ Money (M1) comprises currency outside credit institutions, deposits with the HNB by other banking institutions and other domestic sectors and credit institutions' demand deposits.

⁽³⁾ Broad money (M4) comprises money (M1), savings and time deposits and foreign currency deposits, as well as bonds and money market instruments and money market funds' shares/units.

⁽⁴⁾ Net domestic assets are defined as the difference between total liquid assets and foreign assets (net).

⁽⁵⁾ Domestic credit comprises credit institutions' claims on other non-Government non-financial domestic sectors, investment funds other than money market funds, other financial intermediaries, financial auxiliaries, insurance corporations and pension funds.

In 2015 domestic deposits continued to record strong growth with credit activity weakening further. The annual growth rate of M4, excluding the exchange rate effect, almost doubled compared to the previous year and reached 4.6 per cent. by the end of 2015. In its structure, the growth of deposit money accelerated further, amounting to 12.4 per cent., while the annual growth of savings and time deposits in domestic currency slowed to 2.2 per cent. Foreign currency deposits, which are the largest component of M4, recorded annual growth of 3.2 per cent., excluding the exchange rate effect. The increase of foreign currency deposits was largely the result of the foreign exchange inflow stemming from the purchase of the majority share in Tvornica duhana Rovinj by a foreign investor.

Despite a further decline in lending rates and improving credit standards, domestic lending activity continued to contract in 2015. Total credit to the private sector recorded an annual drop of 2.3 per cent., based on transactions data (with claims on enterprises and households decreasing by 3.0 per cent. and 1.8 per cent., respectively). Similar to the previous year, the increase of foreign corporate debt compensated for the fall in domestic financing of enterprises.

During 2015, the net foreign assets of credit institutions increased by EUR 2.6 billion and for the first time since 2002, banks' foreign assets surpassed their foreign liabilities. Banks adjusted their foreign position primarily by reducing liabilities towards their foreign parent banks. Such developments reflected strong growth of deposits, weak lending activity and the partial write-off of loans indexed to the Swiss franc, which required the banks to adjust their foreign exchange position.

Monetary developments in 2016 have been more positive compared to the previous years. Total placements increased by 1.1 per cent., with placements to enterprises increasing by 3.2 per cent. and placements to households increasing by 0.5 per cent. for the first time in the past seven years (all data is based on transactions, i.e. excluding exchange rate developments, price adjustments of securities and loan sales write-offs). The nominal stock of loans to households continued to be heavily influenced by the Swiss franc loan conversion process and, specifically, by the partial loan write-offs. From the end of November 2015 until the end of December 2016 banks have written off a total of HRK 6.0 billion of Swiss franc-indexed loans, while the total amount of Swiss franc indexed bank claims to households fell to HRK 1.6 billion, down from HRK 21.7 billion prior to the conversion. The changes in the stocks of banks' placements in 2015 and particularly in 2016 have also been affected by a growing trend of banks' sales of claims to third parties. Banks sold claims amounting to HRK 2.7 billion in 2015 and HRK 5.9 billion in 2016. This trend has been supported by more stringent provisioning regulation that, together with the maturing non-performing loan portfolio has forced banks to increase provisioning for non-performing loans. Loan sales have allowed banks to improve the quality of their portfolios, reduce NPL ratios and, in some cases, improve their profitability (i.e. where the sale price is above the net worth of the claim), thus creating a stronger base for new lending activity.

Monetary aggregates recorded strong growth in 2016. The annual growth rate of M1 rose to 18.2 per cent., with the strongest contribution coming from the rise of demand deposits of both households and non-financial corporations. This reflected the recovery of economic activity, as well as the preference for liquid assets amidst falling interest rates on savings and time deposits. Annual growth of kuna savings and time deposits slowed down to 1.2 per cent. in 2016, while FX savings and time deposits recorded a slight drop of 0.2 per cent., compared to an increase of 3.2 per cent. in 2015 (excluding the exchange rate effect). The broadest monetary aggregate M4 recorded a strong annual increase of 5.3 per cent. in 2016 (excluding the exchange rate effect).

The deleveraging of banks continued in 2016 due to weak lending activity, solid deposit collection and the effect of the Swiss franc loans conversion process (i.e. the write-offs of approximately one-third of Swiss franc loans). The net foreign assets of banks increased by EUR 1.1 billion in 2016, primarily through the reduction of liabilities towards their foreign parent banks.

In 2017, favourable monetary trends continued. Total placements increased by 2.9 per cent., with placements to enterprises and households increasing by 2.5 per cent. and 4.0 per cent., respectively (all data based on transactions), reflecting decreasing lending rates, easing credit standards and recovering consumption. Loans for investment are the main driver of corporate lending recovery, whilst general-purpose cash loans are the strongest contributor to increasing household lending. In addition, housing loans recorded positive annual growth rate during 2017, after several years of a decline. In contrast, the nominal stock of placements decreased by 1.2 per cent. during 2017, primarily as a result of banks' selling claims to third parties, which amounted to HRK 8.1 billion during 2017. The decrease was also the result of the appreciation of the kuna against the euro.

The strong growth of monetary aggregates also continued during 2017. The growth of money (M1) increased to 19.1 per cent. compared to 18.2 per cent. in 2016. This was mainly the result of rising demand for deposits of households and enterprises amid recovering economic activity and low level of interest rates on savings and time deposits. Kuna savings and time deposits decreased by 1.2 per cent. whilst FX savings and time deposits decreased by 1.5 per cent. (excluding the exchange rate effect) in 2017. The broadest monetary aggregate M4 increased by 3.2 per cent. in the same period (excluding the exchange rate effect). Net foreign assets of banks continued to grow, reaching EUR 1.5 billion at the end of December 2017, with a recorded increase of 16.7 per cent. on an annual basis.

During 2018, favourable monetary trends continued. Total placements rose by 4.4 per cent., with placements to enterprises and households increasing by 1.9 per cent. and 6.2 per cent., respectively (all data based on transactions, i.e. excluding exchange rate developments, price adjustments of securities and loan sales write-offs). Slower growth in corporate loans compared to 2017 was due to the payment of government guarantees for two distressed shipbuilding companies (Uljanik Group) amounting HRK 1.5 billion in November and December 2018. The nominal stock of total placements increased by 2.0 per cent. during 2018, which was slower than the growth based on transactions (4.4 per cent.), as a result of kuna appreciation and loan sales and write-offs. During 2018 the growth of main monetary aggregates accelerated compared to 2017. M1 rose by 20.7 per cent. in 2018 as a result of a continued increase of demand deposits of both households and enterprises and a preference for liquid assets. On the other hand, kuna savings and time deposits decreased by 1.6 per cent. whilst FX savings and time deposits decreased by 0.2 per cent. (excluding the exchange rate effect) in 2018. The broadest monetary aggregate M4 increased by 6.1 per cent. in the same period (excluding the exchange rate effect). Net foreign assets of banks decreased slightly by 3.2 per cent. during 2018 but remained positive at EUR 1.5 billion at the end of December 2018.

During the first quarter of 2019, credit activity continued to grow. Total placements increased by 1.2 per cent. in the period January-March 2019, with placements to enterprises and households increasing by 1.0 per cent. and 2.0 per cent., respectively (all data based on transactions). The growth of nominal stock of total placements during the first quarter of 2018 was larger than the growth based on transactions and stood at 1.5 per cent. This was primarily the result of the reclassification of almost all money market funds from the monetary financial institutions sector to the sector of non-money market investment funds as a result of the harmonisation of monetary and financial statistics with the Regulation on money market funds (Regulation (EU) No 2017/1131) of the European Parliament and of the Council. The reclassification, which occurred during March 2019, caused a nominal increase of placements to non-money market investment funds⁴. The main monetary aggregates mostly recorded a seasonal decline during the first quarter of 2019, but their annual growth continued. The annual growth of M1 stood at 18.0 per cent. in March 2019 which, as in previous years, was mostly the result of increased demand deposits in an environment of low interest rates on time and savings deposits. In the same period kuna savings and time deposits increased by 0.8 per cent. whilst FX savings and time deposits decreased by 0.7 per cent. (excluding the exchange rate effect). The annual growth of M4 stood at 4.9 per cent. (based on transactions, i.e. excluding the exchange rate effect and the effect of reclassification of money market funds) in March 2019.

The balance of M0 at 31 December 2015 stood at HRK 63.7 billion, or 0.7 per cent. higher compared to the balance at the end of 2014. M0 growth in 2015 reflected an increase of currency outside credit institutions and credit institutions' cash in vaults, reflecting expansionary monetary policy. As at 31 December 2016 M0 was 14.9 per cent. higher compared to end-2015, amounting to HRK 73.3 billion. The increase in 2016 was the result of the surge in credit institutions' deposits with the HNB and, to a lesser extent, of the increase in cash outside credit institutions. The balance of M0 at 31 December 2017 amounted to HRK 86.4 billion, increasing by 17.9 per cent. compared to the balance of M0 at the end of 2016, mainly due to increased credit institutions' deposits with the HNB, reflecting record excess kuna liquidity in the monetary system. As at 31 December 2018, M0 amounted to HRK 101.8 billion, up by 17.8 per cent. compared to end-2017 which was again mostly due to increased credit institutions' deposits with the HNB, reflecting expansionary monetary policy. As at 31 March 2019, M0 amounted to HRK 103.0 billion, up by 1.2 per cent. compared to end-2018.

International Reserves Management

The HNB manages the international reserves Croatia based on the principles of liquidity and safety of investment in accordance with Article 19 of the Law on the HNB. In this context, it maintains the reserves at a high liquidity level and appropriate risk exposure and, in this environment of prolonged low and negative yields, attempts to ensure favourable rates of return on its investments.

⁴ The reclassification of money market funds also affected other monetary aggregates balances. For example, on the assets side of the monetary financial institutions balance sheet, except the nominal increase of placements to non-money market investment funds, the balance of credit institutions' gross claims on the central government declined substantially. Furthermore, on the liabilities side, M1 increased by over HRK 1.0 billion due to the increase in demand deposits of non-money market investment funds. At the same time, quasi money decreased by HRK 3.3 billion, with the money market funds shares balance falling to only HRK 1.3 million from HRK 6.0 billion at the end of February, while the balance of total deposits (excluding demand deposits) of non-money market investment funds due to reclassification increased by HRK 2.7 billion.

The HNB manages international reserves in line with its own guidelines and in accordance with the assumed foreign currency liabilities, depending on the way in which international reserves are formed. The HNB manages international reserves acquired through the outright purchase of foreign currency from banks and the Ministry of Finance through its membership of the IMF, as well as income derived from the investment of international reserves and of other HNB assets in line with its own guidelines. The other component of the reserves, composed of Ministry of Finance funds, foreign currency swaps in the domestic market, IMF membership and other assets owned by other legal persons, as well as funds originated from repurchase agreement investments, is managed by the HNB according to the foreign currency liabilities assumed, the aim being to protect against currency and interest rate risks.

Set out below is the composition of total international reserves as at the dates indicated:

	Twelve months ended 31 December	
	2017	2018
	<i>(EUR millions)</i>	
Total international reserves	15,705.86	17,438.76
Statutory reserves in foreign currency	0.00	0.00
Central Government and European Commission foreign currency deposits	5.49	4.49
Holdings of SDRs.....	365.45	371.81
Repurchase Agreements (plus outstanding amount)	1,599.73	1,242.45
Net international reserves ⁽¹⁾	13,735.20	15,820.01
Imports of goods & services (months).....	7.8	8.0

Source: HNB

⁽¹⁾ *Net international reserves = Total international reserves — Statutory reserve in foreign currency — central Government and European Commission foreign currency deposits — Special Drawing Right ("SDR") holdings-Repurchase Agreements.*

⁽²⁾ *Not available.*

Total international reserves amounted to EUR 17,438.76 million at 31 December 2018, representing an increase of EUR 1,732.90 million as compared to 31 December 2017. At the same time, net international reserves increased by EUR 2,084.81 million to EUR 15,820.01 million. This higher level of total international reserves was mainly influenced by purchases of foreign currency from banks due to appreciation pressures. The other main drivers for the rise in total international reserves were the investment income and appreciation of U.S. Dollar against the euro that increased the USD denominated reserves in euro terms.

In an environment of prolonged low and negative yields the HNB aimed to optimise the proportion of reserves necessary for liquidity maintenance and the investment part of its reserves portfolio which acts as a source of stable income. The invested reserves are managed under policies designed to limit financial risks such as credit risk, liquidity risk and market risk as well as operating risk.

The HNB invests funds with financial institutions and in countries with an investment grade rating; the assessment of creditworthiness is based on ratings issued by internationally recognised rating agencies (Moody's, Standard & Poor's and Fitch Ratings) and on an internally-developed creditworthiness assessment model. There are restrictions on investments in individual financial institutions and countries, which serve to diversify credit risk. The biggest share of HNB's foreign currency portfolios is invested in government securities of selected countries, securities of government agencies and instruments issued by international financial institutions and central banks. Compared with year-end December 2017, there was an increase in the share of investments in collateralised deposits in 2018 and a decrease in the share of investments in instruments issued by international financial institutions and central banks for the same period.

In terms of credit rating, the share of the total reserves placed with or invested in securities issued by countries, banks or international financial institutions with the highest Aaa rating according to Moody's stood at 34.6 per cent. at 31 December 2018. Investments rated Aa1, Aa2 and Aa3 accounted for 43.4 per cent. of total international reserves, while investments rated A1, A2 and A3 were at 8.1 per cent. Investments rated Baa1, Baa2 and Baa3 amounted to 9.3 per cent. The remaining 4.6 per cent. of total international reserves at 31 December 2018 were invested with the IMF and the Bank for International Settlements and foreign currency cash at the HNB.

The following table sets out the composition of net international reserves as at the dates indicated:

	Twelve months ended 31 December	
	2017	2018
	<i>(per cent.)</i>	
Government bonds	64.3	65.0
Financial instruments of central banks and international financial institutions	28.3	22.5
Collateralised instruments	5.3	10.1
Non-collateralised instruments	0.0	0.0
Covered bonds and securities guaranteed by German federal states	2.1	2.4
Total net international reserves	100.0	100.0

Source: HNB

Reflecting their relative credit risk exposure, net international reserves are categorised as: funds invested in government bonds and bonds with government guarantee; international financial institutions; central banks; collateralised instruments with commercial banks; non-collateralised instruments with commercial banks; covered bonds and securities guaranteed by German federal states. In terms of the structure of net international reserves, the share of investments in government bonds increased to 65.0 per cent. at 31 December 2018 from 64.3 per cent. at 31 December 2017. The share of investments with central banks and international financial institutions decreased from 28.3 per cent. at 31 December 2017 to 22.5 per cent. at 31 December 2018. Collateralised investment amounted to 10.1 per cent. at the end of 2018, while investments in non-collateralised instruments with commercial banks remained at 0.0 per cent. of net international reserves at 31 December 2018. The remaining 2.4 per cent. of net international reserves were invested in covered bonds and securities guaranteed by German federal states.

As of 31 December 2018, the share of reserves in euro in net international reserves stood at 86.1 per cent. and was higher than compared to 31 December 2017 when it was 84.9 per cent. At the same time the share of reserves in U.S. dollar was 13.9 per cent., lower than the 15.1 per cent. held at 31 December 2017.

In 2017, the annual rates of return on HNB held-for-trading euro portfolio and U.S. dollar portfolio stood at -0.49 per cent. and 1.01 per cent., respectively. The euro-denominated investment portfolio yielded a return of 0.83 per cent., while the U.S. dollar denominated investment portfolio yielded a return of 1.70 per cent. The U.S. dollar funds entrusted to an external manager yielded 1.05 per cent. on an annual basis. The funds entrusted to an external manager enabled additional diversification and knowledge-exchange in the field of investment management.

Investments in net international reserves generated a total income of EUR 53.2 million in 2017.

In 2018, the euro held-for-trading portfolio generated a rate of return of -0.36 per cent., while the U.S. dollar held-for-trading portfolio generated a rate of return of 2.03 per cent. The euro-denominated investment portfolio yielded a return of 0.93 per cent., while the U.S. dollar denominated investment portfolio yielded 1.75 per cent. The U.S. dollar funds entrusted for management to an international financial institution yielded a rate of return of 1.95 per cent. in 2018.

Investments of net international reserves generated a total income of EUR 62.1 million in 2018.

Banking System

The HNB is responsible for the supervision of, inter alia, banks, savings banks, housing savings banks and credit unions. The supervisory tasks of the HNB also include the issuance and withdrawal of authorisations for these institutions, the adoption of relevant subordinate legislation and the supervision of operations of these institutions. Legal compliance, safety and soundness of bank operations and risk management are assessed through on-site and off-site supervision. On-site supervision is performed according to the HNB'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 supervision department makes assessments of banks' risk profiles based on information provided in compulsory reports that banks submit to the HNB, on-site supervision findings and other

relevant information. If violations or irregularities are established, the HNB issues regulatory orders that require banks to implement remedial measures.

The Credit Institutions Act (OG 159/2013, 19/2015, 102/2015 and 15/2018) (the "**Credit Institutions Act**"), which, *inter alia*, implemented Basel II and Basel III to ensure a more stringent regulatory framework on bank capital adequacy, stress testing, market and liquidity risk, aligns Croatian legislation in that area with the relevant EU directives and regulations. Where a credit institution is either in breach of a law or other regulation or its financial position makes its continued operation uncertain, the HNB may abolish authorisation to provide particular financial services, appoint a special administrator, abolish the credit institution's authorisation, initiate the compulsory winding-up of the credit institution or submit a request to initiate bankruptcy proceedings. Furthermore, the HNB may appoint a trustee when it estimates a need for further evaluation and monitoring over the financial state and over the credit institutions management conditions.

According to the Credit Institutions Act, both direct and indirect acquisition of a banks shares or an increase in the holding of a banks shares must be approved by the HNB in advance. The thresholds set by 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 EU Directive 2013/36/EU. 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, the HNB monitors not only the legal position of a potential acquirer, but also the acquirer's financial health and other relevant factors.

Through the adoption of the Credit Institutions Act, which entered into force in January 2014 (and has subsequently been amended), Croatian banking legislation has been harmonised with Regulation (EU) No 575/2013 (the "**Capital Requirements Regulations**") and Directive 2013/36/EU (the "**Capital Requirements Directive**") ("**CRD IV**"). This has given the HNB a new set of instruments that are designed to address risks more efficiently.

The main change in the legislation, which entered into force in January 2014, is in the area of capital adequacy. Minimum regulatory capital adequacy is now directly regulated by the Capital Requirements Regulation and it is ensured at three levels: Common Equity Tier 1 capital ratio of 4.5 per cent., Tier 1 capital ratio of 6 per cent. and Total Capital ratio of 8 per cent. Also, the additional capital requirement is composed of the following buffers: a capital conservation buffer that ensures the accumulation of capital in a phase of positive conditions which can absorb losses in a period of stress; a countercyclical capital buffer that will reduce the negative effect of overheating of credit growth; a structural systemic risk buffer for the purpose of protection against systemic risks that do not depend on cycles; capital buffers for global systemically important institutions; and capital buffers for other systemically important institutions. Credit institutions shall maintain a capital conservation buffer of common equity tier 1 capital equal to 2.5 per cent. of their total risk exposure amount since January 2014. From May 2014, credit institutions are obliged to apply a structural systemic risk buffer in the amount of 1.5 per cent. and 3 per cent., respectively, of the total amount of risk exposure pending on the market share. Taking into account the expected changes to the system characteristics and systemic importance of individual institutions and in order to remove the possibility of regulatory arbitrage, the HNB adopted a new Decision on the application of the structural systemic risk buffer in August 2017 (Official Gazette 78/2017). The level of two structural systemic buffer rates and application to all exposures remains unchanged. This Decision has changed the method for determining two sub-groups. In January 2015 the HNB adopted the Decision on the countercyclical buffer rate in which was set at 0 per cent, in light of the subdued credit activity. Drawing on a recent analytical assessment of cyclical systemic risk evolution, in March 2019 the HNB updated its announcement that the same countercyclical capital buffer rate of 0 per cent. would continue to be applied in the second quarter of 2020. A capital buffer for other systemically important institutions was introduced in early 2016 at 0.2 per cent. and 2 per cent., respectively. The capital buffer was applicable to nine institutions identified as systemically important for the domestic financial system according to their size, complexity, interconnectedness with the rest of the financial system and significance to the economy. In January 2019, the HNB released the updated results of its annual review of the identification of other systemically important institutions in accordance with Articles 137 and 138 of the Credit Institutions Act. The review identified a total of seven other systemically important institutions to which, depending on its estimated systematic importance, a capital buffer of 0.2 per cent. and 2 per cent. applied, respectively, of the total risk exposure. Since both structural systemic risk buffer and capital buffer for other systemically important institutions are currently applicable to the total amount of risk exposure, only the higher among these two capital buffer rates are effectively in application. Currently (as of May 2019), the structural systemic risk buffer rate is applied as it is the higher of the two buffer rates. Alongside capital buffers, the Capital Requirements Regulation imposes the obligation to form and maintain adequate liquidity buffers of credit

institutions for amortisation of potential liquidity shocks. The Liquidity Coverage Ratio ("**LCR**") is aimed at ensuring short-term resilience of credit institutions by holding liquid assets at all times, the total value of which equals, or is greater than, the net liquidity outflows (difference between liquid outflows and inflows) which might be experienced under stressed conditions over a short period of time (30 days). In October 2015, the LCR was introduced as an obligatory ratio, with gradual implementation by 2018. As of 1 January 2017, the national short-term liquidity ratio was abolished. Alongside the LCR, presently, there is a reporting requirement for Net Stable Funding Ratio ("**NSFR**"), as well as reporting requirements for additional liquidity monitoring metrics ("**ALMM**"). The NSFR aims to ensure a stable funding structure over a one-year horizon (i.e. to address a long-term structural improvement of credit institutions' liquidity). NSFR will become a mandatory ratio two years after the entry into force of the CRDIV package. Additional liquidity monitoring metrics serve as another tool that competent authorities may use as part of their supervisory review and evaluation process. They include reports on the concentration of funding by counterparty and product type, concentration on counterbalancing capacity, prices for various length of funding and roll over of funding. A report on the maturity ladder as part of ALMM has become part of the supervisory reporting.

Due to Croatia's obligation to implement the Bank Recovery and Resolution Directive (Directive 2014/59/EU) (the "**BRRD**"), which includes a common set of tools to enable authorities to improve the effectiveness of the arrangements for dealing with bank failures in the EU, the new Act on the Resolution of Credit Institutions and Investment Firms (OG 19/2015) was adopted and entered into force on 28 February 2015. Parts of the BRRD relating to recovery plans, early intervention measures and group financial support arrangements were implemented in the Act on the amendments to the Credit Institutions Act ("**Act on the amendments**") published in the Official Gazette no. 19/2015. In addition, regarding the investment firms, parts of the BRRD relating to recovery plans, early intervention measures and group financial support arrangements were implemented in the amendments to the Capital Market Act published in the Official Gazette no. 18/2015. New Capital Market Act was adopted in 2018 and published in the Official Gazette no. 65/2018. In 2019, the Act on the Resolution of Credit Institutions and Investment Firms was amended (OG 16/2019) for the purposes of harmonising Croatian legislation with Directive 2017/2399/EU (Creditor Hierarchy Directive) on the ranking of unsecured debt instruments in the insolvency hierarchy. BRRD originally only provided for limited harmonisation of creditor hierarchy in insolvency proceedings, in relation to depositor preference (Art. 108 BRRD) and own funds and subordinated debts (Art. 48 BRRD). Directive 2017/2399/EU amends the BRRD and provides for further harmonisation in the insolvency hierarchy through the creation of a new "senior non-preferred class" which ranks, in normal insolvency proceedings, between subordinated debt and "ordinary unsecured claims". Directive 2017/2399/EU has been fully transposed into Croatian law and came into effect as of 23 February 2019.

According to the Act on the amendments each credit institution, that is not part of a group subject to consolidated supervision, is obliged to draw up and maintain a recovery plan providing for measures to be taken by the credit institution to restore its financial position following a significant deterioration of its financial situation. The parent credit institution has to draw up a group recovery plan. The Act on the amendments introduces early intervention measures which the HNB can impose on a credit institution in the case a credit institution infringes or is likely in the near future to infringe, the requirements of the Credit Institutions Act, Regulation (EU) 575/2013 and other regulations relating to banking operations, to the extent that the liquidity, solvency or viability of operations of a credit institution is jeopardised. During early intervention the HNB may, in addition to supervisory measures, impose the following measures on a credit institution:

- Require implementation or update of a recovery plan.
- Require changes to business strategy.
- Require changes to the legal or operational structures.
- Require a credit institution to convene or if the management body fails to comply with that requirement convene directly, a meeting of shareholders of the institution, and in both cases set the agenda.
- Require one or more members of the management body or senior management to be removed or replaced if those persons are found unfit to perform their duties.

- Require one or more members of the management body or senior management to be removed or replaced irrespective of the fact that they are found fit to perform their duties.
- Require the removal of the management body of the credit institution, in its entirety or with regard to individuals and appoint a substitute management board member.
- Appoint a temporary administrator to the credit institution.
- Appoint a special administration to the credit institution.

Among other amendments to the Credit Institutions Act, a requirement regarding protection of depositors was introduced. If a credit institution intends to reduce Common Equity Tier 1 items it has to repay deposits, including interest, to each depositor who requires so in the period of six months of the public disclosure of the intention to reduce Common Equity Tier 1 capital items. The credit institution is not obliged to execute such repayment of deposits if it decides to postpone the reduction of Common Equity Tier 1 items to the period of two years from the publication of the intention of capital items reduction.

In 2015, the Credit Institutions Act was amended again (OG 102/2015) in order to enable conversion of Swiss franc retail loans into euro-denominated ones. The same amendments were introduced by the Consumer Credit Act to help citizens cope with rising payments. The conversion process had a very short timetable in which credit institutions were required to make offers for conversion to borrowers. The credit institutions were obliged to recalculate all past and future repayments and the principal owed as though the loan had originally been made in euros. The entire cost of conversion is borne by the credit institutions, which resulted in significant one-off losses for the banking sector.

For the purpose of further harmonisation of the Croatian legislation with EU *acquis communautaire*, the Credit Institutions Act was amended at the beginning of 2018 (these amendments, published in the OG 15/2018, came into force in February 2018, with one of the amendments entering into force in July 2018). Based on the Article 103 of the Directive 2013/36/EU, the competence of the HNB in the area of supervision of credit institutions was modified to allow HNB, to the extent that the HNB identifies any credit institutions with similar risk profiles (e.g. similar business models or geographical location of exposures) that are or are potentially exposed to similar risks or present similar risks to the financial system, to apply the same method of supervision and impose the same supervisory measures to such institutions, and inform the European Banking Authority.

As a result of audit reform at the EU level, Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities and repealing Commission Decision 2005/909/EC was adopted. As credit institutions are public-interest entities, the audit reform applies to, except as suspended by the Audit Act (OG 127/2017), the Credit Institution Act, particularly in the area of statutory audits. Amendments to the Credit Institutions Act further regulate the implementation of Regulation (EU) No. 537/2014 in connection with the performance of statutory audits of credit institutions.

Other amendments to the Credit Institution Act seek to harmonise the provisions relating to the holders of a qualifying holding in a credit institution with the provisions of the Joint Guidelines on the prudential assessment of acquisitions and increases of qualifying holdings in the financial sector (JC/GL/2016/01, EBA, EIOPA and ESMA, 20 December 2016) to provide a more precise regulation for situations when there is joint action by the acquirers of a qualifying holding in a credit institution.

During 2017, the HNB issued five bylaws to enable the application of the Housing Consumer Credit Act (OG 101/2017), which entered into effect in October 2017.

At the end of December 2013, the Parliament adopted the Act on the Financial Stability Council (OG 159/2013), an inter-institutional body that will provide assistance in harmonising different policies, coordination of assessment, consideration and systemic risks mitigation activities and communication with the general public. Steps are also being taken to formalise cooperation in terms of crises situation resolution. This law clearly defines the following intermediate objectives of macro-prudential policy: a) mitigation and prevention of excessive credit growth and leverage; b) mitigation and prevention of excessive maturity mismatch and market illiquidity; c) limitation of direct and indirect exposure concentration; d) limitation of the systemic impact of procedures motivated by inappropriate incentives with a view to reducing the breach of business and professional rules of conduct; e) strengthening the resilience of financial infrastructure and f) other goals set out in on the recommendation of the European Systemic Risk Board.

Classification of Placements

A classification scheme that affects loan loss provisions levels and dynamics was implemented in October 2013. The classification scheme regulates loan classification and requires banks to value their collateral more actively. It resulted in increased non-performing loans coverage which is intended, in the long-term, to accelerate the process of non-performing loans resolution and create a solid base for future credit growth.

Recently, the HNB adopted a new Decision on Classification of Exposure into Risk Groups and the Manner of Determination of Credit Losses (OG 114/2017, 110/2018) to prescribe the criteria for the classification of banks' assets (especially loans) and off-balance sheet liabilities and the method of determining losses arising from credit risk pursuant to the Credit Institutions Act and International Financial Reporting Standard 9 - Financial Instruments ("**IFRS 9**"), effective from 1 January 2018.

Also, in 2018, the HNB issued a Decision on governance arrangements (OG 96/2018) which implemented EBA Guidelines on management of non-performing and forborne exposures (EBA/GL/2018/06) that prescribes, among other things, better management of non-performing loans.

Structure of the Banking Industry

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

At the end of 2018, the Croatian banking system comprised of 21 banks, four housing savings banks and HBOR, which is five less than the total number of credit institutions at the end of 2017. In 2018 there were three mergers, one bankruptcy proceeding (the bank in question was very small, so there was no impact on the banking system) and the initiation of one voluntary winding-up proceeding. Three banks remained state owned — Hrvatska poštanska banka ("**Croatian Postal Bank**"), Croatia banka and Jadranska banka. In April 2019 two of these state-owned banks, Jadranska banka (for which resolution proceedings ended in July 2018) and Hrvatska poštanska banka, merged. Thus, the total number of banks decreased to 20.

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

	Twelve months ended 31 December		
	2016	2017	2018
	(per cent.)		
State ownership ⁽¹⁾	6.3	6.1	6.2
Private domestic ownership	4.0	3.7	3.6
Foreign bank ownership	89.7	90.1	90.2
Total	100.0	100.0	100.0

Source: HNB

⁽¹⁾ State owned and privately owned but where at least 50 per cent. of the private owner is owned by the Republic.

The banking system in Croatia is highly concentrated with the two largest banks (Zagrebačka banka and Privredna banka Zagreb) holding 48.0 per cent. of total assets as at 31 December 2018 (an increase from 45.5 per cent. at the end of 2017). The majority of the commercial banks' assets are controlled by foreign shareholders. As at 31 December 2018, 11 entities were majority owned by foreign shareholders, seven by private domestic shareholders and three by the Republic. By virtue of the high level of foreign ownership, the Croatian banking system is exposed to the Austrian and Italian banking systems, among others (See "*Risk Factors. The high level of foreign ownership in the Croatian banking system makes it vulnerable to disruption as a result of internal or external factors*").

The table below provides a breakdown of the ownership of commercial banks in Croatia with a market share of 1.0 per cent. or more as at 31 December 2018 (which together had a 93.4 per cent. market share at 31 December 2018):

	In private domestic ownership	In Government (domestic) ownership	Foreign (private) ownership	Share of market ⁽¹⁾	Share in shareholders' equity
			(per cent.)		
Zagrebačka banka d.d.	2.6	0.5	97.0	27.7	28.7
Privredna banka Zagreb d.d.	0.8	0.1	99.1	20.3	24.8
Erste&Steiermärkische Bank d.d.	0.0	0.0	100.0	15.0	13.7
OTP banka Hrvatska d.d.	0.0	0.0	100.0	10.3	10.5
Raiffeisenbank Austria d.d.	0.0	0.0	100.0	8.0	7.4
Hrvatska poštanska banka d.d.	25.2	74.6	0.2	5.2	3.5
Addiko Bank d.d.	0.0	0.0	100.0	4.5	5.1
Sberbank d.d.	0.0	0.0	100.0	2.4	2.0
Aggregate weighted by market share	2.2	4.0	87.2		
Aggregate weighted by share in shareholders' equity	1.8	2.8	91.0		

Source: HNB

⁽¹⁾ Measured by the Banks assets as a proportion of total banking sector assets

At the end of 2018 there were seven other systemically important credit institutions ("O-SIIs"), i.e. two O-SIIs fewer than at the end of 2017. Splitska banka merged with OTP banka Hrvatska in December 2018, while Sberbank is not considered to be an O-SII since February 2018.

The following table sets forth the structure of bank peer group assets, as a percentage of their assets, as at 31 December 2018:

	Cash, cash balances at central banks, other demand deposits	Loans and advances	Debt securities	Equity investments	Other
			(per cent.)		
O-SIIs	15.4	67.7	13.0	0.3	3.7
Other banks	16.2	61.0	18.5	1.1	3.2
Banking system	15.5	67.1	13.5	0.4	3.6

Source: HNB

The following table sets forth the structure of bank peer group liabilities and equity, as a percentage of their liabilities and equity, as at 31 December 2018:

	Equity	Deposits	Debt securities issued	Provisions	Other liabilities
			(per cent.)		
O-SIIs	14.4	83.4	0.2	0.6	1.4
Other banks	10.0	88.3	0.5	0.3	0.9
Banking system	14.0	83.9	0.2	0.6	1.3

Source: HNB

In 2015, the kuna component in the currency structure of the banks' balance sheet increased. At 31 December 2015, the currency structure of assets consisted of 39.4 per cent. kuna assets, 33.0 per cent. foreign currency indexed assets and 27.6 per cent. foreign currency assets. At the same date, the currency structure of liabilities and capital was 43.4 per cent. kuna, 53.7 per cent. foreign currency and 2.9 per cent. indexed to foreign currency. The kuna share in the banks' balance sheet currency structure increased further in 2016, to 45.2 per cent. of assets and 46.0 per cent. of liabilities and capital. As at 31 December 2017, the currency structure of the assets consisted of 49.0 per cent. kuna assets, 25.7 per cent. foreign

currency indexed assets and 25.3 per cent. foreign currency assets. On the liabilities and capital side, ratios were 49.6 per cent. kuna, 48.1 per cent. foreign currency and 2.3 per cent. kuna indexed to foreign currency. In 2018, the growing trend of the kuna share in the banks' balance sheet continued. At the end of that year the currency structure of the assets consisted of 51.4 per cent. kuna assets, 28.0% per cent. foreign currency indexed assets and 20.5 per cent. foreign currency assets. On the liabilities and capital side, ratios were 51.7 per cent. kuna, 2.3 per cent. kuna indexed to foreign currency and 45.9 per cent. foreign currency.

Capitalisation

The banks' capital to assets ratio in Croatia remained stable at approximately 14 per cent. from 2010-2014. In 2015, it decreased to 12.7 per cent. (mainly due to losses related to the conversion of loans in Swiss francs into loans in euros). In 2016 it recovered to 14.1 per cent. As at 31 December 2017, the banks capital to asset ratio reached 14.9 per cent., due to an increase in capital to HRK 58.2 billion (6.1 per cent. increase compared to the end of 2016). A major contributor to the increase in capital in 2017 was the recapitalisation of one bank, which occurred due to a take-over of another bank. Those two banks merged in 2018 and the capital weakened slightly, to 14.0 per cent. of assets, though still remains strong. An additional contributor was the introduction of IFRS 9, which led to HRK 1.4 billion losses being recorded in retained earnings. Portfolio ageing and the classification rules (regulatory rules on the gradual value adjustment increase for placements with a long history of delinquency) resulted in the increased non-performing loans coverage ratio until the end of 2016, when this ratio reached 63.7 per cent. This is compared to 56.9 per cent. at the end of 2015 and 51.3 per cent. at the end of 2014. At the end of December 2017 the non-performing loans coverage ratio decreased to 61.5 per cent, due to the sale of claims covered by value adjustments and inflow of new NPLs. This trend continued in 2018 and the non-performing loans coverage decreased to 59.5 per cent.

The growth of assets of financial intermediaries in Croatia was 6.1 per cent. in 2010 and 3.9 in per cent. in 2011, followed by 0.8 per cent. growth in 2012 and 2.3 per. cent. growth in 2013, representing a compounded annual growth rate of 7.1 per cent. for the four-year period. In 2014 assets of financial intermediaries increased another 2.2 per cent., followed by an increase of 0.6 per cent. growth in 2015, 1.8 per. cent. growth in 2016 and 0.3 per cent. in 2017. The compounded annual growth rate from December 2010 to December 2017 amounted to 12.3 per cent.

Risk-Based Capital Requirements, Solvency and Profitability Ratios

At 31 December 2014, the regulatory capital of Croatian banks totalled HRK 53.8 billion, a decrease of 0.7 per cent. compared with the end of 2013. In 2014, a new regulatory framework was introduced (Capital Requirements Regulation and Capital Requirements Directive). In the new regime, the definition of "other intangible assets" was expanded by including software, the main reason for a small drop in regulatory capital. At the end of 2014, all aggregate capital ratios determined under the new rules were considerably higher than the required minimum. The common equity tier 1 capital ratio, as well as the tier 1 ratio totalled 20.6 per cent., while the total capital ratio stood at 21.8 per cent. At 31 December 2015, both the common equity tier 1 capital ratio as well as the tier 1 ratio was at 19.1 per cent., while the total capital ratio stood at 20.9 per cent. The decrease of the ratios was a result of losses recorded in 2015 due to Swiss franc loan conversions. Capital conservation buffers (which amount to 2.5 per cent. of risk exposures) have been in effect since 2014, while the structural systemic risk buffer was introduced in May 2014. It amounts to 1.5 per cent. of risk exposures for all credit institutions and is increased by an additional 1.5 per cent. for institutions with a larger scope and more complex operations. Execution of conversion for the major part of Swiss franc loan portfolio and partial principal write-off resulted in a decrease of bank exposure to credit risk in 2016 which resulted in the recovery of capital ratios. The total capital ratio at the end of 2016 stood at 22.9 per cent., while the common equity tier 1 capital ratio and the tier 1 ratio stood at 21.3 per cent. The downward trend in total bank exposure to risks continued in 2017 and resulted in the further increase of the capital ratios. The total capital ratio at 31 December 2017 stood at 23.8 per cent. The common equity tier 1 capital ratio, as well as the tier 1 ratio, stood at 22.3 per cent. The bank capital to un-weighted assets ratio at the end of 2017 stood at approximately 13.4 per cent. Due to an increase in banks' activities, especially lending, exposure to risks increased and total capital ratio decreased to 22.9 per cent. at the end of 2018. The common equity tier 1 capital ratio, as well as the tier 1 ratio, stood at 21.8 per cent. The bank capital to un-weighted assets ratio at the end of 2018 stood at approximately 13.1 per cent.

The following table sets out an overview of the assets and total credit risk exposure (on-balance sheet and off-balance sheet) that is classified into credit risk categories as at the dates indicated:

	Year ended 31 Dec			
	2015	2016	2017	2018
	(HRK millions)			
Total assets	393,394.3	388,721.9	391,336.4	408,667.3
Total credit risk exposure	411,904.4	404,332.6	396,926.3	462,586.0

Source: HNB

The growth in total credit risk exposure in 2018 was primarily due to methodological changes – in 2018 IFRS 9 was introduced (replacing IAS 39) and the definition of total credit risk exposure was extended to financial assets measured at fair value through other comprehensive income.

In 2014, pre-tax profits increased by nearly 200 per cent. compared with 2013 and amounted to HRK 2.1 billion. The increase was primarily due to lower interest expenses and lower provisioning expenses for loan losses. In 2015, banks recorded HRK 5.0 billion pre-tax losses, due to costs of Swiss franc loan conversions. In 2016, banks generated HRK 6.2 billion pre-tax profit from continuing operations. The banks' improving profitability in 2016 was strongly influenced by lower expenses on value adjustments and provisions, especially the influence of expenses on provisions for loan conversions and expenses on loan value adjustments. Another important factor was various one-off revenues. At the end of December 2017, the banks generated a HRK 3.9 billion pre-tax profit, which represents a decrease of 36.7 per cent. from the end of 2016. This lower profit figure can be attributed to an increase in expenses on value adjustments and provisions. Converse trends were recorded in 2018 – a decrease in expenses on value adjustments and provisions led to higher profits. Banks pre-tax profits increased by 43.4 per cent. and amounted to HRK 6.0 billion. Return on equity rose from 5.9 per cent. in 2017 to 8.6 per cent. at the end of 2018.

Loan Exposure

The total (net) loans of Croatian banks as at 31 December 2014 amounted to HRK 253.1 billion, which represents a decrease of 4.1 per cent. as compared to 31 December 2013. Of those loans, 44.6 per cent. were retail loans, while 34.7 per cent. were corporate loans. Compared with 2013, (net) loans to the corporate sector decreased by 6.9 per cent. in 2014 while (net) loans to households decreased by 1.5 per cent. Loans to Government entities were the only loan segment that recorded an increase in 2013 (15.3 per cent. compared to 2012) which increased their share in total loans to 15.2 per cent. in 2013. In 2014, net loans to Government entities decreased by 0.7 per cent. Net loans to non-residents increased by 16.3 per cent. in 2014, resulting in an increase of their share of total net loans to 1.1 per cent. Similar trends continued in 2015, as net loans to non-residents increased by 59.2 per cent., mainly because of loans granted to foreign parent banks. Loans to all domestic sectors decreased, with the Government units as the sole exception. As a result, total net bank loans decreased in 2015 by 2.4 per cent. In 2016 net bank loans decreased by 4.5 per cent., mainly due to the partial principal write-off during the process of Swiss franc loans conversion, change in the financing of the central Government and the sale of claims. Loans to financial institutions were the only exception in 2016 – loans to that sector grew by 1.5 per cent. The growing trend of non-resident loans continued in 2016 (75.9 per cent.), reflecting a strong increase in loans to parent banks. As at 31 December 2017 net loans decreased by 3.9 per cent. in comparison to 31 December 2016. This was predominantly the result of a reduction in loans to central Government and non-resident parent banks. As at 31 December 2017 an increase was registered in net loans granted to households (3.2 per cent), consisting mainly of cash general purpose loans, housing loans and loans to corporates (3.1 per cent.) primarily for tourism activities. New lending in 2017 was primarily made in kuna. Bank credit activity to the household sector intensified in 2018, being a main driver of growth in total net loans (4.6 per cent.). Loans to households increased by 5.9 per cent., mainly due to growth in general-purpose cash loans (11.2 per cent.). Housing loans grew as well (5.0 per cent.), thanks to the government subsidy program that continued for the second year in a row. Loans to corporates increased by 1.6 per cent., and as in 2017, new loans were mainly directed to tourism activities.

During 2014, the share of non-performing loans continued to increase compared with December 2013 as it rose from 15.7 per cent. to 17.1 per cent. This increasing trend from 2008 stopped in 2015, as the share of non-performing loans decreased to 16.7 per cent. and the trend continued in 2016 with share of non-performing loans standing at 13.8 per cent. At the end of 2017 the share of non-performing loans decreased further to 11.3 per cent. The downward trend continued and at the end of 2018 the share of non-

performing loans stood at 9.8 per cent. as banks focused on improving asset quality, particularly by means of NPL sales.

The table below shows the percentage of loans that were non-performing as at the dates indicated:

	As at 31 Dec			
	2015	2016	2017	2018
	(per cent.)			
Non-performing loans	16.7	13.8	11.3	9.8
Non-performing loans to households	12.2	10.3	8.1	6.6
Non-performing loans to enterprises.....	34.7	28.3	22.2	20.4

Source: HNB

Non-performing loans have increased across all sectors after the recent global financial crisis, including in the household sector which had historically demonstrated lower levels of non-performing loans due to the fact that household loans are generally collateralised and often guaranteed by third parties. However, the increase in non-performing loans from 2008 onwards was the greatest in the corporate sector due to continued economic difficulties following the global financial and economic crisis. The quality of loans to the corporate section principally depends on economic activity and the quality of loans to households principally depends on the labour market. Due to intensified non-performing loan resolution measures (especially sales), the amount of non-performing loans fell in 2015 by 0.5 per cent.

Resolution of non-performing loans, especially through the sale of claims, increased in 2016 and resulted in a further decrease of the amount of non-performing loans (21.4 per cent. in comparison to 2015). In addition, loan collection improved and some claims were reclassified as performing, reflecting an improved economic environment. In comparison, corporate loans generally do not benefit from such security and carry higher risk. In 2017, non-performing loans decreased by 22.6 per cent., mainly due to sales of such loans. The amount of loan sales decreased in 2018, but it was still the main contributor to the decrease in non-performing loans (by 10.6 per cent.). If NPL sales were excluded, there would be an increase of NPLs in 2018, principally due to the implementation of IFRS 9 expected credit loss classification and provisioning requirements.

Since 31 December 2015, the CBS has been calculating a new residential real estate price index which is based on the set of market transactions that contributed significantly to its higher representativeness compared to the previous real estate price statistics. The index follows real estate prices since the first quarter of 2008. The decline in real estate prices (measured in terms of average market price) was 5 per cent. in 2009 and 6.3 per cent. in 2010 on annual basis, followed by a stagnation of prices in 2011 and another drop by 1.6 per cent. in 2012. During 2013 and 2014, real estate prices decreased by a further 4.0 per cent. and 1.6 per cent, respectively. Declining trends in residential real estate prices continued in 2015, and the housing price level decreased by a further 2.9 per cent. However during the 2016 this seven-year downward trend came to a halt as the residential real estate prices increased on average by 0.9 per cent, on an annual basis. This seven-year long decline in real estate prices did not have a significant impact on the quality of banks' collateral as banks were 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. In 2017, growth rates had increased as the residential real estate prices increased on average by 3.8 per cent. The intensity of the recovery rate was not equal for all housing markets. Based on the annual rate of change in the residential real estate index, it can be inferred that the strongest price growth in 2017 was present in the touristic Adriatic region (4.4 per cent.) and the City of Zagreb (4.3 per cent.). During 2018 the positive trend in the residential real estate prices continued, as they increased on average by 6.1 per cent, on an annual basis. The growth rate was even more disparate than before, with the strongest average price growth present in the City of Zagreb (10.7 per cent), an average increase of 5.3 per cent in the Adriatic coast, while in other areas it amounted to only 0.5 per cent. Housing non-performing loans ratio has declined to 6.2 per cent., as at the end of 2017 compared to 8.2 per cent. at the end of 2016. Positive overall macroeconomic trends on the one side and the sales and write-offs on other side affected the improvement for NPLs in 2017. Favorable trends continued and housing non-performing loans ratio fell to 5.0 per cent. at the end of 2018.

The performance of housing loans, in addition to job losses and unfavourable labour market developments, was adversely affected by FX induced credit risk relating to Swiss franc loans. As at 31 December 2015, approximately 32.1 per cent. of housing loans, (being an aggregate of HRK 17.6 billion of a total of HRK

55.0 billion of gross housing loans); and approximately 6.4 per cent. of total gross loans (being an aggregate of HRK 17.6 billion of a total of HRK 275.4 billion of total loans), were housing loans in Swiss francs or indexed to the Swiss franc. At the end-2014, Swiss franc housing loans accounted for 36.1 per cent. of total housing loans and the decrease of their share in 2015 was a result of regular repayment and loan conversions (to euros). This was the result of a second government measure related to Swiss franc loans. The first measure took place in January 2015, when the Swiss National Bank abolished the Swiss franc-euro peg and, as a result, the Swiss franc appreciated significantly against the kuna. To address this, at the end of January 2015, the Parliament decided to set, for a one year period, the kuna-Swiss franc exchange rate at 6.39 (versus 7.1420 as at 24 February 2015), the rate prevailing prior to the Swiss National Bank's abolition of the Swiss franc-euro peg. This measure resulted in an approximately HRK 200 million cost for the banking system. Later, in September 2015, the Government issued the second measure, aiming to level the position of Swiss franc and euro debtors. The banks had to offer a conversion of Swiss franc loans to euro loans to their clients. The bulk of the debtors accepted the conversion and by the end of March 2016, 90 per cent. of accepted conversions were realised. A part of the principal of these loans was written-off at the expense of provisions that were set aside in 2015, in line with IAS 37 accounting measures. In 2015, banks recorded HRK 6.8 billion of expenses on provisions for Swiss franc loan conversions and total net losses of HRK 4.6 billion. As at 31 December 2016, Swiss franc (gross) loans amounted to HRK 2.6 billion or 1.0 per cent. of total bank loans and further declined to HRK 1.6 billion or 0.7 per cent. of total bank loans as at 31 December 2017. Housing loans in Swiss francs amounted to HRK 0.9 billion or 1.9 per cent. of all housing loans. In 2018 the share of Swiss franc loans decreased further, to only 0.5 per cent. of total bank loans (gross).

The average interest rate on the stock of household loans indexed to foreign currency was 7.2 per cent., 7.1 per cent., 7.0 per cent., 6.3 per cent., 6.0 per cent., 6.0 per cent., 5.4 per cent. and 4.9 per cent. at December of 2011, 2012, 2013, 2014, 2015, 2016, 2017 and 2018, respectively. As of March 2019, this interest rate fell to 4.8 per cent.

The table below shows a breakdown of total gross loans by currency as at the dates indicated:

	As at 31 December					
	(per cent.)					
	2013	2014	2015	2016	2017	2018
Currency breakdown of total loans						
Euro	64.2	64.0	62.8	62.7	59.7	57.9
Swiss franc.....	8.8	8.3	7.3	1.0	0.7	0.5
Other foreign currencies.....	0.8	0.9	1.1	1.8	0.9	1.1
kuna	26.2	26.8	28.9	34.5	38.8	40.5

Source: HNB

According to audited data, expenses on value adjustments and provisions amounted to HRK 3.7 billion at 31 December 2011 (which represented a 0.4 per cent. increase compared with the level at 31 December 2010) and increased further to HRK 3.8 billion at 31 December 2012. In 2013 these expenses increased by 56.9 per cent. and amounted to HRK 5.9 billion. In 2014, expenses on value adjustments and provisions decreased and amounted to HRK 5.4 billion. However, in 2015 there was strong growth (122.9 per cent.) and the figure increased to HRK 12.0 billion. Expenses on provisions for Swiss franc loan conversions generated the growth, while the expenses on value adjustments and provisions for credit risk decreased slightly (5.6 per cent.). As at 31 December 2016, total expenses on value adjustments and provisions stood at HRK 2.9 billion, down by HRK 9.1 billion in comparison to 31 December 2015. This was mostly due to high one-off provisioning costs for loan conversion in 2015. Much lower costs associated with credit risk were also registered in 2016 (by 49.3 per cent.), both in the household sector and in the non-financial corporations sector, which may be linked to loan conversions and activities aimed at rectifying nonperforming loans. In 2017 expenses on value adjustments and provisions increased significantly in comparison to 2016, due to a deterioration in the quality of exposures to corporates. In 2018, after one-off effects in 2017 (related to Agrokor group), expenses on value adjustments and provisions decreased sharply (57.7 per cent.).

Loans (net) to households reached HRK 112.8 billion at 31 December 2014, recording a decrease of HRK 1.7 billion (1.5 per cent.) compared to 31 December 2013. The share of housing loans, general purpose loans and overdrafts increased in 2014, while the share of credit card loans was flat and the share of mortgage loans, vehicle purchase loans and other loans to households decreased. The decrease in (net) loans to households reflected both a loan decrease in absolute terms and increased loan loss provisions (especially for general

purpose loans, housing loans, mortgage loans and other loans to households). In 2015, loans (net) to households continued to decrease. They decreased by HRK 2.6 billion (or 2.3 per cent), which can partially be attributed to loan sales and principal write-offs for converted loans. Only general purpose loans recorded an increase (HRK 664.9 million or 1.8 per cent.), exclusively due to a growth of the kuna component by HRK 3.6 billion or 26.4 per cent. Housing loans in kuna also recorded considerable growth (HRK 870.1 million; 22.3 per cent.) but total housing loans continued its decreasing trend (by 3.6 per cent.). In 2016 loans (net) to households continued the downward trend. They fell by HRK 6.0 billion or 5.4 per cent. which is mainly attributed to partial principal write-offs for converted loans. Only general purpose loans recorded an increase (HRK 1,3 billion or 3.6 per cent.), exclusively due to a growth of the kuna component by HRK 5.1 billion or 29.3 per cent. Housing loans in kuna recorded sharp growth (95.2 per cent., which is partly attributed to refinancing of converted loans) but total housing loans decreased further (by 12.5 per cent.), even if the effects of the principal write-off in the process of conversion are excluded. In 2017 loans (net) to households grew by 3.2 per cent. mostly due to the continued trend of growth in general purpose loans (by 6.9 per cent. in comparison to 2016) and, to a lower extent, housing loans. Housing loans recorded an increase of 2.4 per cent., mainly due to government subsidies programs. Similar trends continued in 2018, with growth in general-purpose cash loans increasing.

After posting annual growth of 4.9 per cent. in 2010 and 4.5 per cent. in 2011, deposits by banks decreased by 2.0 per cent. in 2012, followed by a recovery of 2.5 per cent. in 2013. Deposits growth continued in 2014, with an additional increase of 1.2 per cent. compared to the end of 2013. In 2014, Government deposits increased by 12.5 per cent., while deposits of the corporate sector increased by 4.3 per cent. In addition, funding in the form of deposits from households increased by 1.9 per cent. while deposits from domestic financial institutions decreased by 2.1 per cent. At the end of 2014, total deposits consisted of 61.6 per cent. household deposits, 15.7 per cent. corporate deposits, with 13.1 per cent. belonging to nonresidents and 9.6 per cent. to Government, non-profit institutions and financial institutions. The share of deposits to total bank liabilities and capital has remained broadly stable since 2009 and increased marginally to 72.4 per cent. as at 31 December 2014. In 2015, the share of deposits increased further to 74.8 per cent. of total liabilities and capital. Deposits growth rate increased in 2015 to 2.8 per cent., primarily due to one-off effects in corporate sector (funds raised by asset sales and bond issues) and growth of deposits of that sector by 18.5 per cent. Household deposits also recorded a noticeable increase of 2.7 per cent. Government deposits and deposits from non-profit institutions increased by 21.3 per cent. and 9.8 per cent., respectively, while deposits from domestic financial institutions decreased by 6.8 per cent. Ultimately, domestic deposits increased by 5.6 per cent. while deposits from non-residents recorded a significant fall of 15.1 per cent., which can mainly be attributed to deleveraging by foreign parent banks. Household deposits dominated in the structure of total deposits with a share of 61.6 per cent., followed by corporates (18.0 per cent.) and non-residents (10.8 per cent.). The remaining 9.6 per cent. belonged to the government deposits, non-profit institutions and financial institutions. In 2016 similar trends continued. Total deposits increased by 0.4 per cent. (to 76.0 per cent. of total bank liabilities and capital) due to growth in domestic deposits, especially deposits from corporates (9.2 per cent), while household deposits increased by only 0.8 per cent. Deposits from non-residents decreased by 24.0 per cent., reflecting further deleveraging and a decrease in parent bank deposits. Household deposits dominated in the structure of total deposits with a share of 61.8 per cent., followed by corporates (19.6 per cent.) and non-residents (8.2 per cent.). In 2017 deposits increased by 0.8 per cent. Domestic deposits increased by 2.8 per cent. in comparison to 2016, mainly due to growth in corporate deposits (8.3 per cent.). The fall in non-resident deposits mainly reflected a decrease in deposits from parent banks and non-financial corporations. After modest 0.4 per cent. growth in 2017, in 2018 household deposits increased by 5.4 per cent. and were the main contributor to the growth of total bank deposits (7.0 per cent.).

The table below shows loans extended and deposits received by the banking sector as at the dates indicated:

	December				December			
	2015	2016	2017	2018	2015	2016	2017	2018
	<i>(HRK millions)</i>				<i>(percentage change over end of previous year)</i>			
Loans	246,949.2	235,954.5	226,674.1	237,092.4	-2.4	-4.5	-3.9	4.6
Households	110,263.3	104,570.0	107,660.7	114,008.6	-2.3	-5.4	3.2	5.9
Enterprises	69,469.6	67,544.4	69,651.8	70,756.7	-20.9	-2.8	3.1	1.6
Government	57,369.5	50,857.2	39,778.5	40,542.7	33.8	-11.4	-2.8	1.9
Financial institutions.....	5,002.3	5,076.1	3,528.3	4,227.6	-21.3	1.5	-30.5	19.8
Non-residents.....	4,494.0	7,906.9	5,724.8	7,232.1	59.2	75.9	-27.6	26.3
Deposits	294,214.6	295,302.8	297,746.3	318,447.5	2.8	0.4	0.8	7.0
Households	181,150.2	186,466.7	183,263.6	193,068.7	2.7	0.8	0.4	5.4

	December				December			
	2015	2016	2017	2018	2015	2016	2017	2018
	(HRK millions)				(percentage change over end of previous year)			
Enterprises	53,103.1	58,008.1	62,851.8	67,040.7	18.5	9.2	8.3	6.7
Government	8,613.4	9,503.0	11,204.4	12,840.0	21.3	10.3	17.9	14.6
Financial institutions.....	15,718.3	17,108.8	17,251.4	19,442.9	-6.8	8.8	0.8	12.7
Non-residents.....	31,852.9	24,216.1	19,000.5	21,463.0	-15.1	-24.0	-21.5	13.0

Source: HNB

As of 31 December 2014, total deposits amounted to HRK 286.1 billion and 65.8 per cent. of which were denominated in a foreign currency, 33.5 per cent. in kuna, and only 0.7 per cent. were deposits indexed to a foreign currency. At 31 December 2015, 65.3 per cent. of total deposits were denominated in a foreign currency, 33.8 per cent. in kuna and the rest, 0.6 per cent., were kuna deposits indexed to a foreign currency. Since 2013, the share of kuna deposits has had an upward trend. In 2016 kuna deposits increased by HRK 6.8 billion or 6.9 per cent. reaching 35.9 per cent. of total deposits. Deposits in foreign currencies accounted for 63.6 per cent. and the rest of 0.4 per cent. belonged to kuna deposits indexed to foreign currency. In 2017 kuna deposits increased further by HRK 12.6 billion or 11.8 per cent., reaching 39.9 per cent. of total deposits. Deposits in foreign currencies accounted for 59.8 per cent. and the rest of 0.3 per cent. belonged to kuna deposits indexed to foreign currency. The primary contributor for the increase in kuna deposits was the rise in demand deposits (i.e., kuna funds in current and giro accounts) reflecting clients' preference for holding more liquid financial assets in an environment of low interest rates for savings and time deposits. On the other hand, the currency structure of savings and time deposits remained unchanged, meaning that domestic sectors have continued to save mostly in foreign currencies (including the euro). In 2018 the significance of demand deposits and, consequently, kuna deposits increased further. Kuna deposits increased by 16.5 per cent. reaching 43.4 per cent. of total deposits. Deposits in foreign currencies accounted for 55.8 per cent. and deposits in kuna indexed to foreign currency for 0.8 per cent. of total deposits. The increase of demand deposits, coupled with an increase in lending activity, increased the maturity mismatch in the banking sector. However, the banking sector still had stable funding in excess of regulatory requirements (measured by the NSFR, which was 144 per cent. as of 31 December 2018 compared to the notional minimum of 100 per cent.).

The total amounts lent by banks to the central Government amounted to HRK 68.3 billion at 31 December 2014, which is a decrease of 5.3 per cent. compared to the end of 2013. This amount consists of HRK 38.3 billion in central Governmental loans and HRK 30.0 billion in Ministry of Finance T-bills and Government securities. In 2015, the total amounts lent to the central Government increased strongly, by 22.2 per cent., mainly because of methodological changes, i.e. due to the switch to ESA 2010. As at 31 December 2016 total amounts lent to central Government amounted to HRK 83.4 billion and consisted of HRK 46.8 billion in loans and HRK 36.7 billion in Ministry of Finance T-bills and other central government securities. In comparison to the end of 2015 the total amount remained stable (-0.2 per cent), reflecting a decrease in loans (-11.8 per cent.) and an increase in securities (19.9 per cent.). In the same period, the deposits of the central Government with commercial banks increased by 11.5 per cent, to HRK 5.7 billion. In 2017, the total amount lent to the central Government decreased by 11.0 per cent. and stood at HRK 74.2 billion. This was a result of a decrease in loans (23.5 per cent.) and an increase in debt securities (4.9 per cent.), due to an increase in investments in Government bonds. As at 31 December 2017 central Government deposits stood at HRK 7.1 billion, showing an increase of 22.8 per cent. in comparison with 31 December 2016. At the end of 2018 total amount lent to central Government stood at HRK 79.9 billion, up by HRK 4.7 billion or 6.4 per cent. compared to end-2017. This was due to an increase in Government securities (HRK 4.3 billion or 11.3 per cent.), specifically bonds, while loans to central Government increased modestly (1.1 per cent.). Central Government deposits increased by 9.9 per cent. and reached HRK 7.8 billion.

Continuing impact of the economic and financial crisis on the financial markets

In 2011, banks increased their operating income by 3.8 per cent. as result of increased net interest income and reduced loan loss provisions. However, eight banks reported negative pre-tax earnings in 2011 which is an increase from five banks at the end of 2010. In 2012, amid high interest costs from foreign financing and weaker non-interest income, the banks' operating income decreased by 12.0 per cent. As loan loss provisions increased by 5.9 per cent., pre-tax profit decreased by 26.1 per cent. In 2013, banks' pre-tax profit decreased by 70.0 per cent. mostly driven by an increase in loan loss provisions of 69.9 per cent. In 2014, banks' pre-tax profits increased by 197.3 per cent. compared to 2013. In 2015, pre-tax losses were recorded at HRK 5.0 billion. In 2016, banks recorded pre-tax profit of HRK 6.2 billion. In 2017, pre-tax

profit recorded a decrease of 36.7 per cent., to HRK 3.9 billion. Banks' earnings in 2017 were adversely affected by movements in charges for value adjustments and provisions, including the deterioration of banks' exposures to the Agrokor Group. Nevertheless, banks' profitability remained relatively high in 2017 as compared to prior years. The decrease in banks' profitability in 2017 as compared to 2016 is also the result of the strong profitability of banks in 2016 as they recorded a pre-tax profit of HRK 6.2 billion. Due to decrease in expenses on value adjustments and provisions, especially those related to the Agrokor Group, banks' pre-tax profit increased in 2018 by 43.4 per cent. and amounted to HRK 5.6 billion.

Although Croatian banks were not directly exposed to the global financial crisis, they are partially dependent on funding from foreign parent banks that were 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 throughout the crisis. In 2008 loans and deposits from parent banks increased by 30.9 per cent. to HRK 52.0 billion, with an additional increase of 15.1 per cent. in 2009 to HRK 59.8 billion. In 2010, financing from foreign owners was reduced by 1.5 per cent. to HRK 58.9 billion, but increased by 16.6 per cent. to HRK 68.7 billion in 2011, which permitted stronger credit growth. However, an extended period of low credit demand and elevated interest costs on foreign funding resulted in substantial external deleveraging by banks in 2012, with the loans and deposits from foreign owners decreasing by 23.3 per cent. to HRK 52.7 billion in 2012. This deleveraging process slowed down but continued in 2013 as the loans and deposits from foreign owners decreased to HRK 48.6 billion at 31 December 2013. In 2014, financing from foreign owners was reduced further to HRK 41.8 billion, a decrease of 18.8 per cent. compared with December 2013. Deleveraging continued throughout 2015, and in comparison to 2014, parent bank funding decreased by 45.5 per cent., to HRK 22.8 billion, only 7.0 per cent. of total funding (in received deposits and loans, issued debt securities and issued subordinated and hybrid instruments). In 2016 parent bank funding decreased by further HRK 10.5 billion or 46.1 per cent. It amounted to HRK 12.3 billion or 3.9 per cent. of total bank funding. Together with the growth in lending to parent banks (reverse repo loans) net parent funding, declined to only 0.4 per cent. Net parent funding is calculated as parent bank funding minus claims on parent banks (expressed as a per cent. of total assets). As at 31 December 2017 net parent funding ratio increased to 0.9 per cent. as a result of decrease in funding (24.0 per cent.) and much stronger decrease in lending to parent banks (44.9 per cent). As at 31 December 2018 parent bank funding amounted to HRK 11.8 billion, up by 26.1 per cent. in comparison to 31 December 2017. The bulk of funds was transferred to parent banks (as reverse repo loans), meaning that the growth in parent bank funding was mainly due to regulatory reasons, i.e. in order to maintain the prescribed coverage of foreign liabilities with liquid foreign assets (see *Foreign Currency Liquidity* below). The level of parent bank funding remained low, 2.9 per cent. of total assets as at 31 December 2018 (it stood at 2.4 per cent. as at 31 December 2017).

Foreign Currency Liquidity

In an economy such as Croatia, which has a high share of foreign currency (predominantly euros) in banks' liabilities and assets, the foreign currency liquidity of banks and of the entire economy is particularly sensitive. The foreign currency liquidity management of banks is regulated by the minimum amount of foreign currency assets required to be held. The minimum prescribed coverage of foreign currency liabilities with foreign currency claims currently stands at 17 per cent. The foreign currency claims and liabilities, as defined by this measure, also include claims and liabilities in domestic currency linked to foreign currencies with a currency clause.

As of March 2019, the ratio of foreign currency liabilities to foreign currency claims of the banking system stood at 21.0 per cent, falling from 26.6 per cent. at the end of 2017 and from 23.2 per cent. at the end of 2018, thus comfortably exceeding the required minimum.

Deposit Insurance

The State Agency for Deposit Insurance and Bank Rehabilitation (the "**Agency**") has been established as a specialised financial institution for deposit insurance of banks and saving banks and for the implementation of bank rehabilitation procedures in insolvency. The Government founded the Agency and 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 EUR 100,000. Prior to obtaining authorisation to provide services, credit institutions must join the deposit insurance scheme run by the Agency. Banks are required to pay a levy on

0.3 per cent. of their initial capital at the start, and are required to pay quarterly premiums of 0.08 per cent. of their insured deposit base at the end of each financial quarter in which they conduct business.

Regulation of the Non-Banking Sector

The Croatian Financial Services Supervisory Agency is the body responsible for the supervision of the non-banking financial sector in Croatia. Its responsibilities include supervision of stock exchanges, investment companies, investment and other funds and their management companies, pension fund insurance companies, the Central Depository & Clearing Company, insurance and reinsurance companies, insurance agents and brokers, legal persons dealing with factoring (unless such activities are conducted by banks in the framework of their registered activity), leasing companies and other entities being otherwise subject to supervision under applicable laws dealing with capital markets, investment and other funds, taking-over, pension insurance, insurances and financial services.

An Investor Protection Fund is operated by the Central Depository & Clearing Company. The membership of this Fund is obligatory for, *inter alia*, investment companies authorised to hold a client's funds and/or financial instruments and credit institutions providing investment services and/or carrying out investment activities on the basis of an authorisation under the Credit Institutions Act, when providing investment services and certain ancillary services under the Capital Market Act.

Money Market

The Government issues both kuna denominated T-bills and EUR linked T-bills at T-bill auctions. EUR linked T-bills are denominated in EUR but settled in kuna at the official HNB rate. In February 2012, EUR denominated T-bills with one and one and a half year maturities were issued for the first time.

The total stock of subscribed kuna denominated T-bills was HRK 24.0 billion at the end of 2014. By the end of December 2015, the total stock of subscribed T-bills had fallen to HRK 18.0 billion, and subsequently fell further to HRK 16.8 billion at the end of 2016. However, after increasing to HRK 17.0 billion at the end of 2017, total stock of subscribed kuna-denominated T-bills increased to HRK 18.1 billion at the end of 2018, while at the end of April 2019 it reached HRK 17.6 billion. The stock of euro-denominated T-bills was EUR 1.3 billion at the end of 2015. By the end of 2016, the stock of euro denominated T-bills increased to EUR 1.6 billion and remained at the same level until the end of 2018. By the end of April 2019 it decreased to EUR 1.2 billion. Consequently, the total stock of T-bills increased from HRK 28.2 billion at the end of 2015 to HRK 28.9 billion at the end of 2016 and remained almost unchanged at the end of 2017. By the end of 2018, the total stock of T-bills increased to HRK 30.2 billion and decreased to HRK 26.3 billion by the end of April 2019.

The weighted interest rates on 182-day T-bills and 365-day T-bills denominated in kuna decreased from 0.63 per cent. and 1.50 per cent. in December 2014 to 0.55 per cent. and 1.48 per cent. in December 2015, respectively. This downward trend continued further during 2016 and 2017 with the weighted interest rates on 182-day T-bills and 365-day T-bills reaching 0.25 per cent. in August 2017 (last auction in 2017) and 0.20 per cent. in December 2017, respectively. The same pattern occurred in 2018 with the weighted interest rates on 182-day T-bills and 365-day T-bills reaching 0.06 per cent. in June 2018 (last auction in 2018) and 0.09 per cent. in December 2018, respectively. The weighted interest rate on 182-day T-bills remained at 0.06 per cent. at the auction in February 2019 (last auction in 2019), while the weighted interest rate on 365-day T-bills, after reaching 0.09 per cent in February 2018, remained at that level until April 2019, when it decreased to 0.08 per cent. Although the weighted interest rate on 91-day kuna T-bills went up from 0.28 per cent. at the end of 2014 to 0.43 per cent. by the end of 2015, in January 2017 it had decreased to 0.20 per cent.

The weighted interest rate on 91-day EUR-linked T-bills fell from 0.30 per cent. in December 2014 to 0.20 per cent. in November 2015. During the same period, the weighted interest rate on 365-day EUR-linked T-bills decreased from 0.48 per cent. to 0.40 per cent. While the weighted interest rate on 91-day EUR-linked T-bills remained at the same level of 0.20 per cent. at the last auction held in February 2016, the weighted interest rate on 365-day EUR-linked T-bills continued its downward trend and reached 0.05 per cent. in November 2016 and 0.01 per cent. in October 2017. The weighted interest rate on 365-day EUR-linked T-bills decreased to 0.00 per cent in May 2018 and remained at that level. The 455-day EUR-linked T-bills issued in November 2017 in the amount of EUR 1.5 billion at 0.10 per cent. was refinanced at the end of January 2019 with the 455-day EUR-linked T-bills in the amount of EUR 1.1 billion at 0.00 per cent.

Against the background of strong financial system liquidity and a stable monetary environment, bank lending interest rates recorded favourable developments in the last few years. Such developments continued in 2018 and first three months of 2019 when the highest liquidity surplus of the financial system was recorded, recovering economic activity continued and country risk premium decreased. The weighted interest rates on kuna denominated short-term corporate loans decreased from 5.42 per cent. in December 2014 to 5.12 per cent. by the end of 2015, and continued falling to 4.56 per cent. by the end of 2016 and 3.82 per cent. by the end of 2017. This interest rate further fell to 3.43 per cent. in December 2018 and 3.16 per cent. in March 2019. During the same period, the weighted interest rates on long-term corporate loans with a currency clause fell from 5.83 per cent. at the end of 2014 to 5.57 per cent. by the end of 2015 and further to 4.22 per cent. by the end of 2016. In 2017 and 2018 this trend continued, with interest rates reaching 3.64 per cent. in December 2017 and 3.09 per cent. in December 2018. After falling below 3 per cent. in January 2019 it increased to 3.15 per cent. in March 2019. For the households sector, the weighted interest rates on short-term kuna-denominated household loans fell from 9.39 per cent. at the end of 2014 to 8.54 per cent. at the end of 2015. By the end of 2016, this interest rate declined to 8.12 per cent. and further to 7.40 per cent. by the end of 2017 and to 7.17 per cent. in December 2018 where it remained until March 2019. The weighted interest rates on long-term household loans with a currency clause recorded a decrease from 6.74 per cent. at the end of December 2014 to 5.91 per cent. by the end of 2015 and 5.68 per cent. by the end of 2016. During 2017 and 2018 this interest rate decreased even further reaching 4.57 per cent. in December 2017 and 4.50 per cent. in December 2018. During the first quarter of 2019 the downward trend continued with the interest rate reaching 4.30 per cent. in March 2019.

The increase in liquidity also affected interest rates on time deposits, reducing them to multi-year lows. The weighted interest rate on time deposits fell from 1.99 per cent. at the end of 2014 to 1.37 per cent. and further to 0.60 per cent. by the end of 2015 and 2016, respectively. By the end of 2017, the weighted interest rates on time deposits decreased further to 0.53 per cent. By the end of 2018 these interest rates increased slightly to 0.57 per cent., but fell again to 0.31 per cent. in March 2019. For the foreign currency time deposits, the weighted interest rates went down from 1.93 per cent. at the end of 2014 to 1.20 per cent. at the end of 2015 and to 0.49 per cent. at the end of 2016. By the end of 2017, the weighted interest rates on foreign currency time deposits decreased further to 0.45 per cent. By the end of 2018 these interest rates increased to 0.60 per cent., but fell again to 0.27 per cent. in March 2019. Interest rates on corporate giro accounts denominated in kuna followed a downward trend and decreased from 0.31 per cent. at the end of 2014 to 0.23 per cent. at the end of 2015 and declined further to 0.12 per cent. at the end of 2016. This trend continued during the following years when interest rates on corporate giro accounts denominated in kuna decreased to 0.07 per cent. by the end of 2017 and 0.04 per cent. in December 2018, at which level they remained until March 2019.

Capital Markets

The Zagreb Stock Exchange ("**ZSE**") is the only stock exchange in Croatia. There are two types of participants in the ZSE system: brokers and specialists which maintain market liquidity of specific shares within boundaries set by the ZSE defining the maximum spread and minimum quoted volume. At the end of March 2019, there were two market specialists and 15 brokerages. Equity trading on the ZSE is organised into three market segments: the prime market, the official market and the regular market. The ZSE also operates a multilateral trade platform. Together with the Bulgarian and Macedonian stock exchanges, the ZSE has established the SEE LINK company in May 2014 with the objective of creating a regional infrastructure for trading securities listed on those three markets. The platform became fully operational as of March 2016. At this time, SEE LINK was joined by the Belgrade and Ljubljana Stock Exchanges, which enabled the integration of regional capital markets whose capitalisation is higher than U.S. dollar 35 billion. Today, SEE LINK consists of seven regional capital markets (along with the Croatian, Bulgarian, Macedonian, Serbian and Slovenian Stock Exchange, SEE Link members are consist of two stock exchanges with headquarters in BiH; Sarajevo and the Banja Luka Stock Exchange).

At the end of 2015, the ZSE acquired the Ljubljana Stock Exchange by taking over 100 per cent. of its shares from the CEE Stock Exchange Group.

From July 2017, the ZSE started using the XETRA trading platform. The Xetra trading system is a system of Deutsche Börse, for which the Vienna Stock Exchange is a distributor and operator for this part of Europe. In addition to Zagreb and Vienna, the Xetra trading system is in use in numerous other exchanges, as well as the Ljubljana Stock Exchange, owned by the ZSE. The second half of the 2017 was marked by the launch of intensive preparations related to Progress, the new trading platform, including, among other things, the creation of a new website, the adoption of progress market rules and the publication of a tender for the grant of Progress Market adviser status. One month following its publication, a large number of applications for the

grant of Progress Market adviser status were received, testifying to the level interest in capital market products in Croatia as well as in the formation of a new branch in the area of business and financial advisory services. Nine companies were found to meet the criteria required for the role of advisers to prospective issuers, and the platform is expected to commence operations in 2018. At the end of 2017, new rules for the ZSE were approved and incorporated, among other things, MIFID II regulation and related regulations were also made to the CE Enter Market Rules.

In 2018, the first issuer was admitted to trading on the Progress Market, with several other companies also expressing interest. During the year, the new Exchange Rules amended the listing criteria for the prime market, the most demanding market segment of the ZSE. The amendments are aimed at ensuring an even higher level of transparency and corporate governance standards in order to make the Prime Market a role model for market practices. Four issuers were admitted to the Prime Market in 2018. Additionally, in June 2018 the ZSE joined the Federation of European Securities Exchanges ("FESE") in a bid to be actively involved in formulating the regulations that affect the operation of smaller exchanges.

2017 and 2018 Trading

The year 2017 had a strong start, with growth in all key trading indicators, but the rest of the year experienced uncertainties about further developments surrounding the shares of the companies that are members of the Agrokor Group. Order book share turnover stood 37.3 per cent. higher compared to 2016, with total order book trading increasing by 24.6 per cent. While market capitalization in shares weakened by 3.4 per cent., growth in bond market capitalization led to total market capitalization growth at a rate of 1.6 per cent. Indices had a mixed close, while CROBEX and CROBEX10 saw a correction of -7 per cent. and CROBEXtr of -5 per cent., CROBEXnutris suffered a substantial also 45.1 per cent. loss. Meanwhile, CROBEXkonstrukt rose 3.4 per cent., with CROBEXturst adding 10.75 per cent. and CROBEXtransport as much as 18.9 per cent.

The strong start of 2018 did not suffice to improve overall statistics compared with the previous year. In the first quarter of 2018 trading suspension of the Agrokor concern member companies' shares was renewed, allowing the market to progress further against a backdrop of predominantly negative investor sentiment that was reversed only late in the year. Order book trading turnover in shares shrank 39.8 per cent. against an 86.6 per cent increase in bonds turnover, resulting in 22 per cent lower total turnover compared to 2017. While bond market capitalisation grew 3 per cent., shares market capitalisation declined at a rate of 4 per cent. Consequently, almost all indices decreased in 2018 with CROBEX and CROBEX10 shrinking around 5 per cent. and CROBEXtr 2.8 per cent.. CROBEXtransport suffered a substantial decrease of 38.2 per cent. while CROBEXnutris rose 6.1 per cent. and was the only index to record growth.

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

	2015	2016	2017	2018
Regular volume	251,377,241	366,642,948	320,351,558	542,561,085
of which Stocks	35,426,627	33,007,384	38,647,825	30,250,322
of which Bonds	208,868,268	331,556,378	281,703,733	512,310,763
of which Rights	4,834,324	0	0	0
of which Commercial Paper	0	0	0	0
of which Structured Products	2,248,022	2,079,186	0	0
Block volume ⁽¹⁾	1,586,948	4,262,524	5,594,906	3,835,666
Reported volume ⁽²⁾	190,148,664	215,504,042	60,000,000	44,000,000
Institutional volume ⁽³⁾	15,372,876,700	19,443,889,656	14,508,293,018	9,337,332,802
Total number of trades	177,943	133,177	181,134	92,538
Number of securities traded	294	233	163	157
Number of trading days	248	251	250	247
Daily average volume	1,763,338	2,336,293	1,543,786	2,390,270

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 than HRK 3.0 million

⁽³⁾ Institutional trades are trades reported by institutional investors

PUBLIC FINANCE

Fiscal Framework - Excessive Deficit Procedure

On 10 December 2013, the European Commission adopted the conclusion on the existence of the excessive budget deficit in the Republic of Croatia, on the basis of the Opinion of the Economic and Financial Committee. On 28 January 2014, the Council of the EU adopted the Recommendations for the Republic of Croatia with an aim of correcting the excessive budget deficit by 2016. It was recommended to Croatia to adopt consolidation measures in total amount of 2.3 per cent. of GDP in 2014, and of 1 per cent. of GDP in 2015 and 2016, with respective reductions in the budget deficit from 4.6 per cent. in 2014 to 3.5 per cent. in 2015 and to 2.7 per cent. of GDP by the end of 2016.

In that context, within the framework of the Excessive Deficit Procedure, the Government submitted six reports to the European Commission in the period between 2014 and 2016.

In May 2016, the European Commission outlined its assessment of the Convergence Programme (as defined below) and the European Commission expected that Croatia would fulfil the requested adjustment efforts in 2016, in line with the EU Council Recommendations with an aim of solving the excessive budget deficit.

In April 2016, Croatia submitted the Convergence Programme and National Reform Programme for 2016 to the European Commission. Based on the April 2016 notification by Croatia, the 2017 Convergence Programme and the European Commission 2017 spring forecast, the EU Council decided that the excessive deficit in Croatia has been corrected and the decision on the existence of an excessive deficit should be abrogated. In June 2017 Croatia fulfilled the EU Council Recommendations and exited from the Excessive Deficit Procedure.

As from 2017, the year following the correction of the excessive deficit, Croatia is subject to the preventive arm of the Stability and Growth Pact, pursuant to which Member States are required to pursue a medium-term objective of ensuring the long-term sustainability of public finances and minimising the risk of their budget deficit exceeding the reference value of 3 per cent. of GDP.

Fiscal developments in 2016

During 2016, the Government continued to implement fiscal consolidation in line with the Recommendations of the EU Council and within the framework of the Excessive Deficit Procedure. In 2016, the general government deficit reached 1 per cent. of GDP, down from 3.2 per cent. in 2015, which was significantly lower in relation to the originally planned amount of 2.6 of GDP, and 5.1 per cent. in 2014. The improvement was mainly driven by rising revenue on the back of strong GDP growth, and restraint on the expenditure side. The recommended structural effort of 1 per cent. of GDP was exceeded slightly, reaching 1.1 per cent. of GDP. Consequently, the EU Council Recommendations were satisfied and the Republic of Croatia exited the Excessive Deficit Procedure.

The total revenue of the general government budget reached HRK 162.7 billion or 46.3 per cent. of GDP, which was the result of economic trends that were significantly better than expected, as well as the good tourist season. Additionally, there were continued efforts to combat the grey economy via the fiscalisation and improvement of the tax control and collection system. As a result, revenues from corporate income tax, special taxes and excise duties, Value Added Tax ("VAT") and property, recorded higher outturn. Revenues from other current and capital transfers also had a significant increase, mainly due to the intense dynamics of EU funds absorption.

Significant savings were achieved on the expenditure side of the general government budget compared with originally planned expenditures, at the level of HRK 166.2 billion or 47.3 per cent. of GDP. Within the category of intermediate consumption, planned savings were made on service expenditure: mainly intellectual services, personal services, overhead expenses, energy and other operating costs of budgetary user business operations (particularly in the science, judiciary and internal affairs sectors). In relation to subsidies, the largest savings were achieved in the agricultural and transport sectors, as well as in active employment policy. Smaller savings were also made in the areas of entrepreneurship, tourism and science. Savings on social benefits and social transfers included reduced spending on repairing damage caused by floods, compensation of unemployed persons, active employment policy, social protection, secondary-level and high-level education and housing care. The planned permanent savings were also made within other current and capital transfers in the sectors of agriculture, maritime affairs, culture, finance, the labour market, science, entrepreneurship, tourism, regional development, the economy and construction. Structural savings

were also achieved on gross investments in capital, primarily in the defence system, science, healthcare and the economy.

Fiscal developments in 2017

In December 2016, Parliament passed the State Budget for 2017 and its projections for 2018 and 2019 which the Government adopted. The budget reflected policy efforts to address structural vulnerabilities and give additional impetus to favourable economic trends. In order to achieve these goals the budget was underpinned by a set of comprehensive and decisive reform measures on both the revenue and expenditure side.

In November 2017, the Government carried out a technical budget revision. Revenues were expected to be higher than originally planned, with the level of total State Budget expenditure remaining the same. Internal reallocations were carried out in order to address additional needs, including (i) an expected increase of base salary for both public and civil servants since the last 2 per cent. increase on 1 November 2017, which was paid in December 2017; (ii) an expected payment of a Christmas bonus for civil and public servants; and (iii) an increase in pensions in accordance with the implementation of the Decision regarding the termination of a decrease in privileged pensions by 10 per cent. (as a savings measure, privileged pensions above 5,000 HRK were decreased by 10 per cent.). Additionally, some savings were expected on interest rates, intermediate consumption, compensation measures for local and regional self-government and on the delay in the implementation of the Law on War Veterans. Such savings were used for the coverage of liabilities of state owned and local hospitals and the coverage of old debts and court disputes. The projected deficit was therefore lower than originally planned for 2017.

A comprehensive tax reform, which came into effect at the beginning of 2017 played a key role in achieving the budget's aims. The tax reform package included 16 modifications of relevant acts, including a simplification and a reduction in personal income tax ("PIT"), a rationalisation of corporate income tax ("CIT"), a one-off incentive for the writing-off of non-performing loans, and changes to VAT categories and the basis for the future introduction of the recurrent property taxation.

The brackets of the PIT were reduced from three (12 per cent., 25 per cent., 40 per cent.) to two (24 per cent. and 36 per cent.) and the personal allowance was significantly increased (from a threshold of HRK 2,600 to HRK 3,800). Other changes in PIT included a more progressive scale for expanding the personal allowance for dependent children and the narrowing of eligibility criteria for other supported family members. Social security contributions for "other income" (i.e. non regular income from employment and self-employment) was also cut. As a consequence, the number of people that do not pay any PIT has increased by 560,000, reaching 1.5 million, while higher-income earners will face a significantly lower tax liability.

Reductions in CIT rates are designed to be broadly compensated by the abolition of costly exemptions and tax breaks. The general CIT rate was cut from 20 per cent. to 18 per cent. and a new, reduced rate of 12 per cent. was introduced for small businesses and farmers with revenues up to HRK 3 million. At the same time, the tax base was broadened by removing some of the exemptions applying to companies in underdeveloped geographical areas and by abolishing the tax break for reinvested earnings. Additional simplifications included the possibility given to small businesses to choose between two methods for calculating their CIT liabilities and the introduction of a system of warnings and recommendations instead of punitive measures for minor offences.

VAT rates remained unchanged, but categories of goods and services were shifted across rates. In a move to support small farmers and households, the reduced rate of 13 per cent. was applied to agriculture, electricity and utility services. In contrast, food and drink services were moved from the reduced to the general rate.

The real estate transfer tax rate was cut from 5 per cent. to 4 per cent., with the entire amount earmarked for local government units.

Total revenue of the general government budget reached HRK 168.6 billion or 46.1 per cent. of GDP, due to positive effects of the comprehensive tax reform. Taxes on production and import amounted to 19.6 per cent. of GDP and registered a year-on-year increase of 5.5 per cent. The largest tax revenue contributor was the value added tax which, in relation to the previous year, increased by 6.8 per cent. The revenues from social contributions also registered a significant increase of 4.6 per cent. and in 2017 amounted to 11.9 per cent. of GDP. Current taxes on income and wealth, which include the income tax and corporate income tax, increased by 0.3 per cent., which was the consequence of a reduction in revenues from income

tax due to the implemented tax reform. Along with tax revenues, the revenues from other current and capital transfers that include revenues from EU funds were also significant and amounted to 2.8 per cent. of GDP.

The total expenditures of the general government budget in 2017 were realised in the amount of HRK 165.7 billion or 45.3 per cent. of GDP in 2017, a reduction of 1.9 per cent. compared to the previous year. Compensation of employees were 11.4 per cent. of GDP. The increase in the compensation of employees was primarily the result implemented measures to increase the base salaries of civil and public servants by 6 per cent. Bonuses based on years of service in the amount of 0.5 per cent. were also paid in 2017. Expenses for intermediary consumption were 8.1 per cent. of GDP. This category includes material expenses of the general government sector units and the costs of healthcare institutions for medicines and medical material. Expenses for subsidies were 1.4 per cent. of GDP. A significant share of expenses in this category stems from allocations in agriculture, expenses for the implementation of concession contracts, stimulation of maritime passenger transport, including the finalisation of a shipyard restructuring process in 2017 and subsidies to producers of energy from renewable sources. Expenses for interests were 2.7 per cent. of GDP, a decrease of 9.9 per cent. compared to the previous year. The decrease was primarily the result of favourable conditions in financial markets, which resulted in lower public service debt costs. Social benefits and social transfers was the most significant category of total general government expenses, which was 15.6 per cent. of GDP. These expenses are mostly determined by trends in expenses for pensions, prescription medications, maternity benefits, social welfare benefits, child allowance and unemployment benefits. Other expenses, mostly related to current and capital transfers, were 3.4 per cent. of GDP. These expenses mostly refer to activities financed from EU funds as well as the payment of the Republic of Croatia's contribution to the EU budget. Gross fixed capital formation expenses were 2.7 per cent. of GDP, a decrease of 13.4 per cent. compared to the previous year. The decrease was due to changes in the implementation of planned investment projects.

In 2017, as a result of favourable macroeconomic trends, including tax reform and rational budget spending, for the first time, a surplus from the general government budget was realised, which was in the amount of HRK 2.9 billion or 0.8 per cent. of GDP, according to the European statistical methodology ESA 2010. During the same period, the share of public debt in GDP decreased by 2.7 percentage points or to the level of 77.8 per cent. of GDP. Furthermore, during 2017, savings on interest amounted to HRK 1 billion. For the years 2016 and 2017 combined, the share of public debt in GDP decreased by 6 percentage points while the savings on interests amounted to HRK 2 billion.

In 2017, the responsible fiscal policy management was recognised by international financial institutions, and as a result, the three leading global rating agencies improved the outlook of the credit rating of the Republic of Croatia, which had been decreased twice in the 2012-2015 period. In addition, in January and March 2018, rating agencies Fitch and S&P increased the rating by one level within the stable outlook classification, which represents the first increase in the rating of the Republic of Croatia by a leading global rating agency since 2004.

Fiscal developments in 2018

The Government adopted the 2018 budget plan and projections for 2019 and 2020 in November 2017. In November 2018, the Government carried out a technical budget revision. Revenues were expected to be higher than originally planned, with the level of total State Budget expenditure remaining the same. Some items of expenditure had to be redistributed, as a result savings were observed in all categories of expenditures, excluding employee expense, subsidies and grants. At the same time, it was necessary to provide additional funds for the guarantee reserve and for the settlement of arrears in the health sector, cover outstanding liabilities from previous periods and costs of court disputes. Guarantee reserve is the budgetary position where the most significant increase was registered due to the activation of government guarantees for Uljanik Group companies which occurred as a result of the termination of the contract for the construction of ships and the failure to meet the obligations of Uljanik Group. Despite the unexpected additional expenditures, as a result of cost savings, the projected deficit was therefore lower than originally planned for 2018.

In 2018, total general government budget revenues were collected at the level of HRK 178.1 billion or 46.6% of GDP as a result of positive macroeconomic developments and the full-year effect of tax reform, which came into effect in early 2017, and further tax unburdening as of January 1, 2018. Effective changes in 2018 referred to the reduction in the taxation by special tax on motor vehicles and the annulment of the tax on purchasing second-hand motor vehicles and replacement thereof with administrative fees, but in smaller amounts. In addition, by the end of 2017, excise duties on tobacco products were increased with an

aim of reaching the agreed excise duty level under Council Directive 2011/64/EU of June 21, 2011 on the structure and rates of excise duty applied to manufactured tobacco. As of January 2018, within the value added tax system, the threshold for entry into the VAT system was increased to HRK 300,000 and the possibility of deducting 50 per cent. of subscription for entrepreneurs was introduced for the purchase of personal cars and other personal means of transport and other related costs.

Taxes on production and imports amounted to 20.1% of GDP and registered a year-on-year increase of 7.2%. Within this category, most income derived from value added tax which was 6.8% higher than in the previous year. The collected revenues from VAT are the result of increased personal consumption due to the growth of disposable income of households, supported by favourable labour market trends and a successful tourist season.

The revenues from social contributions also register a significant increase of 5.2%, which in 2018 amounted to 12% of GDP, as a result of favourable labour market trends, with increased employment. Current income and wealth taxes, which include income tax and corporate income tax, are up 6.7% due to the aforementioned positive trends in the labour market and good results of business operations of enterprises and banks during 2017. In addition to tax revenues, there are also significant revenues from other current and capital transfers, including resources from EU funds. In 2018 they amounted to 2.7% of GDP, with revenues from EU funds registering an increase of 32.1% at the annual level.

Total expenditures of the general government budget were executed at the level of HRK 177.3 billion or 46.4% of GDP in 2018.

Compensation of employees register the level of 11.7% of GDP and they increased by 7%. This increase is primarily the result of a full-year effect of the increase of 6% for public and civil servants in 2017, corrections for years of service by 0.5%, and the change of sectoral collective agreements in certain public service activities, as well as the amendments to regulations regulating salaries in services of external and internal affairs and social care. In addition, these expenditures also include increased allocations for employees financed from EU funds, as well as compensation of employees from the HAC-ONC company, which has been assigned to the HAC since December 2017 and thus classified into the general government sector. Furthermore, there was an increase in compensation of employees registered in local and regional self-government units.

Intermediate consumption expenditures were realised at the level of 8.2% of GDP. This category includes material expenditures of all units of the general government sector, including, inter alia, the costs of healthcare institutions for medicines and medical and sanitary materials. Major allocations were also registered on expenditures on materials and energy and on current and investment maintenance.

Expenditure for subsidies registers the level of 1.5% of GDP. The most significant category of subsidies relates to subsidies of the Croatian Energy Market Operator Ltd. for producers of energy from renewable sources, which are funded from the fee for stimulating electrical energy from renewable sources. A significant share of this category of expenditure stems from allocations for agriculture as well as allocations for the implementation of concession contracts and the stimulation of maritime passenger transport.

Interest expenditure represented a share of 2.3% in GDP. Compared to 2017, this decreased by 0.3 percentage points of GDP or almost HRK 900 million. Such a reduction which was the result of fiscal policy management, followed by the active public debt management policy, which led to a reduction in the costs of public debt servicing. It should be noted here that by the end of the second phase of the financial restructuring of the road sector debt, interest costs in this sector were significantly lowered by more than 30% compared to their earlier costs.

Social benefits and social transfers represent the most significant category of total general government expenditure and record a level of 15.6% of GDP. These expenditures are determined most by the trends in expenditure for pensions, expenditure for prescription medications, maternity benefits, social welfare benefits, child allowance and unemployment benefits. Expenditure for pensions and retirement benefits were realised at the level of 10.3% of GDP, which is primarily the result of the adjustment of pensions realised under the general regulation and special regulations as of January 2018 by 0.94% and as of 1 July 2018 by 2.7%. Furthermore, the increase was influenced by the transferred cumulative effect of the change in the number and structure of the pension beneficiaries from 2017, the cessation of the reduction of pensions earned under special regulations of more than HRK 5,000 by 10% from 2017, application of the provisions on the minimum pension of the new Act on Croatian Homeland War Veterans and Their Family

Members' Rights (OG 121/2017) and the payment of unpaid sums of buyback pensions under the Act on the Continuation of Payment of Buyback Pensions (OG 130/2017). Allocations for child allowance amount to 0.3% of GDP and are reduced due to the application of the Act on Amendments to the Child Allowance Act and the trend of reducing the average number of beneficiaries and the average number of children receiving child allowance. Maternity benefits were realised at the level of 0.7% of GDP. Within this category of expenditure, the full-year effect of the Amendments to the Maternity and Parental Benefits Act, which came into force on 1 July 2017, was included, and as a result of which, the amount of financial support increased through the use of additional parental leave. Unemployment benefits were realised at the level of 0.2% of GDP. Social welfare benefits, including guaranteed minimum benefit, personal disability allowance and allowance for help and care, were realised at the level of 0.6% of GDP. This category of expenditure includes increased appropriations for war veterans' care based on the new Act on Croatian Homeland War Veterans and Their Family Members' Rights of December 2017, which extends the scope of their rights. In addition, in 2018, funds were also provided for the implementation of the Act on the Amendments to the Housing Loan Subsidies Act (OG 65/2017 and 61/2018), which came into force on July 19, 2018, which enabled the subsidising of loans for the purchase of a flat or a house, i.e. for the house construction.

Other expenditures, mostly related to current and capital transfers, represented 3.7% of GDP. They mostly refer to the activities financed from EU funds as well as the payment of the contribution of the Republic of Croatia to the EU budget. In addition, the increase in capital transfers is due to the payment of contested guarantees for the Uljanik group and the takeover of Petrokemija's debt in the process of its privatisation.

Gross fixed capital formation expenditure was realised at the level of 3.5% of GDP, which was an increase of 33.8% in relation to the previous year due to the significant growth of investments of local and regional self-government units as well as of public enterprises in the general government sector.

The general government budget for 2018, according to the European statistical methodology ESA 2010, registers a surplus of 0.2% of GDP, which represents a significant improvement in relation to the initially planned deficit of 0.5% of GDP. This surplus would have been even higher if one-off liabilities, on the basis of the contested guarantees for the Uljanik Group, had not materialised in the amount of HRK 2.5 billion, i.e. 0.7% of GDP. The calling of the guarantee led to a one-off increase in capital transfers on the expenditure side, which directly affected the general government budget surplus reduction.

Overview of the 2019 budget

The Government adopted the 2019 budget plan and projections for 2020 and 2021 in November 2018.

The Fiscal Policy of the Republic of Croatia in the medium term will be determined by the efforts to be undertaken, in line with the provisions of the Stability and Growth Pact, for the purpose of further strengthening of fiscal sustainability and economic growth and development, and ensuring adequate care for all citizens of the Republic of Croatia. A key emphasis will continue to be on the reform activities undertaken on both the revenue and the expenditure side of the budget, aimed at strengthening the long-term potential of the Croatian economy and real convergence towards countries within the euro area and at reducing macroeconomic imbalances. Strict control of the expenditure side of the budget is planned to continue and any revenue surplus in relation to the projected surplus is intended to be used to further reduce the public debt.

In 2019, total general government budget revenues are planned at the level of HRK 186.5 billion or 47% of GDP. They are based on the expected growth of economic activity, taking into account the fiscal effects of the third round of tax unburdening, primarily within the system of VAT, contributions and excise duties, which came into effect at the beginning of 2019. The main change in the VAT system, with the aim of reducing the regressive effect of this tax on the most vulnerable group of citizens, is the reduction of the VAT rate from 25% to 13% for live animals, fresh and frozen meat, fish, fruits and vegetables, eggs, baby diapers and all medicines are taxed at a rate of 5%. The total fiscal impact of these changes is estimated at HRK 1.5 billion or 0.4% of GDP. Furthermore, the amendments in the system of special taxes and excise duties provide for the reimbursement of a part of the excise duty paid on diesel fuel used in the commercial transport of goods by vans of certain payload (tonnage capacity) and for the commercial transport of passengers. This measure provides for tax unburdening of HRK 290 million or 0.1% of GDP. Regarding the excise duties on tobacco products, the amount of excise duties on cigarettes was changed in order to comply with the requirements of EU legislation, the fiscal impact of which is estimated at HRK 350 million or 0.1% of GDP. In the contribution system, the contribution for compulsory insurance in the case of unemployment of 1.7% and the contribution for health protection at work of 0.5% were abolished and at the same time, the

contribution for health insurance increased from 15% to 16.5%. In this way, total allocations by employers for salaries decreased by 0.7 percentage points, which reduces employers' costs by HRK 800 million or 0.2% of GDP and opens up room for salary increase or new investments. Real estate transfer tax decreased from 4% to 3%, which should stimulate the real estate market transfer. The fiscal impact of this measure is estimated at HRK 100 million or 0.03% of GDP. Within the income tax system, tax base was increased for the application of a tax rate of 24% from HRK 17,500 to HRK 30,000, thus positively influencing the retention of highly educated experts in high value-added sectors. The expected effect of this measure is HRK 210 million or 0.1% of GDP. Taxes on production and import represent the most significant category of total revenue. They are projected at the level of 19.8% of GDP. Value-added tax revenue is projected in the amount of 13.3% of GDP based on macroeconomic projections, including the growth of personal consumption, tourist services, but also government expenditure for intermediate consumption, investments and social transfers in kind. In addition, the effects of the aforementioned tax changes are also taken into account. Besides VAT, the expected revenues from excise duties, customs duties and other taxes on consumption are also included in the category of taxes on production and import. Revenues from excise duties amount to 4.6% of GDP and they include the expected trend in the consumption of excise products and the effects of changes in regulations in the excise system, i.e. in excise duties on energy and electricity and excise duties on tobacco. The second most significant group of general government budget revenues are social contributions, projected at a level of 11.9% of GDP. Their dynamics are determined by the trends in the labour market, taking into account the aforementioned legal amendments that came into effect in early 2019.

Revenue from current taxes on income and wealth is estimated at the level of 6.5% of GDP. The personal income tax revenue is planned based on expected labour market trends, including the effects of the aforementioned legal amendments. Corporate income tax revenue in the current year is paid on the basis of the entrepreneurs' business operations of the previous year and is prepared on the basis of the estimation of business operations of enterprises and banks in 2018. The category of other current and capital transfers, projected at the level of 3.3% of GDP which is an increase of 24.2%, also include the revenues from the aids of EU institutions and bodies, which are directly linked to the projects financed from EU funds.

In 2019, total general government expenditures are planned at a level of 47.3% of GDP. Compensation of employees is projected at the level of 11.7% of GDP on the basis of the expected trends in the level of the number of the employed civil and public servants and rights arising from collective agreements. It is important to point out that in 2019 the base for the calculation of salaries is increased by 5%, based on collective agreements for civil and public servants (3% from as of January 2019 and 2% as of September 2019). In addition, the dynamics of the trends in compensation of employees is also determined by paying a bonus of 0.5% for years of service. Furthermore, this category of expenditures also includes the increase of allocations for the purpose of the presidency of the Republic of Croatia of the EU Council, which Croatia assumes as of 1 January 2020, for which a certain number of employees will be transferred to the Permanent Representation of the Republic of Croatia in Brussels in 2019. Intermediate consumption expenditures are planned at the level of 8.4% of GDP. The increase in this category of expenditures compared to 2018 is primarily a result of the trends in the material consumption by all general government sector units, whereby increased spending on medicines and consumables and sanitary material of healthcare institutions is expected as a result of the expected increase in the revenues of the Croatian Health Insurance Fund. In addition, this category of expenditures includes increased costs for the purpose of the Croatian presidency of the EU Council. In 2019, expenditures for subsidies are projected at the level of 1.7% of GDP. A significant part of subsidies of 0.6% of GDP refers to the subsidies of the Croatian Energy Market Operator ("**HROTE**") for the producers of energy from renewable sources, which are financed from the fee for stimulating electricity production from renewable sources. In addition, this category also includes the subsidies in agriculture that are financed from national funds, concession contracts, as well as subsidies for the promotion of maritime passenger transport. Property income expenditure, which is largely determined by the trends in interest expenditure in line with the conditions on financial markets, i.e. the costs of public debt service, registers a level of 2.3% of GDP in 2019. Social benefits and social transfers are planned at the level of 15.6% of GDP, whereby the expenditures for pensions and pension receipts account for 10.1% of GDP. The increase in 2019 is affected by the transferred cumulative effect of changes in the number and structure of pension beneficiaries and the adjustment of total pensions in 2018, changes in the number and structure of pension beneficiaries, adjustment of pensions of 2.5%, the application of a part of the provisions of the new Act on Croatian Homeland War Veterans and Their Family Members and the continuation of the regular payment of buyback pensions which started in March 2018. The allocations for child allowances amount to 0.4% of GDP and are planned by taking into account the full-year effect of the application of the Act on Amendments to the Child Allowance Act. To create more favorable financial conditions for families, the level of income within the means testing was increased as a requirement for the realisation of the right to child allowance from 50% to 70% of the budgetary base. This is in order to expand the number of beneficiaries of child

allowances and thus the pro-natalist allowance realised by child allowance beneficiaries for their third and fourth child. Maternity benefits are planned at the level of 0.6% of GDP and unemployment benefits at the level of 0.2% of GDP. Social welfare benefits are planned at a level of 0.6% of GDP. Apart from the guaranteed minimum benefit, this also includes the implementation of the Act on the Amendments to the Social Welfare Act, according to which the amount of the personal disability allowance and the allowance for assistance and care are increased. Furthermore, the full-year effect of the Act on Amendments to the Housing Loan Subsidies Act, enabling subsidies for flat or house purchase loans, i.e. housing construction, for each year until December 31, 2020, was also included. Other expenditures, mostly related to current and capital transfers, are planned at the level of 3.5% of GDP and are largely determined by the payment of the Republic of Croatia's contribution to the EU budget as well as by activities financed from EU funds. This category of expenditures includes expenditures for the implementation of electoral activities, of which the most significant ones are the elections for the European Parliament and the Croatian presidential elections. In addition, in 2019, the category of capital transfers also includes the expected one-off expense in respect of the contested guarantees of Uljanik Group in the amount of HRK 1.7 billion or 0.5% of GDP. Gross fixed capital formation expenditures are planned at the level of 4% of GDP and they register a strong growth of 21.2% compared to 2018. The most significant growth is anticipated in the area of road and rail infrastructure construction. A large part of the investment is financed from EU funds and the most significant project is the continuation of the construction of the Pelješac Bridge. Capital investments are also planned in the healthcare, judicial and science sectors. In addition, funds are also allocated for the refurbishment of the congress centre of the National and University Library in Zagreb for the purposes of the presidency of the Republic of Croatia of the EU Council.

Following the planned revenues and expenditures, the general government budget deficit is budgeted at the level of 0.3% of GDP in 2019, while the central government deficit is budgeted to amount to 0.5% of GDP and that of the local and self-government unit is budgeted to amount to 0.1% of GDP. Social security funds are target to register a surplus of 0.3% of GDP. The current intention is for any deficit to be financed from borrowings in 2019.

Table: General government budget, ESA 2010 methodology

		Twelve months ended 31 December					
		ESA Code	2015	2016	2017	2018	2019
			(% of GDP)				
1	NET LENDING (EDP B.9) BY SUB-SECTOR						
1	General government	S.13	-3.2	-1.0	0.8	0.2	-0.3
2	Central government	S.1311	-3.1	-1.2	0.7	0.1	-0.5
3	State government	S.1312	n.a.	n.a.	n.a.	n.a.	n.a.
4	Local government	S.1313	0.1	-0.1	-0.1	-0.1	-0.1
5	Social security funds	S.1314	-0.1	0.3	0.2	0.2	0.3
(A)	General government (S13)						
6	Total revenue	TR	45.2	46.3	46.1	46.6	47.0
7	Total expenditure	TE	48.3	47.3	45.3	46.4	47.3
8	Net lending/borrowing	EDP B.9	-3.2	-1.0	0.8	0.2	-0.3
9	Interest expenditure	EDP D.41	3.5	3.1	2.7	2.3	2.3
10	Primary balance		0.3	2.1	3.5	2.5	2.0
11	One-off and other temporary measures ¹		-	-	-	-0.7	-0.3
2	SELECTED COMPONENTS OF REVENUE						
1	Total taxes (12=12a+12b+12c)		25.2	25.8	25.9	26.5	26.3
1a	Taxes on production and imports	D.2	19.1	19.3	19.6	20.1	19.8
1b	Current taxes on income, wealth, etc.	D.5	6.1	6.5	6.3	6.4	6.5
1c	Capital taxes	D.91	-	-	-	-	0.0
2	Social contributions	D.61	12.0	11.9	11.9	12.0	11.9
2	Property income	D.4	1.3	1.2	1.2	1.2	1.2
4	Other		6.7	7.3	7.1	6.8	7.5
	5=6 Total revenue	TR	45.2	46.3	46.1	46.6	47.0
3	P.M.: TAX BURDEN (D.2+D.5+D.61+D.91-D.995)		37.2	37.7	37.8	38.6	38.2
4	SELECTED COMPONENTS OF EXPENDITURE						
1	Compensation of employees + intermediate consumption	D.1+P.2	19.6	19.7	19.5	19.8	20.2
1a	Compensation of employees	D.1	11.5	11.4	11.4	11.7	11.7
1b	Intermediate consumption	P.2	8.2	8.3	8.1	8.2	8.4
2	Social payments (18=18a+18b)		17.0	15.9	15.6	15.6	15.6
	of which Unemployment benefits		0.5	0.4	0.2	0.2	0.2
2a	Social transfers in kind supplied via market producers	D632	2.5	2.4	2.3	2.2	2.2
2b	Social transfers other than in kind	D.62	14.5	13.6	13.3	13.4	13.4
3=9	Interest expenditure	EDP D.41	3.5	3.1	2.7	2.3	2.3
4	Subsidies		1.4	1.5	1.4	1.5	1.7
5	Gross fixed capital formation	P.51	3.2	3.2	2.7	3.5	4.0
6	Capital transfers	D.9	1.3	1.70	1.3	1.8	1.5
7	Other		2.2	2.2	2.1	1.9	1.9.9
	8=7 Total expenditure	TE	48.3	47.3	45.3	46.4	47.3

¹ A plus sign means deficit-reducing one-off measures.

Source: CBS, Ministry of Finance

Central Government Budget

Financing needs and sources (EUR million)					
FINANCING NEEDS					
	2017	2018	2019	2020	2021
Total debt repayment (1)	7,465	4,680	7,121	7,103	6,677
Short term debt (Treasury Bills)	3,878	2,367	4,072	4,003	3,870
Long term debt repayment	3,587	2,313	3,049	3,100	2,807
Domestic bonds local currency denominated	1,282	810	-	675	810
Domestic bonds Foreign currency denominated or linked to FX	-	-	1,032	1,032	-
Domestic loans	986	640	487	358	755
External bonds Foreign currency denominated	1,150	749	1,417	929	1,138
External loans	169	115	113	106	104
Others (2)	1,666	562	485	184	131
Fiscal deficit (3)	309	26	565	185	17
Cash adjustment (accumulation of governmental deposits) (4)	515	782	341	290	383
Funding requirements (1) + (2) + (3) + (4)	9,955	6,050	8,512	7,762	7,174
FINANCING SOURCES					
	2017	2018	2019	2020	2021
Borrowing (1)	9,541	5,659	7,932	7,261	6,723
Short term debt (Treasury Bills)	3,877	2,594	3,870	3,870	3,870
Long term debt raising	5,663	3,064	4,062	3,391	2,854
Domestic bonds local currency denominated	2,335	1,417	1,761	1,774	1,113
Domestic bonds foreign currency denominated or linked to FX	-	-	-	-	-
Domestic loans	541	875	752	444	621
External bonds foreign currency denominated	2,555	746	1,415	927	1,103
External loans	232	26	134	245	16
Other (2)	79	157	27	25	26
Privatisation revenues (3)	16	16	135	135	135
Decrease of government deposits (4)	319	218	418	341	290
Financing (1) + (2) + (3)	9,955	6,050	8,512	7,762	7,174

Source: MoF (Public debt management strategy for the period 2019-2021)

Note: All forward looking figures represent the assessment as published in May 2019 and are subject to reassessment and adjustment from time to time. HRK converted to EUR at a rate 7.41.

Resulting fiscal trends in the Budgetary Central Government for the three months ended 31 March 2019

According to preliminary data and the National Chart of Accounts methodology, the total revenue of the Budgetary Central Government amounted to HRK 129.4 billion. Tax revenues, as the most significant revenue category, amounted to HRK 78 billion. Among tax revenues, revenue generated through VAT amounted to HRK 10.8 billion; corporate tax revenue amounted to HRK 1.9 billion. Revenue generated from excise duties was HRK 3.3 billion. Revenue from social contributions, which is the second highest revenue category, amounted to HRK 6 billion. Revenue from disposal of nonfinancial assets amounted to HRK 201 million.

The total expense of the Budgetary Central Government amounted to HRK 33.6 billion. The largest share of the total expense related to compensation to citizens and households and amounted to HRK 12.2 billion. Compensation of employees amounted to HRK 7.1 billion, grants to HRK 3.8 billion, financial expense to HRK 3.4 billion, material expense to HRK 2.9 billion, subsidies to HRK 2.1 billion and other expenses to HRK 1.7 billion. Expense for the acquisition of nonfinancial assets was realised in the amount of HRK 424 million.

The deficit of the Budgetary Central Government in first three months of 2019 stood at HRK 3.8 billion or 1 per cent of GDP, according to the National Chart of Accounts methodology.

Fiscal Responsibility Act

The Fiscal Responsibility Act (OG 139/2010), which came into force on 1 January 2011, introduced fiscal rules and rules for strengthening fiscal discipline and the obligation of making Statements on the fiscal responsibility for heads of budget users at the state and local (regional) level. The initial fiscal rule envisaged the reduction of expenditures of the general budget, expressed in the share in the gross domestic product by at least one per cent. per year, until achieving the primary balance at the level of zero or a positive amount (in nominal amounts). In terms of severe recession and negative output gap, the rule additionally threatened the prospects of growth because of its cyclic nature. The alignment with EU requirements regarding the new framework for the management of economic policy in the EU, which is focused on strengthening the implementation of the Stability and Growth Pact, was an additional reason to change this rule.

Consequently, drafting of amendments to the Fiscal Responsibility Act (OG 19/2014) was initiated in the second half of 2013 and the said amendments came into force in February 2014. The Amendments to the Act changed the fiscal rule in such a way that the target value of the new fiscal rule became a medium-term budgetary objective, which will be realised according to the adjustment plan.

On this occasion, a professional and independent body for monitoring the implementation of the fiscal rule was also introduced, whose duties were defined by the special regulation. The Fiscal Policy Board was founded in 2011 by the decision of the Government on the Establishment of the Fiscal Policy Board (the "**Board**") and the members of the Board were also appointed by the decision of the Government. Due to the need to strengthen the independence of the Board in accordance with the provisions of the Council Directive 2011/85/EU and to strengthen the role of the Board as a supervisor over the implementation of the Fiscal Responsibility Act, the Parliament adopted a decision to establish the Fiscal Policy Committee as the second working body of the Parliament. The Fiscal Policy Committee (the "**Committee**") of the Parliament replaced the previous Fiscal Policy Board. The members of the Committee, apart from the President of the Committee, were appointed for a period of five years by the Parliament at the end of February 2014.

The drafting of the new Fiscal Responsibility Act (the "**Fiscal Responsibility Act**") was initiated in the second half of 2014, on the basis of specific recommendation number 1 of the EU Council to the Republic and the need for further alignment with the requirements of the Stability and Growth Pact and the Council Directive 2011/85/EU. The reasons for the revision of the Fiscal Responsibility Act include the need to revise the fiscal rule and to further strengthen the independence and extend the authorities of the Fiscal Policy Committee. After a series of consultations carried out with the competent services of the European Commission and Fiscal Policy Committee, the new Fiscal Responsibility Act (OG 111/2018) was adopted by the Parliament in December 2018.

The Fiscal Responsibility Act came into force on January 1, 2019 with a view to ensuring medium-term and long-term sustainability of public finances and further enhancing fiscal responsibility and transparency. It seeks to fully align fiscal rules with the provisions of the Stability and Growth Pact, strengthens the independence of the Fiscal Policy Committee and additionally regulate the obligation of submitting the annual Fiscal Responsibility Statement.

Fiscal rules

The Fiscal Responsibility Act establishes three fiscal rules which refer to the structural balance rule, the expenditure rule and the public debt rule. According to the structural balance rule, the medium-term budgetary objective becomes a target value that will be realised according to the adjustment plan in line with the EU legal provisions. For the purpose of sustainable expenditure trend, the rule is that annual growth of general budget expenditures may not exceed the reference potential GDP growth rate established in accordance with the EU legal provisions, whereby the exemptions for certain categories of expenditures are permitted. The public debt rule stipulates that the share of public debt in GDP must not exceed the 60% reference value. If the share exceeds this value, the difference between public debt in GDP and the 60% reference value has to be reduced according to the dynamics that comply with the EU legal provisions. Temporarily delaying the application of fiscal rules will be permitted in case of exceptional circumstances and provided that this does not endanger fiscal sustainability in the medium-term.

The Act also defines the obligation to abide by the recommendations of the Council of the EU during the excessive budgetary deficit procedure. Procedures have also been prescribed in case the Government of the Republic of Croatia, at the proposal of the Ministry of Finance or the Fiscal Policy Committee, finds significant deviations from the fiscal rules defined by the Act.

Fiscal Policy Committee

The Act provides a legal solution in order to ensure adequate protection of political, financial and functional independence of the Committee and to ensure adequate conditions for the objective assessment of the Government macroeconomic and budgetary projections as well as fiscal-rule-compliance by the Committee. The new Act establishes the basis for the appointment of members of the Committee, thus strengthening the legal framework of the Committee's work and providing it with an even stronger role of a supervisor over the implementation of the Fiscal Responsibility Act and over the implementation of fiscal policy in the entire country, with the aim of improving the public finance system.

The Fiscal Policy Committee is defined as a permanent, independent and autonomous body that carries out tasks within its scope of work and competence, whose responsibilities are established by the Fiscal Responsibility Act.

The Committee consists of the President of the Committee and seven members who are elected for a term of five years. Members of the Committee are nominated by same institutions as before (the National Audit Office, the Central Bureau of Statistics, Zagreb Institute of Economics, Institute of Public Finance, the HNB, Economic and Law Faculties). The novelty provided in the procedure for appointing members of the Committee is that the institutions nominate their representatives to the Committee for Finance and State Budget of the Parliament, which checks their professional qualifications and other requirements stipulated by the Fiscal Responsibility Act and proposes their appointment to the Parliament.

In order to emphasise its independence, the President of the Committee, who organises and manages the work of the Committee professionally, is entitled to a salary at the level of the salary of the vice-president of the State Electoral Commission and general labour regulations will be applied accordingly.

In addition, in order to carry out its duties defined by this Act as professionally as possible, it is anticipated that there will be civil servants working in the Committee who perform professional, administrative and technical tasks. In this way, the Committee is provided with the necessary resources for the calculation of fiscal rules and consideration of the macroeconomic and budgetary projections of the Government, as well as carrying out other tasks stipulated by the Fiscal Responsibility Act. Funding for the work of the Committee is to be provided in the state budget of the Republic of Croatia.

All of the abovementioned measures are designed to strengthen the role of the Committee as a supervisor over the application of this Act, as well as over the fiscal policy of the entire state and for the purpose of improving the stability of public finances.

Budget Process

The State Treasury carries out, amongst other activities, budget preparation and consolidation, budget execution, state accounting and also manages the financial management of EU funds.

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, a new Budget Act entered into force, which incorporated 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 the 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.

In December 2012, the Act on the Amendments to the Budget Act was adopted. A primary reason for these changes was to facilitate EU programmes in light of Croatia's impending accession to the EU. For example, changes introduced by this Act include:

1. Increased flexibility being given concerning execution of the financial contributions of the Republic to the EU Budget based on the system of EU-own resources. These contributions can be executed above the planned level in the same manner as the priority given to repayments of the principal of and interest on state debt and state guarantees.
2. Budget users being allowed to make an advance payment without the consent of the Minister of Finance or the president of a local and regional executive body for liabilities assumed under contracts for projects co-financed by the EU funds.

In February 2015, the Act on the Amendments to the Budget Act was published in the Official Gazette no. 15/2015. Primary reasons for these changes were as follows:

- On 2 June 2014 the European Commission issued Country Specific Recommendations for Croatia based on the assessment of the Convergence Programme and National Reform Programme. The actions proposed by these recommendations should be taken in 2014 and 2015.
- One of the recommendations requires further improvements to be made to the budgetary planning process, to be achieved through the Act on the Amendments to the Budget Act.

The Act on the Amendments to the Budget Act introduced the following changes:

1. The budget process is being harmonised with EU requirements by including two key documents of the European Semester, the National Reform Programme and the Convergence Programme of the Republic of Croatia in the budget planning process.
2. Coverage of the general government sector defined by the Budget Act and the register of budget users and extrabudgetary users is harmonised in the part defining the extrabudgetary users with statistical coverage established by the European statistical methodology ESA 2010.
3. The strengthening of medium-term budget framework through:
 - strengthening the role of projections adopted together with the budget by the Parliament or the representative body of local or regional self-government unit.
 - changes to setting ceilings for budget users as the basis for preparation of the financial plans (ceilings are necessary for the implementation of existing programmes or activities and will be given separately from the ceilings which are necessary for the introduction and implementation of new or changed programmes or activities).
4. The strengthening of the budget transparency principle by prescribing mandatory publication of yearly financial statements for budgets, budget users and extrabudgetary users on their websites.
5. The improvement of projections and control of future spending through monitoring and approving the creation of multi-annual liabilities regardless of the source of financing (both state and local or regional self-government units) or budget users' own or earmarked revenues that are currently not paid into the budget (EU projects are excluded).
6. Improved control of the use of budget funds as a result of the provision requiring budget users, extrabudgetary users and local or regional self-government units to conduct inspections of purposeful and lawful use of the funds paid from the budget pursuant to special legislation and by improving provisions relating to budget supervision.
7. Greater flexibility in the execution of EU projects will be introduced by facilitating the reallocation of up to 15 per cent. for national participation in project financing (an increase from 5 per cent.).
8. Improved implementation of the objectives of public debt management as a result of the obligation to prepare public debt management strategy and to monitor its implementation.

Budget preparation consists of four steps:

1. The Strategic Plans for a three-year period are prepared by budgetary users in coordination with the ministry in charge of structural reforms and coordination of EU funds (by the end of March) and they are used as a basis for The National Reform Programme. The Ministry of Finance, on the other hand, prepares the Convergence Programme. The National Reform Programme and Convergence Programme are intended to be adopted by the Government (by the end of April).
2. 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).
3. Instructions for the Preparation of the State Budget Proposal are prepared and delivered to the budgetary and extrabudgetary 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 September).

4. 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 economic developments, the Government may propose amendments to the State Budget, which are subject to the same approval process as the original budget.

The Strategy for Improvement and Modernisation of the Processes within the State Treasury set 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 and public debt management and also 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.

Budget execution in Croatia is prescribed by means of the Budget Act and the Budget Execution Act that is adopted on a yearly basis, together with the State Budget. The Budget Execution Act regulates, among other things, the exemptions and special features arising from the adopted budget and facilitates the implementation and execution of the budget.

The budget execution process is supported by SAP Treasury system and Single Treasury Account. Key steps in budget execution process are: entry of reservation of funds, recording obligations in the general ledger of the State Budget and payments according to the request for payments.

In order to further improve the budget execution process, the Ministry of Finance is implementing a project aimed at developing an IT system 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.

The abovementioned integration of information systems has enabled data to be recorded in one place in the central State Treasury and to be accessible by all users. The key role of the IT system, as well as managing data, is to ensure that budget users enter only those procurement procedures for which there is coverage in the current budget, or approval by the Government to create a projection for the next two years. The new IT system can therefore also be used to manage liabilities.

More Efficient System of Financial and Statistical Planning and Reporting By Extra-Budgetary Users in the Transport Sector

According to the provisions of the Budget Act, extra-budgetary users, companies and other legal persons in which the state or a local and regional self-government unit has a decisive influence on management and which, according to the rules of the EU statistical methodology (ESA 2010), are classified into the general budget sector and are not budgetary users, are considered extra-budgetary users. Among the most important ones, by the size of the impact on the fiscal balance of the general budget or the public debt, are the following trade companies in the transport sector: Croatian Motorways ("HAC"); Rijeka-Zagreb Motorway ("ARZ"); Croatian Railways Infrastructure ("HŽI"); and Croatian Railways Passenger Transport ("HŽPP"). It is therefore intended that the procedures for planning and reporting on the implementation of the financial plans of the abovementioned users will be harmonised with the existing procedure applicable to extra-budgetary users. This includes the approval of the Croatian Parliament of financial plans and reports on the execution of financial plans of extra-budgetary users in the transport sector. In this context, their data will be expressed in accordance with the rules of budgetary accounting. Taking the foregoing into account, it is anticipated that the Croatian Parliament will for the first time

approve the financial plans of extra-budgetary users in the transport sector along with the adoption of the State Budget of the Republic of Croatia for 2020 and the projections for 2021 and 2022.

Ex-Post Evaluation of the Effects of Selected Programmes, Activities and Projects

For the purpose of continuous improvement of the system of budget planning and better control of the use of resources from public sources, an ex-post evaluation of the effects of selected programmes, activities or projects has been introduced. Emphasis is placed on controlling the effectiveness and foundation thereof. More specifically, this means that special attention is paid to the justification of the implementation thereof, cost-effectiveness (which includes cost-benefit analysis), optimisation and sustainability of results. In addition, the overall effects of the programmes, activities or projects observed, including their potential positive and negative aspects, i.e. risks and reasons that led to them, are also considered. When selecting programmes, activities and projects subject to ex-post evaluation, several parameters are taken into account, in particular their fiscal value, the long-term time frame needed to implement them and the high rating of potential risks. In 2019, the ex-post evaluation of the effects of selected activities in the healthcare, water management and environmental protection sectors will be carried out. The use of such tools will contribute to a more efficient use of public resources and cost rationalisation, will enable the identification of potential risks and will open up space for better implementation of a particular programme, activity and project.

Revision of the strategic planning process

The Act on Amendments to the Budget Act aligns the budget process of Croatia with the European Semester, since Croatia, as a Member State, is obliged annually to adopt two key documents - the Convergence Programme and the National Reform Programme. Consequently the process of national strategic planning was adapted to meet the pace of the National Reform Programme preparation. Strategic plans are prepared by the obliged entities on the basis of the Instructions on the Preparation of Strategic Plans. Instructions on the Preparation of Strategic Plans, (prepared by the Ministry of Finance in cooperation with the ministry in charge of structural reform and coordination of European Union funds) ("Instructions") are delivered to the ministries and other state bodies at the level of organisational classification no later than at the end of February 2017. These Instructions contain defined strategic plans, including reform measures with all the information needed for National Reform Programme. The ministries and other state bodies at the head level of organisational classification prepare their strategic plans for a three-year period and submit them to the Ministry of Finance no later than the end of March of that year. They do so on the basis of both the Instructions and sectoral strategic documents designated for the use of European Union funds. Strategic plans are also submitted to the ministry in charge of structural reform and European Union fund coordination. Relying on those strategic plans, the ministry in charge of structural reform and coordination of European Union funds, in cooperation with the ministries in charge of specific structural reforms, prepares the National Reform Programme. The Ministry of Finance prepares the Convergence Programme.

The Parliament of the Republic of Croatia in December 2017 adopted the Act on Strategic Planning System and Management Development of the Republic of Croatia (OG 123/2017). This Act regulates the system of strategic planning of the Republic of Croatia and the management of public policies, namely the preparation, implementation, reporting, monitoring of implementation and impact and the evaluation of the acts of strategic planning and public policy implementation which, in accordance with their competencies, are drafted and implemented by public bodies. According to this Act the strategic planning process will be in the competence of the state administration body competent for regional development and EU funds from 2020. These changes will be introduced by the new Budget Act.

The new Budget Act (in progress)

The new Budget Act currently under preparation is aimed at strengthening the institutional framework for public finance management and improving the efficiency of the use of budget funds both on the revenue side and on the expenditure side. Therefore, this Act is intended to strengthen budget planning and the content of key budget cycle documents and is intended to improve the control of expenditure execution as well as monitoring of the realisation and the use of earmarked and own revenues and receipts of budgetary users. The borrowing framework for local and regional self-government units as well as the provisions relating to fiscal statistics are intended to be improved in accordance with the provisions of Council Directive 2011/85/EU on requirements for budgetary framework of the Member States. It is envisaged that the Act will be adopted by the end of 2019.

In terms of improving the quality of key budget cycle documents, the content of the economic and fiscal policy guidelines are intended to also be further expanded in the area of macroeconomic and fiscal frameworks, which are also the strategic predecessor of the instructions for the preparation of the state budget proposal. The new Act will also prescribe the obligation of ministries to prepare more detailed guidelines for budgetary and extra-budgetary users within their competence, where they, inter alia, allocate the amount of expenditure for the implementation of programmes and activities, including the level of users. Based on the aforementioned amount of allocated expenditure, budgetary users will make financial plan drafts and submit them to the relevant ministry, which will then prepare an integrated financial plan draft. In addition, the new legal framework, along with the general and the specific part, makes the explanation an integral part of the budget, both at the state level and at the level of local and regional self-government units. The obligation to express expenditures by functional and organisational classification and sources of funding is prescribed by the explanation of the general part. By introducing mandatory performance indicators, the emphasis is placed on the results of the implementation of budget activities and projects, thus strengthening the responsibility of budgetary users with an aim of purposeful use of allocated funds.

The system of control over the creation of multi-annual liabilities has been improved in scope since 2003 when it was first introduced through the Budget Act. Currently, the approval of the Government of the Republic of Croatia, i.e. the Minister of Finance, is not required for liabilities related to government borrowing and to government debt management and for liabilities assumed pursuant to international agreements and projects funded by EU. However, as EU funds become an increasingly important source of funding, the national component of the co-financing of such projects increases as well. Therefore, the new Act will introduce better control over the creation of multi-annual contractual obligations under EU projects, in a way that will not slow down the contracting and implementation thereof.

Furthermore, some of the amendments to the Budget Act aim to harmonise monitoring and improve control of the use of own and earmarked revenues and receipts. Since 2015, own and earmarked revenues and receipts of all budgetary users of the state budget have been expressed in the state budget, whereby at the part of institutions they are not part of the cash flow of the State Treasury system. Based on the monthly reports of these institutions on the use of own and earmarked revenues and receipts, they are recorded in the State Treasury system. The plan is to carry out a detailed analysis with the aim of identifying areas for improving the way of recording the realisation and use of earmarked revenues and receipts and own revenues of these institutions, so that the data in the reports on the execution of the state budget are uniformly expressed. As the monitoring and control of these categories of revenue is an important element of fiscal responsibility, consideration will be given to the introduction of the obligation for ministries and local and regional self-government units to adopt acts which will formally regulate the realisation and use of earmarked revenues and receipts and own revenues of their users.

The new Budget Act is also aimed at improving the borrowing framework of local and regional self-government units. According to the existing Act, a local and regional self-government unit may engage in long-term borrowing (by obtaining loans and providing guarantees/consents) only for investment financed from its budget, which is confirmed by its representative body, with the prior approval of the Government of the Republic of Croatia, where its total liability may not exceed 20% of the revenue realised in the year preceding the year in which it borrows, minus the revenues from grants and donations and revenues realised on the basis of the additional share in personal income tax and equalisation grants for financing of decentralised functions. The fiscal limit control of the aforementioned 20% does not refer to the projects of local and regional self-government units that are co-financed by EU funds. In these cases, there is no need for the Croatian Government's approval of the borrowing, only the consent of the Minister of Finance. However, since the share of borrowing for co-financing of projects from EU funds is significantly increased in relation to the revenues of individual local and regional self-government units, it is necessary to consider introducing limitations in relation to the revenues of a unit, provided they do not slow down the contracting and the implementation of EU projects. Situations will also be prescribed where re-approval of the Government of the Republic of Croatia will be unnecessary if the credit or loan term and conditions change in a way that are more favourable, i.e. they reduce the burden of borrowing for local and regional self-government units.

Particular emphasis will be placed on provisions referring to state guarantees. The current legislative framework is based on annual acts on the execution of the state budget, i.e. on individual decisions on granting state guarantees, as well as on contracts that are concluded on the basis of such decisions of the Government of the Republic of Croatia, which determine the rights and obligations of all parties of this procedure. The new Act will also consolidate the provisions on state guarantees, which are now contained

in various regulations and acts, which will contribute to a clearer arrangement of this area and will improve the system of monitoring thereof.

For the purpose of improving fiscal statistics, a more efficient financial and statistical reporting system will be established, particularly of those extra-budgetary users entering the general government sector according to the ESA 2010 methodology. Furthermore, the new Budget Act will also prescribe the obligation to publish information on potential liabilities with significant impact on the budget, as well as the obligation of defining the contents, time period and scope and way of publishing information on the effects of tax expenditures on revenues. It is also anticipated that the method of monitoring and publishing fiscal data for the general budget will be prescribed according to ESA 2010 methodology.

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, real estate transfer tax and excise duties. In addition, there are also custom duties. Income taxes are assessed on individuals.

The Croatian tax system is fully in line with EU legislation.

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); and special taxes (on motor vehicles, coffee and non-alcoholic beverages; and on liability and comprehensive road vehicles insurance premiums) and excise duties levied on alcohol, alcoholic beverages, tobacco products, energy-generating products and electrical energy; 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 from betting games); slot machine games; and fees for organising occasional one-time games of chance.
- **County taxes:** inheritance and gifts tax; tax on road motor vehicles; tax on vessels; and tax on coin-operated machines for amusement.
- **City or municipal taxes:** surtax on income tax; consumption tax; tax on holiday homes; real estate transfer tax; 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.

There is also a levy on the organisers of prize games for the benefit of the Croatian Red Cross.

Income tax is regulated by the new Income Tax Act (OG 115/2016 and 106/18) that came into force on 1 January 2017, with the following exceptions: Articles 14(5) and 14(6) related to children and dependants, Article 26 related to the tax card, Article 33(1)(5) related to personal motor vehicles and other means of personal transportation of entrepreneurs and Article 83(4) related to the access to data via eTax system. These exceptions came into force on 1 January 2018.

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, capital gains and income of dividends and shares of profit on the basis of the share in capital 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. The following does not count as interest income from capital: default interest, charged interest on court rulings and decisions of local and district (regional) governments, interests on a positive balance at the giro account, current or foreign currency account, the interest earned on the basis of deposits and savings deposits, which are generated by banks, savings banks and other financial institutions and the interests earned on the basis of dedicated term deposits which are used for insurance claims of banks under conditions that the interests is less than the lowest rate of interest for term savings, or if they amount up to

0.5 per cent. annually (the lowest interest rate for term deposits does not apply to dedicated time deposits which are used for securing bank claims), revenues from interest earned by investing in bonds, regardless of the issuer and the type of bond, receipts based on the yield on life insurance with saving feature, paid compensation over the paid insurance premiums and the yield on the basis of voluntary pension insurance.

One significant change introduced by the entry into force of the Income Tax Act is the increase of the level of basic personal allowance from HRK 2,600 to HRK 3,800 for all taxpayers.

Income Tax on employment income (pensions and salary) for taxpayers with habitual residence in the assisted areas of Group I pursuant to special regulation on regional development of Croatia and in the City of Vukovar, has been reduced by 50 per cent. on a monthly basis. The same reduction is prescribed for pensioners and the pensions received (but they can use only one of the prescribed tax reductions on the basis of their habitual residence or pensioner status).

Advance payment of income tax from employment shall be paid at rates of 24 per cent. to the amount of the tax base 17,500.00 HRK and 36 per cent. of the monthly tax base over 17,500.00 HRK.

The income tax referred to in Article (1)(2) of the Income Tax Act 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 30,000	— Up to HRK 360,000.00	24 per cent.
— Over HRK 30,000	— Over HRK 360,000.00	36 per cent.

The Income Tax Act also introduced the method of determining income: yearly income through annual tax return and through a special procedure for determining annual income tax.

Changes for taxpayers are as follows:

- exemption from tax for certain taxpayers who perform activities in the area of the City of Vukovar under conditions prescribed in the Income Tax Act.
- reduction of 50 per cent. for taxpayers who perform activities in assisted areas of Group I pursuant to special regulation on regional development of Croatia, under conditions prescribed in the Income Tax Act.
- the ability to pay the respective tax in a lump sum, under the conditions prescribed in the Income Tax Act.
- increasing the threshold for determining income in a lump sum to the amount prescribed for the obligatory entry in the value added tax system.
- as of 1 January 2018, the circle of dependants has been narrowed.
- increasing the amount by which someone can be considered a dependant (child) up to HRK 15,000.
- excluding the financial aid that has been laid down by the law governing maternity, parental support and donation in determining the right to a personal exemption for dependants.
- as of 1 January 2018, a new way of delivering tax card to employers and application data changes on the tax card.
- extension of deadlines for the payment of income tax and reporting for certain categories of taxpayers.
- abolition of the exemption to the receipts generated within the Employee Stock Ownership Programme or on the basis of employee stock ownership.

The following changes were prescribed as of 1 January 2019:

- The scope of persons to be considered as dependants of immediate family, or dependent children, was expanded. When establishing the right to personal allowance for dependants, the following is to be excluded:
 - scholarships, excellence awards to pupils and students paid from budget and grants paid from budget, funds and programmes of the EU for the purpose of education and professional training irrespective of the amount;
 - insurance indemnities paid for serious injuries and recognised disability;
 - aid to a child for education up to the 15th year of age, i.e. until the completion of the primary education, which an employer pays to the child of a deceased worker or the child of a former worker.
- Local self-government units are to adopt a decision prescribing the amount of the flat-rate tax per bed, i.e. camp accommodation unit, from HRK 150.00 to HRK 1500.00. If it fails to adopt such a decision prescribing the amount of the flat-rate tax per bed, the amount of HRK 750,000 will be applied per bed.
- The interest rate which is considered a favourable interest rate when approving loans and which is considered as a receipt in kind is reduced from 3 per cent to 2 per cent.
- Income from insurance is repealed, i.e. paid and tax-deductible premiums of voluntary pension insurance and life insurance premiums are no longer considered as income from insurance.
- Awarding or optionally purchasing own shares which employers give to their workers or other related parties is taxed as income from capital at the rate of 24 per cent. and not as a receipt in kind based on salary.

The new Income Tax Act also stipulates that the Tax Administration may allow, through eTax system and based on the data from its official records, a data access regarding pertinence of recipients' municipality/city, to the payers of earnings from which other income, income from property rights and income from capital and insurance is determined (with application as of 1 January 2018).

In addition, the new Income Tax Act also stipulates that the resident taxpayer who pays the advance payments of income tax (i.e. final income tax) abroad on the basis of income realised from abroad or abroad during the tax period, can apply for exemption from payment of income tax advances or final income tax regardless of the existence of the agreement on avoidance of double taxation. The same applies to the income of residents seconded to work abroad by their domestic employers and the income earned by residents working as Members of the European Parliament.

Profit tax (Corporate Income Tax) is regulated by the Profit Tax Act (OG 177/2004, 90/2005, 57/2006, 146/2008, 80/2010, 146/2008, 22/2012, 148/2013, 143/2014, 50/2016, 115/2016 and 106/18) and is aligned with acquis communautaire.

Recent amendments to the Profit Tax Act were adopted by the Parliament on 2 December 2016 and have introduced certain changes as a part of the tax reform which has been carried out with the aim of reducing the overall tax burden and encouraging competitiveness. Thus, from 1 January 2017, the profit tax rate has been reduced from 20 per cent. to 18 per cent., while the rate for taxpayers who earn revenue up to HRK 3 million in a tax period, has been reduced to 12 per cent.

The following are subject to profit tax:

- a company and another legal and 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 natural 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;
- an entrepreneur, namely a natural person who derives income from craft or the activities equalised therewith, if:
 1. his/her total revenue in the preceding tax period exceeded HRK 3,000,000;
 2. or if he/she fulfils two of the following three conditions:
 - his/her total income in the preceding tax period exceeded HRK 400,000;
 - the value of his/her long term assets exceeds HRK 2,000,000;
 - he/she employed more than 15 employees on average during the preceding tax period;
 - generally, non-profit legal entities engaged in economic activity; and
- any other entrepreneur not subject to income tax and whose profit is not subject to taxation elsewhere.

In order to presume a certain level of revenue, there has been an abolition of tax relief on reinvested profit as well as changes to how the regional tax incentives are used.

Profit tax base is a profit that shall be determined according to the accounting regulations as the difference between revenues and expenditures before calculating the profit tax, increased and decreased according to the provisions of the Profit Tax Act. Taxpayers who in the preceding tax period did not generate revenues exceeding HRK 3,000,000, may use a newly introduced method of determining the tax base, i.e. they may determine the tax base pursuant to the cash principle (paid – unpaid), which could create potential difficulties. Exceptionally, certain taxpayers (e.g. non-profit legal entities engaged in economic activity) may determine the profit tax base as a lump sum, if their revenue on the basis of their economic activity in preceding tax period did not exceed the amount prescribed for entering into the value added tax system, pursuant to a special regulation on the VAT. This type of lump-sum taxation is not applicable to the aforementioned taxpayers who perform only the economic activity on the basis of which they are subject to the profit tax or if the achieved revenue on the basis of such activity makes 50 per cent. of their total revenue.

In addition, withholding tax is levied on profits generated by a non-resident in Croatia and is charged on interest, dividends, shares in profit and on copyright, as well as other intellectual property rights (reproduction rights, patents, licenses, copyrighted marks, designs or models, manufacturing procedure, production formulas, sketch, plan, industrial or scientific experience and other similar rights), market research services, tax, business counselling and auditing services paid to foreign entities (subject to certain exemptions). Withholding tax is payable at the rate of 15 per cent., except for the dividends and shares in profit, for which the rate of withholding tax is 12 per cent. In addition, a rate of withholding tax of 20 per cent., is payable on services rendered by service providers which have their registered seat (or the place of actual management or supervision) in countries which are considered to be a tax heaven or financial centres. The withholding tax at the rate of 20 per cent. also applies to other services that are not previously listed. However, this special rate does not apply to Member States and countries with which Croatia has concluded and, therefore, applies double taxation avoidance treaties, such countries being included in a list adopted by the Minister of Finance and published on the website of the Ministry of Finance and Tax Administration.

The said provision was amended by the Act on Amendments to the Profit Tax Act (OG, 106/18) and as of 1 January 2019 a new provision was applied which prescribes an efficient defensive measure according to which withholding tax is paid at the rate of 20% for all services and all remunerations that are subject to withholding tax (dividends, interests, royalties etc.) when paid to persons having their headquarters or place of effective management, or supervision of business, in the countries placed on the EU list of non-cooperative jurisdictions for tax purposes, with which the Republic of Croatia has no applicable double taxation treaties.

Furthermore, as of 1 January 2019, withholding tax shall be paid at a rate of 15% for remuneration for performances of foreign performers (artists, entertainers and athletes) when remuneration is paid under an agreement with a foreign person who is not a natural person which does not give rise to the obligation of assessment of income tax and contributions for the natural person who is the performer.

Having in mind the obligation to implement Council Directive (EU) 2016/1164 of 12 July 2016 which lays down rules against tax avoidance practices that directly affect the functioning of the internal market, a rule controlled foreign company rule (CFC) was prescribed as well as a new rule on interest costs.

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 lower than the one prescribed by domestic tax regulations.

In Croatia, VAT rates were 0 per cent., 10 per cent. and 23 per cent. prior to March 2012, with both goods and services are assessed at the same rate. As of 1 March 2012, a new general VAT rate of 25 per cent. entered into force. Given the regressive nature of this tax form, there was an intention to make some changes in the tax system in order to ease the effect of the changes for lower-income categories of population. In that respect, instead of 23 per cent., the VAT rate of 10 per cent. was applied to individual products and services, such as edible oils and fats of vegetable and animal origin, children's food and processed food for children and infants on the basis of cereals, supply of water, except bottled or otherwise packaged drinking water, white sugar from sugar cane and sugar beet. Starting on 1 January 2013, the VAT rate of 10 per cent. was also applicable on the services of preparing food and providing services of catering and preparing and serving non-alcoholic drinks and beverages, wine and beer in catering facilities. Furthermore, in order to achieve greater rationality of the VAT system, abolishment of input VAT deduction was stipulated for acquisition and renting of vessels for entertainment, airplanes, personal motor cars and other types of personal transport, including acquisition of all goods and services in relation to of the aforementioned goods. Furthermore, complete abolishment of input VAT deduction is stipulated for acquisition of goods and services for the purpose of representation. These provisions simplify the process of determining the tax obligation, decrease tax evasion and also ensure the inflow of funds in the State Budget. From 1 January 2013, amendments to the Value Added Tax Act (OG 136/2012) were in effect whereby VAT for products which have been taxed with 0 per cent. rate now amounts to 5 per cent. In addition, from 1 January 2013, the fiscalisation process has started, with an objective of reducing tax evasion in cash transactions. In order to bring Croatia into full compliance with the EU VAT legislation, a new Value Added Tax Act was adopted on 14 June 2013, promulgated on 17 June 2013 and published in OG 73/2013 on 18 June 2013. The majority of the provisions of this new Value Added Tax Act came into force upon Croatia's accession to the EU on 1 July 2013. As of 1 January 2014, the VAT rate of 10 per cent. increased to 13 per cent. The Value Added Tax Act was further amended at the end of 2014. A few provisions of this amendment came into force on 11 December 2014, however, the majority of the provisions thereof came into force on 1 January 2015. At the end of 2016, the Value Added Tax Act was amended within the tax reform. Provisions regarding redistribution between VAT rate of 25 per cent. and 13 per cent. came into force on 1 January 2017. The reduced VAT rate of 13 per cent. now applies to (i) accommodation provision (bed and breakfast, half board, full board) in hotels and facilities of similar use, including holiday accommodation, rental space in vacation camps or places designated for camping and accommodation in nautical tourism vessels, (ii) certain newspapers and magazines under conditions prescribed by the Value Added Tax, (iii) edible oils and fats of vegetable and animal origin, (iv) car seats for children and baby food and processed cereal-based food for infants and children, (v) water supply within the meaning of public water supply and drainage pursuant to the special regulation (with exception of water placed on the market in bottles or other packaging), (vi) concert tickets, (vii) electricity supply, (viii) public service of collecting communal waste, (ix) urns and coffins, (x) seedlings and seeds, (xi) fertilisers and pesticides and other agro chemical products and (xii) animal food (with exception of food for pets). The reduced VAT rate of 13 per cent. no longer applies to (i) services of preparing food and performing food services in restaurant facilities and on preparing and serving non-alcoholic beverages, wine and beer in these facilities and (ii) supply of white sugar which is placed on the market in crystalline form. Provisions on the right to deduct 50 per cent. of input tax for the acquisition or lease of personal cars and other personal means of transport whose value does not exceed HRK 400,000 including the acquisition of all goods and services in relation with goods, increase of threshold for entry into the VAT system up to HRK 300,000 as well as the application of accounting category of VAT on imports of machinery and equipment worth more than HRK 1,000,000 came into force on 1 January 2018. Provisions on taxation of vouchers in accordance with the Council Directive 2016/1065/EU, entered into force on 1 January 2019.

The Value Added Tax Act was further amended at the end of 2018. New provisions came into force on 1 January 2019, except the provision on the standard rate of 24 per cent., which shall come into force on 1 January 2020. The application of reduced VAT rates is expanded. The reduced VAT rate of 5 per cent. applies to: (i) books; (ii) newspaper of the newspaper publisher which has the status of a medium, published daily, in any form; and (iii) medicines which have the approval of the competent authority for medicines and medical products. The reduced VAT rate of 13 per cent. applies to: (i) newspapers and periodicals issued periodically, in any form; (ii) baby diapers; (iii) supply of live animals; (iv) supply of fresh or chilled meat and edible offal; (v) supply of fresh or chilled sausages or similar meat products, meat offal or blood products; (vi) supply of fresh fish; (vii) supply of fresh or chilled fish, molluscs or other aquatic invertebrates; (viii) supply of fresh or chilled crustaceans; (ix) supply of fresh or chilled vegetables, roots and tubers, including dried leguminous vegetables; (x) supply of fresh and dried fruits and nuts; (xi) supply of fresh poultry eggs in shell; and (xii) services and related copyright of writers, composers and performing artists under special regulations. Provisions on the right to deduct 50 per cent. of input tax for the acquisition or lease of personal cars, without limit regarding the value of those cars, including the acquisition of all goods and services related to those goods came into force on 1 January 2019. Services supplied for consideration shall not refer to the use of personal cars for private purposes for which was applied limited deduction of input tax. Reverse charge mechanism applies on supply provided by taxpayer not established in Croatia only if he is not registered for VAT purposes in Croatia. The amended Act provides for the application of reverse charge mechanism on supplies of concrete steel and iron and products of concrete steel and iron (reinforcement) provided in Croatia. The amended Act prescribes an obligation to enter into the VAT taxable person registry during the calendar year. The amended Act also prescribes an obligation to submit special records on received invoices. If doubts exist regarding the justification of the assignment of VAT identification number, the Tax Administration may request the taxable person who has been assigned a VAT identification number to submit a security instrument for VAT payments for the period of not more than 12 months. The Tax Administration or the Customs Administration may request the taxable person who is acquiring used means of transport from another Member State, prior to registration, to provide security to cover VAT liabilities arising from the acquisition of such used means of transport. The amended Act prescribes thresholds for determining the place of the supply in distance sale of goods.

At the end of 2012, excise taxes on tobacco products were increased in order to achieve the minimum level of excise duties required by the EU. Besides changes which entered into force in February 2013, as part of Croatia's obligation to ensure that the total excise tax on cigarettes is at least 57 per cent. of the weighted average retail selling price of cigarettes released for consumption and a minimum of €64 per 1,000 cigarettes irrespective of the weighted average retail selling price, further adjustments of excise duty on manufactured tobacco were implemented in June 2013. In March 2014 further adjustments of excise duty on manufactured tobacco were implemented as part of Croatia's obligation to ensure that the minimum excise tax on tobacco products (cigarettes) should be €77 per 1,000 cigarettes irrespective of the weighted average retail selling price. Furthermore, new adjustments and increases of excise on manufactured tobacco (cigarettes, fine cut tobacco and other smoking tobacco) were made in April 2015. In December 2016 further adjustments of excise duty on manufactured tobacco (cigarettes, fine cut tobacco and other smoking tobacco) were implemented as part of Croatia's obligation to ensure that until 31 December 2017 the overall excise duty on cigarettes should be at least 60 per cent. of the weighted average retail selling price of cigarettes released for consumption. That excise duty should not be less than EUR 90 per 1 000 cigarettes irrespective of the weighted average retail selling price. The amendments and the harmonisation with the EU requirements for the level of excise duties on tobacco products were implemented in December 2017. At the end of 2018, excise on tobacco products increased and now the minimum excise duty on cigarettes is 775 kuna per 1000 cigarettes. The specific excise tax is 335 kuna per 1000 cigarettes and the proportional excise tax is 34% of the retail price.

From 23 July 2013, the excise rates on energy products and electricity were increased in order to reach a minimum level of excise duties required by the EU. Also, in order to harmonise with EU legislation, from 1 July 2013 excise taxes on natural gas and electricity were introduced. The excise tax for fuel also increased from September 2013 and again from April 2014. The last increase was in April 2015, the excise duty on leaded petrol, unleaded petrol and gas oil for power increased by HRK 0.20/litre. At the end of 2018, a refund of part of the excise duty paid on diesel fuels for commercial transport of goods by trucks of at least 7.5 gross tonnage and for the commercial transport of passengers was introduced. The aim is to exclude the impact of excise on energy sources in the process of distribution and supply of goods and passenger transport and reduce the cost of carriers.

At the end of 2014 the Government defined new tax brackets for tax on earnings from games of chance (entered into force on 1 January 2015), with the assignment of higher tax rates to higher achieved earnings. The following was determined for betting games: (i) 10 per cent. tax rate on earnings up to HRK 10,000; (ii) 15 per cent. tax rate on earnings from HRK 10,000 to 30,000; (iii) 20 per cent. tax rate on earnings from HRK 30,000 to 500,000; and (iv) 30 per cent. tax rate on earnings over HRK 500,000.

The Act on amendments to the Excise Duties Law (OG 100/2015) implemented in the Croatian excise tax system a reduced rate for beer produced from independent small breweries, with yearly production limited to 125,000 hl. This entered force on 26 September 2015.

From 1 January 2017 the Croatian excise tax system implemented a reduced rate for ethyl alcohol produced from small distilleries, for commercial purposes, with production limited to 10 hl of pure alcohol per year. This provision was introduced in the Act on amendments to the Excise Duties Law (OG 115/2016). In addition, excise duties were introduced on raw tobacco, heated tobacco products, e-liquid and novel tobacco products. New Excise Duties Law (OG 106/2018) entered into force in November 2018.

Since the beginning of 2018, amendments to the special tax for motor vehicles have entered into force, changing the calculation of the special tax with the aim of furthering tax cuts for citizens and entrepreneurs and creating more favourable tax treatment for motor vehicles with new and environmentally acceptable technology. The CO₂ emissions rate of vehicles is given great emphasis as an assessment criterion of the special tax. In addition, new vehicles with a selling price of less than HRK 150,000, representing 65 per cent. of all new vehicles sold, have been exempted from the special tax; however, such motor vehicles still remain subject to the motor vehicles county tax pursuant to the provisions of the Local Taxes Act (OG 115/2016 and 101/2017).

PUBLIC DEBT

Overview

The total general Government debt (which includes both the internal and external debt of the central Government, extra budgetary funds and local government units) stood at HRK 284.7 billion as at 31 December 2018, corresponding to 74.6 per cent. of the GDP. The majority of general Government debt as at 31 December 2018 was internal debt, which amounted to HRK 180.3 billion or 63.3 per cent. (44.2 per cent. long-term debt securities, 14.9 per cent. loans and 4.2 per cent. T-bills), whereas external debt amounted to HRK 104.4 billion or 36.7 per cent. (20.2 per cent. long term securities and 16.4 per cent. loans) of total general Government debt. Total Government guarantees (including internal and external guarantees and guarantees in respect of HBOR) stood at HRK 6.3 billion as at 31 December 2018, corresponding to 1.7 per cent. of the GDP.

The table set forth below provides an overview of general Government debt and Government guarantees in absolute terms and as a percentage of GDP as at the end of the periods indicated:

	Twelve months ended 31 December				
	2014	2015	2016	2017	2018
General Government Debt (HRK billion).....	278.5	284.4	282.8	284.3	284.7
— as a percentage of GDP	84.0	83.7	80.5	77.8	74.6
Government Guarantees (HRK billion)	8.4	8.6	10.9	11.2	6.3
— as a percentage of GDP	2.5	2.5	3.1	3.1	1.7

Source: Ministry of Finance and HNB

General Government Debt and Debt Instruments

General Government Domestic Debt Stock of Croatia

The following table shows the general Government Domestic Debt Stock of Croatia for the periods indicated:

	Twelve months ended 31 December				
	2014	2015	2016	2017	2018
	<i>(HRK millions)</i>				
1. Domestic General Government Debt¹	160,179	166,066	173,290	172,898	180,279
1.1. Central Government	155,076	161,224	168,814	168,586	175,723
Securities other than shares, short-term	19,870	15,368	12,754	12,630	11,909
Securities other than shares, long-term	82,306	92,053	108,609	119,414	126,436
Loans	52,899	53,803	47,451	36,542	37,379
1.2. Central Government Funds	4	2	1	0	1
Securities other than shares, short-term	0	0	0	0	0
Securities other than shares, long-term	0	0	0	0	0
Loans	4	2	1	0	1
1.3. Local Governments Debt	5,298	5,110	4,809	4,747	5,080
Securities other than shares, short-term	0	0	0	0	0
Securities other than shares, long-term	75	59	13	0	0
Loans	5,223	5,050	4,796	4,747	5,080
2. External General Government Debt	118,315	118,307	109,476	111,418	104,415
2.1. Central Government	117,834	117,894	109,101	111,076	104,077
Securities other than shares, short-term	643	63	13	150	5
Securities other than shares, long-term	64,692	68,126	58,451	61,840	57,610
Loans	52,499	49,705	50,636	49,087	46,463
2.2. Central Government Funds	0	0	0	0	0
Securities other than shares, short-term	0	0	0	0	0
Securities other than shares, long-term	0	0	0	0	0
Loans	0	0	0	0	0
2.3. Local Governments Debt	481	414	375	342	337
Securities other than shares, short-term	0	0	0	0	0
Securities other than shares, long-term	130	65	31	0	0
Loans	351	348	344	342	337
3. Total (1+2)	278,493	284,373	282,766	284,316	284,694
Supplement: General Government Guarantees	8,406	8,613	10,866	11,214	6,330
Domestic	4,119	3,316	5,293	6,262	3,464
External	4,287	5,297	5,573	4,951	2,866

Note: Exchange rate as at the end of period

¹ Domestic General Government Debt=1.1+1.2+1.3-consolidation elements

Source: HNB

Central Government Debt and Debt Instruments

Central Government Domestic Debt Stock of Croatia

The following table shows the central Government Domestic Debt Stock of Croatia for the periods indicated:

Debt item	31 December				Maturity
	2015	2016	2017	2018	
	(HRK thousands)				
G Bonds - Series 07 D-19	7,635,047	7,557,787	7,513,648	7,417,575	2019
G Bonds - Series 12 D-17	5,500,000	5,500,000	0	0	2017
G Bonds - Series 13 D-20	5,000,000	5,000,000	5,000,000	5,000,000	2020
G Bonds - Series 14 D-20	7,635,047	7,557,787	7,513,648	7,417,575	2020
G Bonds - Series 15 D-17	4,000,000	4,000,000	0	0	2017
G Bonds - Series 16 D-16	3,500,000	0	0	0	2016
G Bonds - Series 17 D-22	7,635,047	7,557,787	7,513,648	7,417,575	2022
G Bonds - Series 18 D-18	6,000,000	6,000,000	6,000,000	0	2018
G Bonds - Series 19 D-24	10,689,066	10,580,902	10,519,107	10,384,605	2024
G Bonds - Series 20 D-25	6,000,000	6,000,000	6,000,000	6,000,000	2025
G Bonds - Series 21 D-26	6,000,000	10,000,000	10,000,000	10,000,000	2026
G Bonds - Series 22 D-21	0	6,000,000	6,000,000	6,000,000	2021
G Bonds - Series 23 D-22	0	0	3,000,000	3,000,000	2022
G Bonds - Series 24 D-28	0	0	5,500,000	5,500,000	2028
G Bonds - Series 25 D-32 I	0	0	3,000,000	3,000,000	2032
G Bonds - Series 26 D-23	0	0	5,800,000	11,300,000	2023
G Bonds - Series 27 D-29	0	0	0	5,000,000	2029
Long term loans (HRK)	4,274,639	5,709,488	4,960,090	6,095,561	
Long term loans (EUR)	21,636,110	15,452,039	13,149,252	13,668,125	
Long term loans (USD)	933,413	302,989	25,957	0	
Long term debt	96,438,369	97,218,779	101,495,349	107,201,015	
Treasury Bills	18,016,000	16,807,000	16,952,000	18,074,000	
Treasury Bills indexed to eur	841,993	790,545	467,349	968,735	
Treasury Bills FX	9,355,987	11,336,681	11,270,472	11,126,363	
Other short term debt	0	0	0	0	
Short term debt	28,213,980	28,934,225	28,689,821	30,169,098	
Total debt	124,652,349	126,153,004	130,185,170	137,370,113	

Source: Ministry of Finance

There are no limitations on the aggregate amount of internal debt, or on its component parts. 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.

T-bills are sold through publicly announced auctions and are issued under the Ministry of Finance's Treasury Bills Issuance Programme, created in July 1996. The average weighted treasury bill yields for the periods indicated are set forth below:

	Twelve months ended 31 December			
	2015	2016	2017	2018
	<i>(per cent.)</i>			
364 days HRK	1.50	0.97	0.45	0.09
364 days EUR.....	0.40	0.17	0.02	0.00

Source: Ministry of Finance

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 focused on education of operating personnel, installation and development of information technology systems for debt management and debt recordings and establishment of electronic auction facilities for internal debt, as well as development of central depository and agency functions.

As of 31 December 2018, the average maturity of Croatia's domestic medium and long-term central Government debt was 5.1 years.

Domestic bank syndicated loans amounting to HRK 3.8 billion and domestic bonds amounting to HRK 7.4 billion are scheduled to mature in 2019.

Redemption of domestic debt

The following table sets forth Croatia's domestic central Government debt stock which is, as of 31 December, scheduled to be redeemed between 2019 and 2030.

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
						(HRK thousands)						
Redemption of principle.....	11,192.5	16,107.5	12,058.3	12,568.8	14,830.0	10,888.8	6,094.8	10,094.8	75.7	5,541.6	5,062.7	37.6
Bonds – Series 07 D-19.....	7,417.58	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Bonds – Series 13 D-20.....	0.00	5,000.00	0.00	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	7,417.58	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Bonds – Series 17 D-22.....	0.00	0.00	0.00	7,417.58	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Bonds – Series 19 D-24.....	0.00	0.00	0.00	0.00	0.00	10,384.61	0.00	0.00	0.00	0.00	0.00	0.00
Bonds – Series 20 D-25.....	0.00	0.00	0.00	0.00	0.00	0.00	6,000.00	0.00	0.00	0.00	0.00	0.00
Bonds – Series 21 D-26.....	0.00	0.00	0.00	0.00	0.00	0.00	0.00	10,000.00	0.00	0.00	0.00	0.00
Bonds – Series 22 D-21.....	0.00	0.00	6,000.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Bonds – Series 23 D-22.....	0.00	0.00	0.00	3,000.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Bonds – Series 24 D-28.....	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	5,500.00	0.00	0.00
Bonds – Series 25 D-32 I.....	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Bonds – Series 26 D-23.....	0.00	0.00	0.00	0.00	11,300.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Bonds – Series 27 D-29.....	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	5,000.00	0.00
Long term Loans (HRK).....	944.89	1,647.96	2,491.46	513.96	263.96	423.96	43.96	43.96	25.48	3.50	0.00	0.00
Long term Loans (EUR).....	2,830.07	2,042.01	3,566.80	1,637.29	3,266.04	80.24	50.19	50.19	50.19	37.64	62.73	37.64
Interest payments.....	4,278.2	3,373.4	2,815.7	2,505.0	1,933.0	1,706.00	1,092.0	816.2	385.4	301.0	221.9	98.6
Bonds – Series 07 D-19.....	398.69	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Bonds – Series 13 D-20.....	337.50	168.75	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Bonds – Series 14 D-20.....	482.14	241.07	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Bonds – Series 17 D-22.....	482.14	482.14	482.14	482.14	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Bonds – Series 19 D-24.....	597.11	597.11	597.11	597.11	597.11	597.11	0.00	0.00	0.00	0.00	0.00	0.00
Bonds – Series 20 D-25.....	270.00	270.00	270.00	270.00	270.00	270.00	270.00	0.00	0.00	0.00	0.00	0.00
Bonds – Series 21 D-26.....	425.00	425.00	425.00	425.00	425.00	425.00	425.00	425.00	0.00	0.00	0.00	0.00
Bonds – Series 22 D-21.....	165.00	165.00	165.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Bonds – Series 23 D-22.....	67.50	67.50	67.50	33.75	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Bonds – Series 24 D-28.....	158.13	158.13	158.13	158.13	158.13	158.13	158.13	158.13	158.13	79.06	0.00	0.00
Bonds – Series 25 D-32 I.....	97.50	97.50	97.50	97.50	97.50	97.50	97.50	97.50	97.50	97.50	97.50	97.50
Bonds – Series 26 D-23.....	197.75	197.75	197.75	197.75	197.75	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Bonds – Series 27 D-29.....	118.75	118.75	118.75	118.75	118.75	118.75	118.75	118.75	118.75	118.75	118.75	0.00
Long term Loans (HRK).....	139.57	129.12	85.78	39.48	26.23	14.50	6.47	3.68	0.88	0.04	0.00	0.00
Long term Loans (EUR).....	341.37	255.61	151.06	85.34	42.55	25.04	16.18	13.17	10.16	5.67	5.64	1.12
Total debt service.....	15,470.7	19,481.0	14,874.0	15,073.0	16,763.0	12,594.8	7,186.2	10,910.4	461.1	5,842.2	5,284.6	136.3

Source: Ministry of Finance

Note: Exchange rate: Mid exchange rate of the HNB as of 31 December 2018

Overview of external central government debt stock and redemptions

		Amount in (EUR*)	2019. (EUR*)	2020. (EUR*)	2021 (EUR*)	2022. (EUR*)	2023. (EUR*)	2024. (EUR*)	2025. (EUR*)	2026. (EUR*)	2027. (EUR*)
USD 1.500.000.000	Principal	1.308.215.690	1.308.215.690								
6.75 % , Maturity: 2019.....	Interest		88.304.559								
USD 1.250.000.000	Principal	1.090.179.742	0	1.090.179.742							
6.625 % , Maturity: 2020.....	Interest		72.224.408	72.224.408							
USD 1.500.000.000	Principal	1.308.215.690	0	0	1.308.215.690						
6.375% Maturity: 2021.....	Interest		83.398.750	83.398.750	41.699.375						
EUR 1.250.000.000	Principal	1.250.000.000	0	0	0	1.250.000.000					
3.875% , Maturity: 2022.....	Interest		48.437.500	48.437.500	48.437.500	48.437.500					
USD 1.500.000.000	Principal	1.308.215.690	0	0	0	0	1.308.215.690				
5.500% Maturity: 2023.....	Interest		71.951.863	71.951.863	71.951.863	71.951.863	35.975.931				
USD 1.750.000.000	Principal	1.526.251.639	0	0	0	0	0	1.526.251.639			
6.000% Maturity: 2024.....	Interest		91.575.098	91.575.098	91.575.098	91.575.098	91.575.098	45.787.549			
EUR 1.500.000.000	Principal	1.500.000.000	0	0	0	0	0	0	1.500.000.000		
3.000% Maturity: 2025.....	Interest		45.000.000	45.000.000	45.000.000	45.000.000	45.000.000	45.000.000	45.000.000		
EUR 1.250.000.000	Principal	1.250.000.000	0	0	0	0	0	0	0	0	1.250.000.
3.000% , Maturity: 2027.....	Interest		38.250.000	38.250.000	38.250.000	38.250.000	38.250.000	38.250.000	38.250.000	38.250.000	38.250.
EUR 750.000.000	Principal	750.000.000	0	0	0	0	0	0	0	0	0
3.000% , Maturity: 2028.....	Interest		20.250.000	20.250.000	20.250.000	20.250.000	20.250.000	20.250.000	20.250.000	20.250.000	20.250.
EUR 1.275.000.000	Principal	1.275.000.000	0	0	0	0	0	0	0	0	0
2.750% , Maturity: 2030.....	Interest		40.927.500	35.062.500	35.062.500	35.062.500	35.062.500	35.062.500	35.062.500	35.062.500	35.062.
Principal Repayment (EUR*).....			1.308.215.690	1.090.179.742	1.308.215.690	1.250.000.000	1.308.215.690	1.526.251.639	1.500.000.000	0	1.250.000.
Interest Payment (EUR*)			600.319.679	506.150.119	392.226.336	350.526.961	266.113.530	184.350.049	138.562.500	93.562.500	93.562.
Total Servicing Costs (EUR*).....			1.908.535.369	1.596.329.862	1.700.442.027	1.600.526.961	1.574.329.220	1.710.601.688	1.638.562.500	93.562.500	1.343.562.
Total Principal Outstanding (at year end) (EUR*).....			11.257.862.762	10.167.683.020	8.859.467.329	7.609.467.329	6.301.251.639	4.775.000.000	3.275.000.000	3.275.000.000	2.025.000.

* Exchange rate: Mid exchange rate of the HNB as of 31 December 2018

External Debt

The following table sets out Croatia's external debt ratios at the end of the periods indicated:

	2014	2015	2016	2017	2018
Total outstanding external debt/GDP	106.8	101.7	89.3	82.1	75.4
General government external debt/GDP	35.3	35.7	31.8	29.5	26.5

Source: Croatian National Bank

The following table sets out the ratio of debt service to exports of goods and services at the end of the periods indicated:

	2014	2015	2016	2017	2018
Ratio of debt service to exports of goods & services	44.1	42.5	34.9	32.0	26.4

⁽¹⁾ External debt service includes principal payments on bonds, long-term trade credits and long-term loans (excluding liabilities to affiliated enterprises), as well as total interest payments (including FISIM), without interest payments on direct investment.

Source: Hrvatska narodna banka

As of 31 January 2019, the average remaining maturity of Croatia's external central Government debt (according to BPM6) was 6.3 years.

As of 31 December 2018, Croatia had hedging arrangements in place in respect of four of its five outstanding U.S. dollar denominated bond issues (U.S.\$ 1.25 billion issued in 2010, U.S.\$ 1.5 billion issued in 2011, U.S.\$ 1.5 billion issued in April 2013 and U.S.\$ 1.75 billion issued in November 2013). These hedging arrangements have been executed with international and domestic banks under ISDA documentation. ISDA documentation contains a set-off provision, which one party may exercise if certain default or early termination events occur in respect of the other party. If exercised against Croatia, the set-off provision allows a hedging bank to offset any amount that would otherwise be payable by it under the ISDA against the nominal amount of a debt obligation of Croatia, including the Notes, regardless of the market value of that obligation. Croatia is evaluating the option of entering into further hedging arrangements in respect of debt denominated in U.S. dollars.

In 2013, two U.S. dollar bonds were issued totaling U.S.\$3.25 billion. International bonds amounting to EUR 500 million maturing in 2014 were fully repaid at maturity in April 2014. In May 2014, bonds amounting to EUR 1.25 billion were issued and eurobonds amounting to EUR 750 million were fully repaid at maturity in January 2015. In March 2015, eurobonds amounting to EUR 1.5 billion were issued. In 2016, there were no issuances of bonds or eurobonds. In March 2017 bonds amounting to EUR 1.25 billion were issued and in April 2017 U.S. dollar bonds amounting to U.S.\$1.5 billion were repaid. In November 2017 bonds amounting to EUR 1.275 billion were issued. In June 2018 bonds amounting to EUR 750 million were issued.

Relations with the IMF

The Republic of Croatia's quota in the IMF amounts to a Special Drawing Right ("SDR") 717.40 million. Croatia's total net cumulative allocation (including general and special allocations made in 2009, which have not been used) amounts to SDR 347.34 million. Currently, Croatia does not have any financial arrangement with the IMF.

Total External Debt (Public and Private)

The following table sets out the total external debt of Croatia divided according to sector in EUR million:

	2014	2015	2016	2017	2018	Jan 2019
	<i>(EUR millions)</i>					
General government.....	15,351	15,911	14,834	14,465	13,655	13,697
Short-term.....	84	8	2	85	21	26
Currency and deposits.....	0	0	0	0	0	0
Debt securities.....	84	8	2	20	1	6
Loans.....	0	0	0	65	20	20
Trade credit and advances.....	0	0	0	0	0	0
Other debt liabilities.....	0	0	0	0	0	0
Long-term.....	15,267	15,902	14,832	14,380	13,635	13,671
Currency and deposits.....	0	0	0	0	0	0
Debt securities.....	9,089	10,106	8,992	8,728	8,423	8,372
Loans.....	6,178	5,796	5,841	5,652	5,211	5,299
Trade credit and advances.....	0	0	0	0	0	0
Other debt liabilities.....	0	0	0	0	0	0
Central bank.....	483	1,692	1,419	2,039	1,657	2,613
Short-term.....	122	1,307	1,030	1,676	1,288	2,241
Currency and deposits.....	84	51	80	76	45	42
Debt securities.....	0	0	0	0	0	0
Loans.....	0	1,238	950	1,600	1,243	2,199
Trade credit and advances.....	0	0	0	0	0	0
Other debt liabilities.....	38	18	0	0	0	0
Long-term.....	361	385	389	363	370	372
Special drawing rights (allocations).....	361	385	389	363	370	372
Currency and deposits.....	0	0	0	0	0	0
Debt securities.....	0	0	0	0	0	0
Loans.....	0	0	0	0	0	0
Trade credit and advances.....	0	0	0	0	0	0
Other debt liabilities.....	0	0	0	0	0	0
Deposit-taking corporations, except the central bank.....	8,160	6,125	4,555	3,769	4,073	4,224
Short-term.....	1,951	1,697	1,765	1,654	2,269	2,435
Currency and deposits.....	1,513	1,603	1,704	1,521	2,140	2,339
Debt securities.....	0	0	0	0	0	0
Loans.....	411	66	25	97	91	63
Trade credit and advances.....	0	0	0	0	0	0
Other debt liabilities.....	27	29	36	35	38	33
Long-term.....	6,209	4,428	2,789	2,116	1,804	1,789
Currency and deposits.....	3,646	2,846	1,780	1,286	924	917
Debt securities.....	3	2	14	10	20	22
Loans.....	2,559	1,579	993	817	858	849
Trade credit and advances.....	0	0	0	0	0	0
Other debt liabilities.....	2	2	2	2	2	2
Other sectors.....	16,102	16,229	15,118	13,436	13,324	13,070
Short-term.....	703	676	628	717	641	641
Currency and deposits.....	0	0	0	0	0	0
Debt securities.....	24	68	76	83	83	83
Loans.....	601	495	373	414	385	384
Trade credit and advances.....	78	113	179	221	173	174
Other debt liabilities.....	0	0	0	0	0	0
Long-term.....	15,399	15,553	14,490	12,719	12,683	12,429
Currency and deposits.....	0	0	0	0	0	0
Debt securities.....	1,538	1,640	1,488	1,011	996	1,003
Loans.....	13,718	13,731	12,644	11,350	11,488	11,247
Trade credit and advances.....	144	182	358	359	198	179
Other debt liabilities.....	0	0	0	0	0	0
Direct investment: intercompany lending	6,321	5,426	5,743	6,538	6,126	6,033
Debt liabilities of direct investment enterprises to direct investors.....	3,752	3,672	4,009	4,408	4,545	4,475
Debt liabilities of direct investors to direct investment enterprises.....	232	216	297	588	304	335
Debt liabilities to fellow enterprises.....	2,337	1,538	1,436	1,542	1,277	1,223
Gross external debt position.....	46,416	45,384	41,668	40,247	38,836	39,636

Source: Croatian National Bank

⁽¹⁾ Exchange rate as at 31 December in the relevant year.

Gross External Debt (Public and Private) Service and Maturity Calendar

The following table sets forth the projected principal payments for all external debt outstanding as at 31 January 2019:

	Gross External												
	Debt as at												
	31 Jan	Immediate/											
	2019	Arrears	2019*	2020	2021	2022	2023	2024	2025	2026	2027	2028	Other
	(EUR millions)												
Public sector.....	17,254	0	4,511	1,493	1,666	1,609	1,173	1,302	1,212	434	1,159	826	1,868
Other investment.....	17,251	0	4,510	1,492	1,666	1,609	1,173	1,302	1,212	434	1,159	826	1,868
Short-term.....	2,295	0	2,294	1	0	0	0	0	0	0	0	0	0
Long-term.....	14,957	0	2,216	1,491	1,666	1,609	1,173	1,302	1,212	434	1,159	826	1,868
Direct investment.....	2	0	1	2	0	0	0	0	0	0	0	0	0
Short-term.....	0	0	0	0	0	0	0	0	0	0	0	0	0
Long-term.....	2	0	1	2	0	0	0	0	0	0	0	0	0
Publicly guaranteed private sector.....	162	8	105	-42	0	0	0	0	0	0	0	0	91
Other investment.....	162	8	105	-42	0	0	0	0	0	0	0	0	91
Short-term.....	0	0	0	0	0	0	0	0	0	0	0	0	0
Long-term.....	162	8	105	-42	0	0	0	0	0	0	0	0	91
Direct investment.....	0	0	0	0	0	0	0	0	0	0	0	0	0
Non-publicly guaranteed private sector.....	22,221	4,011	8,658	2,334	2,464	1,158	837	505	361	432	621	277	562
Other investment.....	16,190	3,669	6,087	1,724	1,653	812	622	305	268	361	241	183	264
Short-term.....	3,049	269	2,763	16	0	0	0	0	0	0	0	0	0
Long-term.....	13,142	3,400	3,324	1,708	1,653	812	622	305	268	361	241	183	264
Direct investment.....	6,030	342	2,571	610	811	345	215	200	93	71	380	94	298
Short-term.....	581	26	550	4	0	0	0	0	0	0	0	0	0
Long-term.....	5,450	316	2,021	606	811	345	215	200	93	71	380	94	298
Total.....	39,636	4,019	13,274	3,786	4,130	2,767	2,010	1,807	1,573	866	1,780	1,103	2,522

* Repayments made until January 2019 and projected repayments for the following months.

Exchange rate as at 31 January 2019

Source: HNB

Gross External Debt (Public and Private) by Domestic Sectors and Projected Interest Payments

The following table sets forth the projected interest service payments for all external debt outstanding as at 31 January 2019:

	Gross External												
	Debt as at												
	31 Jan	Immediate/											
	2019	Arrears	2019*	2020	2021	2022	2023	2024	2025	2026	2027	2028	Other
	(EUR millions)												
Public sector.....	17,254	0	307	433	331	288	193	158	125	87	94	57	109
Other investment	17,251	0	307	433	331	288	193	158	125	87	94	57	109
Short-term	2,295	0	0	0	0	0	0	0	0	0	0	0	0
Long-term	14,957	0	307	433	331	288	193	158	125	87	94	57	109
Direct investment	2	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
Long-term	2	0	0	0	0	0	0	0	0	0	0	0	0
Publicly guaranteed private sector.....	162	8	0	0	0	0	0	0	0	0	0	0	0
Other investment	162	8	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
Long-term	162	8	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
Non-publicly guaranteed private sector	22,221	4,011	228	181	168	108	92	80	54	61	29	43	230
Other investment	16,190	3,669	178	130	81	57	57	35	30	38	15	26	80
Short-term	3,049	269	1	0	0	0	0	0	0	0	0	0	0
Long-term	13,142	3,400	177	130	81	57	57	35	30	38	15	26	80
Direct investment	6,030	342	50	51	87	50	35	45	24	23	14	17	150
Short-term	581	26	2	0	0	0	0	0	0	0	0	0	0
Long-term	5,450	316	49	51	87	50	35	45	24	23	14	17	150
Total	39,636	4,019	535	614	499	396	285	238	179	148	123	101	339

* Repayments made until end-January 2018 and projected repayments for the following months.

Source: Croatian National Bank

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 person 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 Income Tax Act (OG 115/2016 and 106/2018) payment of the interest on the Notes to foreign natural persons is not subject to personal income tax. Pursuant to the Profit Tax Act (OG 177/2004, 90/2005, 57/2006, 146/2008, 80/2010, 22/2012, 148/2013, 143/2014, 50/2016, 115/2016 and 106/2018) 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 being a legal person (which is not resident or incorporated in Croatia) in respect of any Notes. No Croatian tax will be payable in respect of any gain, whether realised or unrealised, made by a holder being a natural person (which is not resident in Croatia) in respect of any Notes, provided such Notes are not deposited with a Croatian depositary. 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.

The proposed financial transactions tax ("FTT")

On 14 February 2013, the European Commission published a proposal (the "**Commission's proposal**") for a Directive for a common FTT in Belgium, Germany, Estonia, Greece, Spain, France, Italy, Austria, Portugal, Slovenia and Slovakia (the "**participating Member States**"). However, Estonia has since stated that it will not participate.

The Commission's proposal has very broad scope and could, if introduced, apply to certain dealings in the Notes (including secondary market transactions) in certain circumstances. The issuance and subscription of Notes should, however, be exempt.

Under the Commission's proposal, FTT could apply in certain circumstances to persons both within and outside of the participating Member States. Generally, it would apply to certain dealings in the Notes where at least one party is a financial institution, and at least one party is established in a participating Member State. A financial institution may be, or be deemed to be, "established" in a participating Member State in a broad range of circumstances, including (a) by transacting with a person established in a participating Member State or (b) where the financial instrument which is subject to the dealings is issued in a participating Member State.

However, the FTT proposal remains subject to negotiation between participating Member States. It may therefore be altered prior to any implementation, the timing of which, remains unclear. Additional EU Member States may decide to participate.

Prospective holders of the Notes are advised to seek their own professional advice in relation to the FTT.

SUBSCRIPTION AND SALE

Citigroup Global Markets Limited, Erste Group Bank AG and J.P. Morgan Securities plc, (together, the "**Joint Lead Managers**") have, in a subscription agreement (the "**Subscription Agreement**") dated 17 June 2019, jointly and severally agreed to subscribe and pay for, or to procure subscriptions and payment for, the Notes at their issue price of 98.148 per cent. of their principal amount less a combined management and underwriting commission. In addition, the Issuer has agreed to reimburse the Joint Lead Managers for certain of their expenses in connection with the management of the issue of the Notes. The Joint Lead Managers are entitled in certain circumstances to be released and discharged from their obligations under the Subscription Agreement prior to the issue of the Notes. The Issuer has agreed to indemnify the Joint Lead Managers against certain liabilities in connection with the issue of the Notes.

United States

The Notes have not been and will not be registered under the Securities Act and may not be offered or sold in the United States except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act. There will be no public offering of the securities in the United States. Each Joint Lead Manager has agreed that it will not offer, sell or deliver any Notes within the United States, except as permitted by the Subscription Agreement.

In addition, until 40 days after the commencement of the offering of the Notes, an offer or sale of Notes within the United States by any dealer, whether or not it is participating in the offering of the Notes, may violate the registration requirements of the Securities Act.

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 Financial Services and Markets Act 2000 (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.

Republic of 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, to the best of the relevant Joint Lead Manager's knowledge and belief, authorised or licensed under Croatian law to acquire, hold, manage or dispose of the Notes on the date of their offer.

Professional investors (as defined pursuant to Article 101 of the Capital Market Act) that are generally authorised to acquire, hold, manage or dispose of the Notes, include, but are not limited to, credit institutions, investment companies, insurance companies, pension funds and investment funds, subject to limitations set out under applicable regulations.

Any Joint Lead Manager not having arranged for a "passport" notification to the HNB in accordance with Article 87 of the Credit Institutions Act is authorised to sell the Notes to respective residents of the Republic of Croatia or legal entities incorporated in the Republic of Croatia, provided such sale is not made directly in the territory of the Republic of Croatia, but either at a distance (e.g. by post, fax, or electronic mail) on a reverse inquiry basis or outside of the territory of the Republic of Croatia.

Any Joint Lead Manager having arranged for the relevant "passport" notification to the HNB, as referred to in the previous paragraph, is authorised to directly render respective mutually recognised financial services in the territory of the Republic of Croatia on a temporary basis (i.e. such services should not be rendered on a regular, frequent or on an on-going basis).

Republic of Italy

The offering of the Notes has not been registered with Commissione Nazionale per le Società e la Borsa ("**CONSOB**") pursuant to Italian securities legislation and, accordingly, no Notes may be offered, sold or delivered, nor may copies of the Offering Circular or of any other document relating to the Notes be distributed in the Republic of Italy, except:

- (i) to qualified investors (*investitori qualificati*), as defined pursuant to Article 100 of Legislative Decree No. 58 of 24 February 1998, as amended (the "**Financial Services Act**") and Article 34 ter, first paragraph, letter (b) of CONSOB Regulation No. 11971 of 14 May 1999, as amended from time to time ("**Regulation No. 11971**"); or
- (ii) in other circumstances which are exempted from the rules on public offerings pursuant to Article 100, first paragraph, letter (d) of the Financial Services Act and Article 34 ter of Regulation No. 11971.

Any offer, sale or delivery of the Notes or distribution of copies of the Offering Circular or any other document relating to the Notes in the Republic of Italy under (i) or (ii) above must be:

- (a) made by an investment firm, bank or financial intermediary permitted to conduct such activities in the Republic of Italy in accordance with the Financial Services Act, CONSOB Regulation No. 20307 of 15 February 2018 (as amended from time to time) and Legislative Decree No. 385 of 1 September 1993, as amended (the "**Banking Act**"); and
- (b) in compliance with any other applicable laws and regulations or requirement imposed by CONSOB, the Bank of Italy (including the reporting requirements, where applicable, pursuant to Article 129 of the Banking Act and the implementing guidelines of the Bank of Italy, as amended from time to time) and/or any other Italian authority.

General

No action has been or will be taken by the Joint Lead Managers or the Republic of Croatia that would, or is intended to, permit a public offering of the Notes or possession or distribution of this Offering Circular or any other offering or publicity material relating to the Notes in any country or jurisdiction where any such action for that purpose is required. Each Joint Lead Manager has undertaken to the Republic of Croatia that it will not, directly or indirectly, offer or sell any Notes or have in its possession, 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. The Republic and the Joint Lead Managers have agreed that each Joint Lead Manager will obtain any consent, approval or permission which is, to the best of the relevant Joint Lead Manager's knowledge and belief, required for the offer, purchase or sale by it of Notes under the laws and regulations in force in any jurisdiction to which such Joint Lead Manager is subject or in which it makes such offers, purchases or sales and it will, to the best of its knowledge and belief, comply with all such laws and regulations. No Joint Lead Manager is authorised to make any representation or use any information in connection with the issue, subscription and sale of the Notes other than as contained in this Offering Circular or any amendment or supplement to it.

GENERAL INFORMATION

Listing and Admission to Trading

Application has 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 2014/65/EU).

The total expenses related to the admission to trading of the Notes are approximately €4,900.

Documents

Copies (and certified English translations where the documents in question are not in English) of the following documents may be inspected during usual business hours on any weekday (Saturdays, Sundays and public holidays excepted) at the offices of the Paying Agent in Luxembourg during the period of 12 months following the date of this Offering Circular:

- (a) the Agency Agreement which includes the form of the Certificates;
- (b) the Deed of Covenant;
- (c) the resolution of the Minister of Finance dated 14 June 2019 authorising the issue of the Notes; and
- (d) the budget of the Issuer for the current fiscal year.

In addition, copies of this Offering Circular are available on the Luxembourg Stock Exchange's website at www.bourse.lu.

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 Minister of Finance dated 14th June 2019 (Class: 450/08/19-01/1, Reg. No. 513-10-19-1), passed in accordance with the Law on Execution of the State Budget of the Republic of Croatia for the year 2019 (OG 113/2018) and the Budget Act (OG 87/2008, 136/2012 and 15/2015).

Litigation

The Issuer 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 Issuer 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 Issuer.

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 Issuer since 31 December 2018.

Clearing Systems

The Notes have been accepted for clearance through Euroclear and Clearstream, Luxembourg. The relevant identification numbers are set forth below:

Common code: 184343487

ISIN: XS1843434876

CFI: DBFNFR

FISN: REPUBLIC OF CRO/1.125EUR NT 2029061

The address of Euroclear is Euroclear Bank SA/NV, 1 Boulevard du Roi Albert II, B-1210 Brussels and the address of Clearstream, Luxembourg is Clearstream Banking, 42 Avenue JF Kennedy, L 1855 Luxembourg.

Legal Entity Identifier

The Legal Entity Identifier ("LEI") number of the Ministry of Finance of the Republic is 74780000O00QGQ7CER13.

Yield

On the basis of the issue price of the Notes of 98.148 per cent. of their principal amount, the yield on the Notes is 1.324 per cent. on an annual basis.

Third Party Information

The Issuer confirms that where information included in this Offering Circular 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.

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. In addition, in the ordinary course of their business activities, the Joint Lead Managers and their affiliates may make or hold a broad array of investments and actively trade debt and equity securities (or related derivative securities) and financial instruments (including bank loans) for their own account and for the accounts of their customers. Such investments and securities activities may involve securities and/or instruments of the Republic or the Republic's affiliates. Certain of the Joint Lead Managers or their affiliates that have a lending relationship with the Republic routinely hedge their credit exposure to the Republic consistent with their customary risk management policies. Typically, such Joint Lead Managers and their affiliates would hedge such exposure by entering into transactions which consist of either the purchase of credit default swaps or the creation of short positions in securities, including potentially the Notes offered hereby. Any such short positions could adversely affect future trading prices of Notes offered hereby. The Joint Lead Managers and their affiliates may also make investment recommendations and/or publish or express independent research views in respect of such securities or financial instruments and may hold, or recommend to clients that they acquire, long and/or short positions in such securities and instruments. For the purpose of this paragraph the term "**affiliates**" includes also parent companies and parent companies' affiliates.

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