REPUBLIC OF CROATIA

€2,000,000,000 1.500 per cent. Notes due 2031

Issue price: 98.572 per cent.

The issue price of the €2,000,000,000 1.500 per cent. Fixed Rate Notes due 2031 (the "**Notes**") issued by the Republic of Croatia (the "**Issuer**", the "**Republic**" or "**Croatia**"), will be 98.572 per cent. of their principal amount. The Notes will mature on 17 June 2031 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 1.500 per cent. per annum from and including 17 June 2020 and will be payable in Euro annually in arrear on 17 June in each year, commencing on 17 June 2021. 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 Regulation (EU) 2017/1129 (the "**Prospectus Regulation**") nor a light prospectus pursuant to Part III of the Luxembourg Act dated 16 July 2019 on prospectuses for securities (the "**Luxembourg Act**"). Accordingly, this Offering Circular does not purport to meet the format and the disclosure requirements of the Prospectus Regulation and Commission Delegated Regulation (EU) No. 2019/980, and it has not been, and will not be, submitted for approval to any competent authority within the meaning of the Prospectus Regulation and in particular the *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- (stable 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 ("**EU**") and the United Kingdom ("**UK**") respectively and registered under Regulation (EU) No 1060/2009 (as amended) (the "**CRA Regulation**"). Moody's is not established in the European Economic Area ("**EEA**") or in the UK but the rating it has given to the Notes is endorsed by Moody's Investors Service, Ltd, which is established in the UK 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 (including UK) 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 or the UK 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 and non-UK credit rating agencies, unless the relevant credit ratings are endorsed by an EU-registered or UK-registered credit rating agency or the relevant non-EU and non-UK 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). If the status of the rating agency rating the Notes changes, European (including UK) regulated investors may no longer be able to use the rating for regulatory purposes and the Notes may have a different regulatory treatment. This may result in European (including UK) regulated investors selling the Notes which may impact the value of the Notes and any secondary market. 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 17 June 2020 (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

BANCA IMI/ PRIVREDNA BANKA ZAGREB | **BARCLAYS** | **DEUTSCHE BANK**

J.P. MORGAN

15 June 2020

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.

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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**"). The procedure is expected to be finalised during the second half of 2020. 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**"). On 4 July 2019, the Republic of Croatia sent a letter of intent to the euro area member states, Denmark and EU institutions expressing its intent to enter the ERM II. This marked the first formal step towards the Republic of Croatia's joining the ERM II, which precedes the introduction of the euro as a country's official currency. The letter of intent was accompanied by an Action Plan detailing the reforms that the Republic of Croatia will implement before entering the ERM II (the "**Action Plan**"). The Republic of Croatia successfully passed and implemented the agreed measures from the Action Plan and will formally inform the institutions and the ERM II parties by submitting its final report on implementation in June 2020. 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 in to 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, including the impact of the Coronavirus pandemic, see "— *Croatia's economy remains vulnerable to both internal and external economic shocks as a result of the global Coronavirus pandemic*", 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 recovers in the future following the Coronavirus pandemic, 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 both internal and external economic shocks as a result of the global Coronavirus pandemic

Since the beginning of 2020, the ongoing Coronavirus outbreak, also known as COVID-19, has escalated into a global pandemic resulting in the implementation of stringent travel and transport restrictions, quarantines and extended shutdowns of certain businesses globally, including in Croatia, in an attempt to contain the continued spread of the virus. On 11 March 2020, the Government declared an extraordinary epidemic "state of emergency" due to the Coronavirus outbreak (the "**State of Emergency**"). On 19 March 2020, the Government made a decision to implement strict measures in an attempt to stay ahead of the spread of the Coronavirus including: instituting restrictions on social gatherings and work in trade and service activities, including food and beverage service activities, temporarily halting border crossing for the Republic of Croatia; cancelling all sporting, cultural and other large public events; and the closing all educational institutions, sport facilities recreational areas and children's activity centres. The duration of these health measures is dependent upon the effectiveness and efficiency of coping with the current situation both domestically and internationally.

The Coronavirus pandemic is assumed to reach its first peak in the second quarter of 2020 with the economic activity to start a gradual recovery thereafter. Therefore, the country's real gross domestic product ("**GDP**") is expected to decline by 9.4 per cent. in 2020, a decline of 11.9 percentage points from the pre-crisis GDP estimate. Domestic demand is expected to decline by 5.2 per cent. during 2020, as social distancing and increased unemployment will lead to a drop in private consumption, while the increased uncertainty will result in lower private investment. The external sector contribution to GDP will be negative as lower external demand, global supply chain disruptions and restricted international travel is expected to lead to a decline in the export of goods and services by approximately 29 per cent. in 2020. It is expected that the accommodation and food service activities, the arts, entertainment and recreation and the transport sector will be the economic sectors most directly impacted by the state of emergency measures as a result of a decrease in demand.

As noted above, although the Coronavirus pandemic is assumed to reach its first peak in the second quarter of 2020, with economic activity expected to commence a gradual recovery thereafter, the restrictive travel and quarantine measures currently in place globally may continue to have an adverse effect on Croatia's tourism sector beyond the expiration of said measures. While the Government has implemented numerous measures to address the impact of the Coronavirus pandemic on the country's tourism industry, there is no guarantee that the Government's measures will be effective or that tourists will return in similar numbers compared to before the pandemic. For more information, see "*The Economy – Coronavirus – Measures to assist the economy due to the Coronavirus pandemic*". The reduction in tourism has had a materially negative effect on the financial condition of Croatia, and a sustained gap in tourism may increase this effect or delay Croatia's recovery. Moreover, no assurance can be made as to the negative impacts of a second wave, whether in Croatia or globally and the ongoing impact remains highly uncertain.

In addition, the Coronavirus pandemic is expected to impact the labour market, especially in the second and third quarters of 2020. The number of employed is estimated to decrease in 2020, and the unemployment rate to reach 9.5 per cent. as compared to 6.6 per cent. in 2019. Employers are expected to adjust to the lower economic activity through reduction of workers or a reduction in hours for workers. These outcomes could result in lower revenues from social security contributions and higher expenditure on social security benefits. Even with the Government's preventative measures to mitigate the potential economic impact of the Coronavirus pandemic, the Coronavirus pandemic could have an adverse effect on the funds available to social security and healthcare services in Croatia in the future.

On 17 March 2020 and 2 April 2020, the Government adopted two comprehensive and targeted packages of economic measures to mitigate the Coronavirus pandemic's negative impact on economic activity. The goal of these measures was to help the private sector, as the bearer of economic activity, to overcome the crisis through job preservation and payment of salaries and to solve the liquidity problems of those business activities, which have been reduced by the Coronavirus pandemic. For more information on these measures and policies see "*The Economy – Coronavirus – Measures to assist the economy due to the Coronavirus pandemic*". The combined impact of the slowdown in economic activity and the cost of such measures has had a material negative impact on the Government's budget. As a result of the Coronavirus pandemic, Government expenditures increased significantly while budget revenues decreased, resulting in the Government's need to amend the initial 2020 State Budget in May 2020. For more information see, "*The Economy – Functioning of the public finance system and the sustainability of public services financing*". As a result, Croatia's deficit is expected to increase in 2020, requiring both reductions in other spending and external financing. Moreover, the debt/GDP ratio is expected to rise to 86.7 per cent. in 2020. In addition, the Croatian National Bank ("**CNB**") implemented, within its mandate, numerous measures aimed at both preserving the stability of the banking system and strengthening its flexibility to reduce the adverse effects on households and companies from the restrictions caused by the pandemic. No assurance may be given that the Government's deficit and public debt will not increase more than expected, on the availability of external financing and the terms of such financing or that the Government's measures will be sufficient to limit the negative economic effects of the Coronavirus pandemic and, after its end, to put Croatia's economy on a path to recovery, which in turn may have a negative effect on the financial condition of the Issuer.

Accordingly, Croatia's economy and its capacity to repay principal and/or interest on the Notes may be adversely affected as a result of issues arising from the ongoing Coronavirus pandemic, including the impact on Croatia's public finances or linked to an economic slowdown in the Eurozone or owing to a prolonged recession or depression in the global economy.

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 (OG 32/2017) 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 CNB 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 April 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, 2018, and 2019. 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 CNB has intervened in the foreign currency as part of its policy of pursuing a stable euro/kuna exchange rate, including in the first half of 2020 as a result of depreciation during volatile market conditions resulting from the Coronavirus pandemic. 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 CNB's ability to implement its monetary policies

In recent years, the role of the euro in the Croatian economy and circulation of the euro in Croatia substantially increased as a result of sizeable euro capital inflows from abroad, including from persons working abroad who send money to their families in Croatia; the tourism industry, in particular the population's willingness to accept euro from tourists; and the fact that a majority of corporate and household loans are euro-denominated or euro-indexed. As the Government's domestic monetary policy mostly impacts 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 CNB 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 CNB to implement its monetary policies may have an adverse effect on the Croatian economy and thus on the ability of Croatia to repay principal and make payments of interest on the Notes.

The current account balance may deteriorate

Croatia's current account deficit has declined gradually since 2008 and recorded surpluses in each year since 2014, although this is likely to reverse owing to the Coronavirus pandemic in 2020. 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 or additional spending is required, 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 as a result of the Coronavirus pandemic, as well as the earthquake in Zagreb in 2020, Government expenditures increased significantly and revenues decreased requiring a revised Budget, see "*The Economy – Functioning of the public finance system and the sustainability of public services financing*". 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- (stable 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 2019, general Government debt stood at HRK 293.0 billion (73.2 per cent. of GDP) and Government guarantees stood at HRK 4.4 billion (1.1 per cent. of GDP), for a total amount of HRK 297.4 billion or 74.3 per cent. of GDP

(See "*Public Debt – Overview*"). As of 31 January 2020, the weighted average remaining maturity of external government debt was 6.2 years whereas the average maturity of the domestic public debt outstanding as at 31 December 2019 was 4.8 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 of 7.6 per cent. at the end of 2018. However, in 2019 the share of non-performing loans decreased to 5.5 per cent. at the end of 2019. Non-performing loans to enterprises also decreased and stood at 13.6 per cent. as at 31 December 2019. (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 2019, foreign banks owned approximately 90.3 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 48.2 per cent. of banks' assets in Croatia) and Austria (which owns approximately 28.6 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 (63) out of 180 countries under review, with a score of (47)/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. For more information on the impact of the Coronavirus pandemic on tourism in Croatia, see "*—Croatia's economy remains vulnerable to both internal and external economic shocks as a result of the global Coronavirus pandemic*" above.

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 CNB 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 principle 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. Enforcement of English court judgments is also subject to provisions of the Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community (2019/C384 I/01).

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 CNB, which is an independent central bank legally distinct from the Government. Accordingly, such reserves would not be available to satisfy any claim or judgment in respect of the Notes.

On 15 October 2012, the new Execution Act (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 €2,000,000,000 1.500 per cent. Notes due 2031 (the "**Notes**", which expression shall in these Conditions, unless the context otherwise requires, include any further notes issued pursuant to Condition 16 (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 17 June 2020 (such agreement as amended and/or supplemented and/or restated from time to time, the "**Agency Agreement**") made between the Republic and Deutsche Bank Luxembourg S.A. as registrar (the "**Registrar**"), Deutsche Bank AG, London Branch as fiscal agent (the "**Fiscal Agent**"), Deutsche Bank Luxembourg S.A. 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 17 June 2020 (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 17 June 2020 at the rate of 1.500 per cent. per annum, payable annually in arrear on 17 June in each year (from and including 17 June 2021) until maturity (each an "**Interest Payment Date**"). The first payment for the period from and including 17 June 2020 to but excluding 17 June 2021 and amounting to €15.00 per €1,000 principal amount of Notes shall be made on 17 June 2021.

The period beginning on, and including, 17 June 2020 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 17 June 2031.

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 17 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 the 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.

6. **Registration of Title**

The Registrar will not register title to the Notes in a name other than that of the Relevant Nominee for a period of 7 calendar days preceding the due date for any payment of principal, or interest in respect of the Notes.

7. **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 €1,969,840,000 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 4.1 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 Zoran Milanović (elected in January 2020) 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
Davor Božinović	Deputy Prime Minister and Minister of the Interior
Zdravko Marić	Deputy Prime Minister and Minister of Finance
Predrag Štromar	Deputy Prime Minister and Minister of Construction and Physical Planning
Gordan Grlić Radman	Minister of Foreign and European Affairs
Tomislav Ćorić	Minister of Environment and Energy
Vili Beroš	Minister of Health
Marija Vučković	Minister of Agriculture
Dražen Bošnjaković	Minister of Justice
Vesna Bedeković	Minister of Demography, Families, Youth and Social Politics
Marko Pavić	Minister of Regional Development and EU Funds
Josip Aladrović	Minister of Labour and Pension System
Mario Banožić	Minister of State Property
Tomo Medved	Minister of War Veterans
Ivan Malenica	Minister of Public Administration
Oleg Butković	Minister of the Sea, Transport and Infrastructure
Gari Cappelli	Minister of Tourism
Blaženka Divjak	Minister of Science and Education
Nina Obuljen Koržinek	Minister of Culture
Darko Horvat	Minister of Economy, Entrepreneurship and Crafts
Tomislav Ivić	State Secretary at the Ministry of Defence

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 (OG 99/1999 and 29/2002). 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**"); and
- 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 and 66/2019). 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**"). On 18 May 2020, the Parliament adopted a resolution on its dissolution, following the Government's proposal ahead of parliamentary elections. The next Croatian parliamentary elections are scheduled to take place on 5 July 2020.

The following table sets out the composition of the Parliament prior to its dissolution:

	Seats	Percent of Parliament (per cent.)
Croatian Democratic Union (HDZ)	55	36.67
Social Democratic Party of Croatia (SDP)	28	18.67
Bridge of the Independent Lists (MOST)	10	6.67
Croatian People's Party - Liberal Democrats (HNS)	5	3.33
Bandić Milan 365 - Labour and Solidarity Party	5	3.33
Croatian Peasant Party (HSS)	5	3.33
Civic Liberal Alliance (GLAS)	4	2.67
Istrian Democratic Assembly (IDS)	3	2.00
Youth Independent List (NLM)	3	2.00
Independent Democratic Serbian Party (SDSS)	3	2.00
Human Blockade	2	1.33
Croatian Demochristian Party (HDS)	2	1.33
Croatian Pensioners Party (HSU)	2	1.33
Let's Change Croatia (PH)	1	0.67
Croatian Democratic Alliance of Slavonia and Baranja (HDSSB)	1	0.67
Croatian Social Liberal Party (HSLS)	1	0.67
People's Party – Reformist	1	0.67
HRAST - Movement for Successful Croatia	1	0.67
Power - People's and Civic Engagement Party (SNAGA)	1	0.67
Ivan Pernar's Party	1	0.67
Democrats	1	0.67
Block for Croatia	1	0.67
Independent for Croatia	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 22 December 2019, a first round of presidential elections was held and Mr. Zoran Milanović won 29.55 per cent. of votes, which was not sufficient to win the elections outright. A second round of presidential elections was held on 5 January 2020 between first-round winner Mr. Zoran Milanović and first-round runner-up Ms. Kolinda Grabar-Kitarović, nominated by the HDZ, Mr. Zoran Milanović won 52.69 per cent. of votes, becoming newly elected president for a 5-year term starting in February 2020.

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 Katančićeva 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 CNB and the Ministry of Finance of Croatia.

Economic Reform Policy

The Government's policies have shown progress in important structural reforms, resulting in a significant decrease of public debt over the previous years. The policies in previous years, based on fiscal consolidation, structural reforms, investments and effective tax reforms has led to economic growth and increasing income per capita. The fiscal policies have primarily worked to stabilise public finances and address and reverse the negative trends associated with public debt. These results were one of the reasons for the improvements to the Croatian credit rating.

Structural reforms are the main component contributing to better allocation of factors of production. Higher total factor productivity (TFP) growth is a key precondition for reaching higher rates of economic growth in Croatia and ensuring real convergence with other advanced EU economies. With a relatively high share of the lower productivity sectors, such as low technology manufacturing and services like trade and tourism, the Government faced obstacles to the reallocation of labour and capital away from such sectors, resulting in low productivity growth. Impediments to the reallocation of factors of production include skills gaps, the high presence of state-owned enterprises in the economy and excessive goods and services market regulation. To address these impediments, reform efforts in recent years were orientated to ensuring higher potential growth by improving the business environment and reducing administrative and financial burden on the business sector, as well as aligning education with labour market needs. Over the past few years, Croatia has also reduced the restrictiveness of its goods and services market regulation.

In the face of two crises, the Coronavirus pandemic and the consequences of the earthquake in the Croatian capital, the Government has been decisive in continuing its actions across all economic areas.

Main objectives, reform priorities and measures of the economic policy

The National Reform Programme (NRP) was adopted on 30 April 2020, within the framework of the European Semester, defining the economic policy priorities and measures, which the Republic of Croatia plans to implement in the coming 12 to 18 months. To ensure long-term sustainability of the economic growth rate, the Government will focus on several key areas including reforms in public administration, the healthcare system, and the judicial system, as well as improving the business environment. Reform priorities have been established with respect to three objectives: (i) sustainable economic growth and development; (ii) aligning education with labour market needs; and (iii) ensuring the sustainability of public finances. The Republic of Croatia will aim to advance these specified objectives through the implementation of 25 economic policy measures categorised into ten reform priorities, as set out below.

Objective 1: Sustainable economic growth and development

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 reform priority is implemented through measures and action plans aimed at reducing administrative burdens and parafiscal contributions resulting in the systematic elimination of administrative obstacles and financial burdens. The liberalisation of the services market and digitisation of starting a business will facilitate access to the market for new entrepreneurs and market competition. The goal in liberalising the services market is to continue boosting competition in the services market, by reducing the overall regulation of service professions and discouraging the introduction of new regulations in the services market and service professions, in order to open opportunities for increasing productivity and innovation in the economy, (self-) employment of new entrepreneurs and more competitive prices for services. Mechanisms will be also established to incentivise the transferring of unreported work and unregistered business activities into legitimate operations.

2. *Investment policies directed towards the future*

The reform priority of encouraging investment is to establish an effective system for promoting private investment into sustainable development goals, in order to contribute to a proper and inclusive transition to a competitive green and digital economy. Public water service suppliers from public water utilities and public sewage utilities will be integrated to improve their implementation capabilities and investment capacities. The transfer to a smart and low-carbon society will be encouraged. Interventions in the public city transport sector will lead to modernisation of the public city transport through investments in new vehicle fleets in order to reduce negative environmental impacts and increase energy efficiency. Efforts will be made to improve the existing level of readiness and capacity to reduce risks from the consequences of natural catastrophes. The competitiveness of the economic fleet in inland maritime waterways will be increased, further routes for maritime development will be determined, especially nautical tourism and the strengthening of tourism potential in undeveloped areas.

3. *Improving management and utilisation of state assets*

With the aim of ensuring the responsible management and successful business of state-owned enterprises, activities directed at improving management of state assets will continue, including establishing the management of enterprises by management boards and supervisory boards. In addition, measures for the activation of unutilised state assets generating large expenses will be undertaken and such assets put into use for economic development. Further, the Government plans to implement its goal of constructing an effective and long-term sustainable road sector, business and financial restructuring of state-owned road enterprises. Further, the Government aims to restructure the rail sector to increase its efficiency and competitiveness and encourage investments in all other aspects of transport including, safety, ecological sustainability, efficiency and competitiveness.

4. *Improving public administration*

Improving public administration includes improving capabilities for an integrated approach in forming and implementing public policies and projects. The Government plans to strengthen the institutional framework for the implementation of EU funds in the Republic of Croatia, the normative framework for combating corruption and the operational capacities of public administration in terms of regulatory methodologies and processes. Improvements will be made to the provision of electronic public services to reduce the burdens on citizens and business entities.

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. With the aim of further strengthening the legal certainty and efficiency of the judicial system, the Government will continue to work on improving the functioning of the system.

Objective 2: Aligning education with labour market needs

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

Education and training in line with labour market needs involves reforms in general and vocational education, lifelong learning and promoting efficient and relevant higher education. The next step in view of the curriculum reform, implemented to establish a harmonised and efficient education system, is the continuation of professional training live and online as well as equipping all primary and secondary schools with teaching aids. The comprehensive digital transformation of schools, developing digitally advanced schools within the education process, as well as the completion of the process to establish regional centres of competence will continue. A distance learning model will be devised for primary and secondary schools. An experimental program for all-day classes will also be introduced. The quality system for adult education including higher education and science will be improved, and a curriculum for the Andragogical Education of Workers and a curriculum for Basic Adult Education will be devised. The instruments for improving the quality and relevance of adult education and lifelong learning programmes, as well as study programmes, will continue to be strengthened in order to ensure their compliance with the real needs of the economy and society as a whole.

Objective 3: Sustainability of public finances

7. *Strengthening the framework for managing public finances 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. Given the greater number of extra-budgetary users whose financial plans and reports on the execution of financial plans require approval from the Parliament, the aim is to modernise and achieve uniformity between the methods of creating financial plans and reports on the execution of financial plans, resulting in better financial planning and allocation of public funds.

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. In view of unfavourable demographic trends, activities contributing to strengthening and supporting families will be continued including providing assistance in childcare.

9. *Improving the social welfare system*

The aim is to ensure a transparent and coordinated system of social benefits with available data on the type and amount of benefits for a particular person or beneficiary of social welfare rights, to ensure continuity in tracking social welfare benefits at the local and state level and transparency in tracking for the purpose of better allocation of funds and poverty reduction. Another goal is provide suitable institutional and extra-institutional care for elderly citizens by applying innovative services targeted responsibly towards new social risks, in a uniform manner for the entire territory of the country and establish an equal status for users of social welfare services regardless of the type and status of service providers. The aim is to establish equal access to all social welfare service providers and achieve a price that conforms to the quality of a provided service.

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

Ensuring financial stability, sustainability and quality of the healthcare system includes establishing a structure, processes and procedures for introducing data analysis and reporting into existing practices for making decisions and policies at the level of the healthcare services provider, payer and policymakers. A national healthcare information management system will be established. The process to establish the national information management system commenced in 2020. The initial step in the process was to define a strategic framework for e-health development in order to improve management capacity and quality through the more efficient use of data. Currently, the situation analysis of e-health development and implementation in Croatia has been conducted. The project of preparing a strategic framework for Croatian e-health development will be completed by April 2021. The process of functionally integrating hospitals is to be continued. An analytical study will be conducted and the costs of major inefficiencies in the healthcare system will be calculated. A comparative analysis of major inefficiency variables will be performed along with a projection of the efficiency frontier of efficient EU healthcare systems. Solutions will be recommended and action plans for implementing such solutions will be devised.

The Croatian Economy under Coronavirus Pandemic Conditions

The epidemiological reaction in the Republic of Croatia has been successful to date with a strategy of relatively strict restriction measures regarding social gatherings and economic activity, with an aim to flatten the curve of the number of the infected as much as possible to minimise negative healthcare consequences. On 3 June 2020, there were 2,246 people with confirmed COVID-19 infection in Croatia, of which 2,095 people recovered and 103 people died, meaning that there were only 48 active cases on this date. A total of 67,814 COVID-19 tests had been conducted in Croatia by 3 June.

Since the epidemiological measures have led to the desired results, at the end of April it was decided to ease the measures in three phases. The first phase started on 27 April 2020 and included the opening of all business entities that perform trading activity (except those operating within shopping malls) In addition, public city and inter-city transport within the county and some service activities and physical training, were permitted. The second phase started on 4 May 2020. It involved the reopening of healthcare organisations closed due to the pandemic, enabling the healthcare system and remaining service activities to return to pre-crisis full workload levels. The third phase started on 11 May 2020 and introduced the reopening of shopping malls, catering facilities, national parks and nature parks, kindergartens and elementary one-teacher school education. In addition, gatherings of up to ten people in one place were permitted. All three phases assume the application and strict adherence to all prescribed epidemiological measures, and any increase in infections may require re-imposition of stricter measures.

However, on the economic side, the aforementioned approach has resulted in a significant decrease in economic activity in the short term. Assuming a temporary threat to the healthcare system (as well as taking into consideration the greater economic disruption), as well the Croatian epidemiological and economic measures, the cumulative negative economic effect of the crisis in case of the Republic of Croatia is expected to be less than the impact of the global financial crisis, since the consequences of the 2008 crisis were extended over six years in recession.

The Republic of Croatia believes that it is better prepared to manage the negative effects of the pandemic compared to the global financial crisis in 2008, with lesser external and internal imbalances. This primarily refers to the long-lasting process of deleveraging of domestic sectors induced by the previous crisis, as well as to the decreased size of certain domestic sectors of lower productivity oriented exclusively towards the internal market that were, before 2008, financed mostly by debt and thus burdened the economy. These processes were reinforced by fiscal policy and by the accession to the EU, and resulted in significantly more favourable indicators of debt sustainability and the net international investment position. In addition, the labour market is in a more favourable position, with a record low unemployment rate just before the outbreak of the Coronavirus pandemic.

The expected trajectory of the recovery, as well as the medium-term Croatian economic outlook, are based on the swift and firm economic support to the private sector that has been provided, and on the fast and successful easing of the epidemiological measures without a “second wave”. The support provided to the private sector refers primarily to the fiscal support, and then to the broader financial aid, but also to the legislative and logistical solutions. These target, in the first place, the sectors of micro and small enterprises and threatened households, effectively trying to enable the “freezing” of the economy with the least possible permanent loss of output. This primarily refers to overcoming liquidity disturbances as well as to the prevention of problems with solvency of otherwise healthy and potentially productive economic entities and limiting the decline in employment. Taking into account relatively low indicators of liquidity and high indebtedness, liquidity support to the economy through open channels of the banking sector, use of guarantee funds, and programmes and debt moratoriums represent an extremely important part of the short-term macroeconomic assistance strategy. Regarding the household sector, it is crucial that the measures are designed to target the segments with the highest marginal propensity to consume. The Croatian economic measures, taking into account the relative size of the economy as well as other objective limitations of the Croatian government and financial sector, are comparable with all the published international packages, which was possible due to the creation of fiscal headroom during previous years.

Measures to assist the economy due to the Coronavirus pandemic

As of March 2020, in the Republic of Croatia there were numerous epidemiological measures implemented, including social isolation measures, which had a significant adverse effect on the Republic of Croatia's economic activity. Economic activities in the Republic of Croatia have been reduced or suspended in almost all areas, except those essential for the functioning of the society. In the first phase, key efforts were primarily directed towards halting the spread of the Coronavirus and the prevention of unsustainable pressures on the public healthcare system. Furthermore, on 22 March 2020, Zagreb was hit by the strongest earthquake in the last 140 years, causing large infrastructural damage and additional pressure on the Republic of Croatia's public services. The urgent response to the challenges of the Coronavirus pandemic as well as to the reduced economic activity, has also led to strong challenges for fiscal policy and fiscal indicators (which were, until then, positive).

On 17 March 2020 and 2 April 2020, the Government of the Republic of Croatia adopted two comprehensive and targeted packages of economic measures to mitigate the Coronavirus pandemic's negative impact on the economic activity. The goal of these measures were to help the private sector, as the bearer of economic activity, to overcome the crisis through job preservation and payment of salaries and to solve the liquidity problems of those business activities which have been reduced. In addition, the aim was to safeguard the income of the most vulnerable groups in the population and to set the foundations for a quick economic recovery. In this context, horizontal measures were adopted to assist the economy and population, as well as a series of measures directed towards mitigating the negative consequences in individual sectors. The Government of the Republic of Croatia continues to diligently monitor the trends in the economy and will, if necessary, suggest the adoption of new measures.

Horizontal Measures

Postponement and write-off of direct taxes and contributions for all entrepreneurs facing difficulties in their business operations

Pursuant to the Amendments to the General Tax Act and the Ordinance on the Amendments to the Ordinance on the Implementation of the General Tax Act, entrepreneurs (which includes all businesses) that have had or have estimated they will have higher than a 20 per cent. decline in their revenues, are entitled to an interest-free postponement of direct taxes and contributions and payment thereof in instalments. In addition, this measure was strengthened by the 2 April 2020 package of economic measures within which the entrepreneurs with annual revenue less than HRK 7.5 million (accounting for 93 per cent. of entrepreneurs in the Republic of Croatia), whose revenues had declined in excess of 50 per cent., will be fully exempt from paying the public levies that are due during the months of April, May and June 2020. During the same period, those companies that realise revenue greater than HRK 7.5 million, whose revenues have declined in excess of 50 per cent., will be partially exempt from paying the public levies that are due, depending on the level of decline of their revenues. Furthermore, the possibility of paying VAT only upon invoices that have been paid has also been introduced (i.e. VAT payments will not be due until the payment is received from the customers) with an aim of ensuring additional liquidity of economic operators.

Subsidies for job preservation

In order to preserve jobs in the most vulnerable sectors affected by the Coronavirus pandemic, a measure was adopted to subsidise the cost of salaries to the amount of HRK 3,250 per employee for March. That amount was increased for April and May to HRK 4,000, whereby the cost of contributions for pension and health insurance will also be borne by the State Budget. Furthermore, the conditions for the use of the “permanent seasonal worker” measure were amended by extending the pension insurance and rights to financial aid for the duration of the crisis. This measure is available to employers from industries which have periods of reduced work due to the seasonal nature of their business operations. This measure has mostly been used in the tourism and catering sectors.

Measures directed towards micro, small and medium-sized entrepreneurs

These measures are financed with support from ESIF funds, carried out by CASB-BICRO. Thus, the allocation for the financial instrument ESIF Micro loans for working capital has been increased, while interest rates to investment loans have been reduced and the maximum guarantee rate for ESIF individual guarantees for loans for working capital has been increased from 65 per cent. to 80 per cent. of the loan principal. A moratorium on all instalments of ESIF loans and loans for agriculture and rural development has also been introduced until 31 December 2020, as well as an extension of the repayment/deadline for the use of loans for which such a guarantee has been issued. In addition, new financial instruments are being established. The first such instrument is a COVID-19 loan programme for working capital. This programme provides additional liquidity for micro, small and medium-sized entities whose business operations have negatively been impacted by the Coronavirus pandemic. The amounts of such loans are capped at HRK 750,000 for working capital, with the interest rate of 0.25 per cent., a grace period of up to 12 months and a maximum repayment deadline of 5 years, with the shortened procedure for application processing. The second such instrument is a Micro loan programme for rural development. This programme is intended to provide working capital for entities in agricultural, manufacturing and forestry sectors. The amounts of the loans are between EUR 1,000 and EUR 25,000. The deadline for repayment is up to 3 years with an interest rate of 0.5 per cent. and a grace period of up to 12 months.

*Loans of the Croatian Bank for Reconstruction and Development ("**CBRD**") and commercial banks*

The entrepreneurs who have been approved loans directly from CBRD or via a commercial bank may make use of a moratorium of three months for liabilities due after 29 February 2020, with an option of extension thereof. The users of CBRD loans are provided with the possibility of rescheduling their existing loan liabilities along with having a grace period for the repayment of their loan principal. In addition, CBRD will, in cooperation with commercial banks, approve for entrepreneurs new loans to provide liquidity at favourable interest rates, while the funds are intended for the financing of basic operating costs (so-called overhead expenses).

Two new CBRD programmes for support to the economy have also been approved by the EC. The first programme will be used for financing the liquidity of exporters through insurance policies, with the total credit potential amounting to HRK 6 billion. The second programme is based on the instruments of more favourable CBRD loans with interest subsidies provided by the State, and will be carried out via three basic modes: (i) framework loans to banks, whereby State funds will be placed via CBRD along with zero percent interest rates for half of the total interest calculation, while the second half will account for the interest rates of banks (whose highest amount will be capped); (ii) loans in cooperation with banks according to the risk-sharing model; and (iii) direct CBRD loans to entrepreneurs. Total credit potential for this second measure is estimated at HRK 7.6 billion. In addition, commercial banks have adopted a series of measures that will provide entrepreneurs and citizens with the right to moratoria, rescheduling the payment of loan liabilities, and also new loans for liquidity and working capital.

Functioning of the public finance system and the sustainability of public services financing

A series of measures has also been adopted with the aim to facilitate the functioning of the public finance system and of the sustainability of public services financing, along with the reactivation of the economy and the protection of vulnerable layers of society. Therefore, the Act on the Execution of State Budget for 2020 (OG 117/2019, 32/2020, 42/2020 and 58/2020) was amended in a way that enabled additional borrowing of the State as well as additional borrowing of extra-budgetary users above previously established limits, with the consent of the Government. Due to the different dynamics of the inflow of funds and maturity of liabilities, there will be a reduction in the revenues of local and regional self-government units, the Croatian Health Insurance Fund and the Croatian Pension Insurance Institute. The Republic of Croatia will provide an interest-free loan for bridging finance. This interest-free loan may be disbursed up to the level of income tax, surtax to income tax and contributions the payment of which is exempt or postponed, i.e. up to the level of the expected return.

Due to the occurrence of exceptional circumstances that are recognised by the provisions of the Fiscal Responsibility Act (OG 111/2018 and 41/2020) and the Stability and Growth Pact, the Decision on the temporary postponement of the application of fiscal rules, including the structural balance rule, expenditure rule and public debt rule, was adopted. For the period in which fiscal rules are not applied, the deviation from the medium-term budgetary objective has been made temporarily possible, for the purpose of more rapidly responding to the consequences of the Coronavirus pandemic. This will enable the implementation of measures that will be directed towards the removal of healthcare, social, economic and other consequences of this epidemic.

With an aim of optimal use of limited fiscal space, the Government adopted the Decision on the restriction of the usage of funds planned by the State Budget of the Republic of Croatia and financial plans of extra-budgetary users of the State Budget for 2020 (OG 41/2020). This Decision rationalised the public procurement procedures, the giving of donations and grants and limited employment in the public sector, whereby funds for financing measures and activities fighting the pandemic were provided. On 18 May 2020, the Decision was abolished and the provisions of the Act on Amendments to the Act on the Execution of the State Budget of the Republic of Croatia for 2020 (OG 58/2020) shall be applied to requests received on the basis of the Decision.

Furthermore, the Government has adopted a measure limiting the expenses of budgetary and extra-budgetary users of the state budget as a consequence of the change in economic circumstances. In this context, negotiations with social partners have been initiated on the topic of the calculation of civil servants' salaries and others working in the public services in 2020, as well as negotiations on the payment of certain material rights agreed upon by collective agreements and the rights linked with the increase in the coefficient of the complexity of job positions and supplements to basic salary. The guidelines for the rationalization of business operations of companies majority-owned by the State will also be prepared. Local and regional self-government units will also carry out measures to limit expenses.

Pursuant to the Amendments to the Accounting Act and the Bylaw on the deadlines for submission of financial statements and accounting documents in special circumstances (OG 45/2020), the deadline for the submission of financial statements for 2019 was also extended from 30 April 2020 to 30 June 2020. Entrepreneurs are also exempt from paying a fee to the Financial Agency for the publication of financial statements.

The Amendments to the Act on the Implementation of the Enforcement of Monetary Funds provides the suspension of implementation of this Act during the following three months, with an aim of providing support to citizens whose accounts have been blocked. During this time period no default interests on due liabilities will be accrued.

The purpose of the Act on the Intervention Measures in the Enforcement and Bankruptcy Procedures During the Exceptional Circumstances (OG 53/2020), which was passed on 30 April 2020 and entered into force on 1 May 2020, is to improve the situation of citizens who have had enforcement imposed on their salaries or pensions or other permanent financial income as well as the position of economic entities facing bankruptcy, and of users of grants for the implementation of their projects.

Sector Measures

A series of measures was also adopted directed towards the mitigation of negative consequences in individual sectors particularly threatened by the Coronavirus epidemic. In the first package of Government measures adopted on 17 March 2020, the Ministry of Agriculture proposed a number of measures directed towards aiding, and providing flexibility for, liquidity of the agriculture sector. Besides the provision of liquidity via EU funds for affected sectors, additional measures were introduced including postponement of due liabilities for the Croatian Forests for wood assortments, postponement of payment of rent and concession fees for agricultural land and for the fishery sector. A national online platform has also been introduced, creating a digital market where it will be possible to buy and sell local agricultural and food products among farmers and purchasers. An extraordinary intervention purchase of the surplus of milk from small dairy farms has also been adopted. In addition, the decision on the programme of the support to primary agricultural producers in the sectors of plant production and livestock farming in 2020 worth HRK 53 million was adopted.

In the tourism sector, the postponement or exemption from paying the tourist board membership fee for economic operators and private renters was provided as well as the postponement or exemption from paying tourist fees for private renters (a flat-rate tax). Furthermore, support for programmes of financing working capital and improving the liquidity of affected entrepreneurs in tourism was also provided. Special attention was given to small and medium sized businesses in the tourism industry, such as small hotels, through CBRD's Working Capital temporary measure including a loan programme. The Amendments to the Act on the Provision of Services in Tourism introduced a moratorium on the termination of a contract for tourist agency packages for the duration of 180 days after the end of these special circumstances, whereby the possibility of returning money for non-used travel packages is also given. Amendments to the regulations linked with the concessions concerning tourist land in camping sites co-owned by the Republic of Croatia have also been concluded, the variable part of the concession fee for such land will not be charged.

By establishing a crisis fund, subsidies to liquidity in the culture sector have been provided in the amount of HRK 70 million – to independent artists, self-employed and other natural and legal persons that are left without any revenue due to restrictions on gatherings and the closing-down of theatres, cinemas, museums and concert halls. Via this crisis fund, funds will also be disbursed to natural and legal persons in the cultural field for the extended period of preparatory activities for approved cultural projects, the realization of which is postponed until further notice due to the epidemic. In addition, Amendments to the Act on the Protection and Preservation of Culture Goods allow the suspension of payment of monument annuity during the special circumstances caused by the Coronavirus epidemic.

Zagreb Earthquake

On 22 March 2020, Zagreb was hit by its strongest earthquake in the last 140 years, causing large infrastructural damage and additional pressure on the Republic of Croatia's public services. Due to the date and time of the earthquake there was very little loss of life, while there was significant property damage. In the midst of the Coronavirus pandemic, the Government allocated funds in the amount of HRK 141 million by passing the Decision on providing financial assistance for temporary and necessary protection and repair of buildings damaged by the earthquake in the area of the City of Zagreb and its surroundings (OG 55/2020) that entered into force on 9 May 2020, for the first and urgent phase of the reconstruction of family houses, residential and commercial buildings damaged by the earthquake in Zagreb and its surrounding area. However, the total damage from the earthquake was quite extensive and will require additional measures beyond the planned first and urgent phase of reconstruction. The restoration of the complete damage caused by the earthquake is expected to take years. The Ministry of Construction and Physical Planning drafted a law that will provide a legal framework and enable the reconstruction of earthquake-damaged buildings and houses, which is currently in public debate. The procedure for concluding a Loan Agreement between the Republic of Croatia and the International Bank for Reconstruction and Development for the Earthquake Recovery Project and the strengthening of the Coronavirus response was initiated in May, with the total value of the loan amounting to EUR 200 million. Furthermore, the Republic of Croatia will apply for assistance from the EU Solidarity Fund, which provides financial support to Member States experiencing major natural disasters with serious consequences.

EU Structural Funds

Croatia is a beneficiary of the EU Structural and Investment Funds. The EU Structural and Investment Funds (ESIF funds) aim to achieve a balanced development within the EU and to strengthen the global competitiveness of the European economy. Those funds include the European Social Fund the European Regional Development Fund the Cohesion Fund, the European Maritime and Fishery Fund and European Agricultural Fund for Rural Development Croatia defined the investment area through specific ESIF programmes. In order to receive disbursements, 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 programmes is subject to a co-financing requirement by Croatia.

ESIF funds contribute to addressing structural challenges and to fostering growth and competitiveness in Croatia. The financial allocation from ESIF 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 March 2020. approximately EUR 9.7 billion (around 91 per cent. of the total ESIF funds allocated) had been contracted for 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 100 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 is actively working on entering the ERM II. 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.

On 27 May 2019, the Republic of Croatia submitted a request to the ECB for the establishment of close cooperation between the ECB and the Croatian National Bank in the exercise of supervisory tasks over credit institutions within the SSM. The procedure for the establishment of close cooperation with the ECB consists of two steps. The first step involves the preparation and adoption of the relevant national legislation enabling the ECB to exercise supervisory tasks. 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.

On 4 July 2019, the Republic of Croatia sent a letter of intent to the euro area member states, Denmark and EU institutions expressing its intent to enter the ERM II. This marked the first formal step towards the Republic of Croatia's joining the ERM II, which precedes the introduction of the euro as a country's official currency. The letter of intent was accompanied by an Action Plan detailing the reforms that the Republic of Croatia will implement before entering the ERM II (the "**Action Plan**"). The Action Plan commitments includes six policy areas with a total of 19 measures and nine institutions responsible for implementing the measures. In that context, the Republic of Croatia is committed to implement reforms in the following areas:

- to further strengthen the supervision of the banking system by establishing close cooperation between the Croatian National Bank and the European Central Bank;
- strengthen the macroprudential policy framework by introducing an explicit mandate for borrower-based measures;
- strengthen the anti-money laundering framework;
- upgrade the system of statistical data collection, processing and publication;
- improve public-sector management; and
- reduce the administrative and financial burden on the economy.

The Republic of Croatia successfully passed and implemented the agreed measures from the Action Plan and plans to send a letter of notification on the implementation of reform measures in June 2020. The letter of notification will also include a request for a formal assessment of the implementation of the reform measures by the Eurogroup, the European Central Bank and the European Commission. This letter will be followed by feedback from the aforementioned institutions on the fulfilment of measures and confirmation of the possibility of joining ERM II and the Banking Union. The Republic of Croatia's date of entry into ERM II and, subsequently, into the eurozone are dependent on Croatia's ability to fulfil the relevant membership criteria and measures agreed with EU institutions and Member States.

On 5 June 2020, the European Central Bank published the results of a comprehensive assessment of five Croatian banks, following Croatia's request to establish close cooperation between the ECB and CNB. The exercise comprised an asset quality review (AQR) and a stress test, both of which were based on the methodologies applied by the ECB Banking Supervision in its regular comprehensive assessments of banks that have recently been classified as significant or could potentially become significant. The comprehensive assessment showed that the five banks do not face any capital shortfalls as they did not fall below the relevant thresholds used in the AQR and the stress test.

The Republic of Croatia's entry into ERM II is expected to be finalised during the second half of 2020.

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 2019-2024 period, 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; and
- 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 USD 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 USD 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, 114/2018 and 32/2020) (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*) ("**CBRD**") 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. CBRD has developed new models of risk sharing. For instance, CBRD 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 CBRD 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.
- In May 2020, the Government passed a decision on the merger of ARZ with HAC as part of the continuation of the reform in order to achieve long-term sustainability in motorway management.

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				
	2015	**2016**	**2017**	**2018**[(1)]	**2019**[(1)]
Nominal GDP (HRK millions)	339,696	351,169	366,426	382,965	400,102
Real GDP (HRK millions)[(2)]	339,696	351,530	362,565	372,335	383,267
Nominal GDP (EUR millions)	43,640	44,640	49,118	51,654	53,969
Nominal GDP per capita (EUR)	10,619	11,174	11,907	12,632	13,270
Real GDP growth (per cent.)	2.4	3.5	3.1	2.7	2.9

Source: CBS and CNB
(1) Preliminary data for 2018 and 2019.
(2) Constant previous year prices, reference year 2015.

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

	Year ended 31 December				
	2015	2016	2017	2018	2019
			(per cent.)		
Households	0.2	3.1	3.1	3.2	3.5
NPISH	0.4	6.7	1.1	3.2	1.3
Government	(0.9)	0.5	2.2	1.3	3.3
Gross fixed capital formation	3.8	6.5	5.1	4.1	7.1
Exports of goods and services	10.3	7.0	6.8	3.7	4.6
Imports of goods and services	9.4	6.5	8.4	7.5	4.8
Change in overall GDP for the period	**2.4**	**3.5**	**3.1**	**2.7**	**2.9**

(1) Preliminary data for 2018 and 2019.
Source: CBS

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

	Final consumption expenditure						
	Households	NPISH	Government	Gross fixed capital formation	Exports of goods and services	Imports of goods and services	Gross domestic product (market price)
				(per cent.)			
2015							
First quarter	(1.1)	8.3	0.7	1.5	8.4	9.5	1.4
Second quarter	(0.6)	9.8	(0.8)	2.4	10.6	7.0	1.9
Third quarter	0.4	11.1	(1.4)	5.0	10.3	8.0	3.9
Fourth quarter	1.8	12.3	(1.9)	6.3	11.7	13.3	2.3
2016							
First quarter	2.7	6.1	(1.2)	6.4	6.9	6.2	3.3
Second quarter	2.8	6.8	12.2	8.0	4.8	8.0	3.1
Third quarter	3.4	7.3	1.0	4.9	8.6	5.9	3.6
Fourth quarter	3.3	6.6	1.0	6.5	6.8	6.0	4.0
2017							
First quarter	3.1	2.0	1.5	6.1	12.8	11.6	3.0
Second quarter	3.3	1.5	1.8	3.7	8.3	6.3	3.4
Third quarter	3.2	0.8	2.6	3.7	5.4	8.3	3.6
Fourth quarter	3.0	0.2	3.0	7.0	3.4	7.6	2.5
2018							
First quarter	*3.5*	3.7	1.1	4.9	(2.1)	7.4	2.2
Second quarter	*3.3*	2.5	1.0	4.3	5.2	6.7	3.2
Third quarter	*2.4*	3.9	2.5	5.0	5.4	6.5	3.0
Fourth quarter	*3.7*	2.9	0.9	2.3	2.3	9.2	2.2
2019							
First quarter	4.4	1.8	3.1	11.5	4.1	6.5	4.1
Second quarter	2.7	2.4	3.9	8.2	3.3	8.3	2.4
Third quarter	3.1	0.5	2.9	5.0	5.1	4.3	2.9
Fourth quarter	4.0	0.6	3.5	4.0	5.6	0.1	2.5

(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 2018 to the fourth quarter of 2019 are provisional.
Source: CBS

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 10.3 per cent. Household consumption, including Non-profit Institutions Serving Households ("**NPISH**") increased in real terms by 0.4 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 9.4 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 7.0 per cent., year-on-year. Household consumption (including NPISH) increased by 3.1 per cent., gross fixed capital formation by 6.5 per cent. and government consumption by 0.5 per cent. year-on-year. Imports of goods and services, which recorded a growth of 6.5 per cent., year-on-year caused a negative contribution to GDP growth.

In 2017 GDP increased by 3.1 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 6.8 per cent. and household consumption (including NPISH) with a real growth of 3.1 per cent. year-on-year. Gross fixed capital formation increased by 5.1 per cent., government consumption by 2.2 per cent. and imports of goods and services by 8.4 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 2017. The data for 2018 and 2019 is provisional.

Positive developments continued in 2018 and real GDP increased by 2.7 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 3.2 per cent., year-on-year. Exports of goods and services increased by 3.7 per cent., gross fixed capital formation by 4.1 per cent. and government consumption by 1.3 per cent. year-on-year. Imports of goods and services, which recorded a growth rate of 7.5 per cent. year-on-year, contributed negatively to GDP growth.

Positive developments continued in 2019 and real GDP increased by 2.9 per cent., year-on-year, according to provisional data. The greatest 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 4.6 per cent., gross fixed capital formation by 7.1 per cent., government consumption by 3.3 per cent., year-on-year. Imports of goods and services, which recorded a growth rate of 4.8 per cent. year-on year, contributed negatively to GDP growth

According to the European Commission's Spring 2020 forecast, the Republic of Croatia's economy is expected to contract by 9.1 per cent. in 2020, before partially recovering by 7.5 per cent. in 2021. Despite accounting for more than half of the drop in 2020, domestic demand is expected to recover faster than exports, due to significant uncertainties surrounding the current outlook for global trade. The Government's wage support measures and the operation of automatic stabilisers are expected to help sustain household consumption during this period. At the same time, investment is expected to be supported by the ongoing implementation of projects financed by EU funds and several liquidity support measures for companies. While goods exports are expected to contract in 2020, primarily due to the expected recession in Croatia's main trading partners, service exports are expected to suffer even more due to the negative impact of the suppression and restriction measures placed on the travel, hospitality and transport sectors. Conversely, under the Croatian Convergence Programme for 2020 and 2021, the real GDP for the Republic of Croatia is expected to decrease by 9.4 per cent. in 2020, followed by a recovery of 6.1 per cent. in 2021. Initial estimates for the first quarter 2020 predict GDP growth of 0.4 per cent. year-on-year and a decline of 1.2 per cent. quarter-on-quarter.

Gross Value Added ("GVA")

In 2015, total GVA growth amounted to 2.3 per cent. This increase was primarily a result of an increase by 5.0 per cent. in wholesale and retail trade, transportation, storage, accommodation and food service activities and an increase by 3.9 per cent. in information and communication. In 2016 real GVA recorded an increase of 3.6 per cent., year-on-year, which was primarily the consequence of growth of GVA in industry (5.7 per cent.), agriculture, forestry and fishing (6.4 per cent.) and in wholesale and retail trade, transportation, storage, accommodation and food service activities (4.4 per cent.). In 2017, real GVA recorded an increase of 2.6 per cent., 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 (5.3 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 2.2 per cent. in real terms, year-on-year, which was due to the growth of GVA in wholesale and retail trade, transportation, storage, accommodation and food service activities (4.2 per cent.), information and communication (4.8 per cent.) and construction (4.5 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. In 2019, total GVA growth amounted to 2.7 per cent. This increase was primarily the result of an increase in construction of 8.0 per cent. All categories in 2019 had a positive contribution to GVA growth.

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

	Year ended 31 December						
	2015		**2016**		**2017**		**2018**
	(HRK millions)	*(per cent. of total)*	*(HRK millions)*	*(per cent. of total)*	*(HRK millions)*	*(per cent. of total)*	*(HRK millio*
Agriculture, forestry and fishing	10,228	3.6	10,923	3.8	10,757	3.6	10
Manufacturing, mining and quarrying and other industries	58,437	20.8	60,143	20.7	61,128	20.2	61
Construction	14,138	5.0	14,509	5.0	15,253	5.0	16
Wholesale and retail trade, transportation, storage, accommodation and food service activities	63,365	22.5	65,496	22.5	70,101	23.2	74
Information and communication	13,146	4.7	13,595	4.7	14,515	4.8	15
Financial and insurance activities	17,995	6.4	18,460	6.3	19,153	6.3	19
Real estate activities	27,923	9.9	28,238	9.7	28,719	9.5	29
Other[(1)]	76,228	27.1	79,674	27.3	83,032	27.4	87
Total	**281,466**	**100.0**	**291,037**	**100.0**	**302,659**	**100.0**	**314**

(1) Category contains professional, scientific, technical, administrative and support service activities as well as public administration and defence, educa
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 2018 and 2019 a

Source: CBS

The following table sets forth real GVA, reference year 2015, for the periods indicated:

	Year ended 31 December						
	2015		**2016**		**2017**		**2018**
	(HRK millions)	*(per cent. of total)*	*(HRK millions)*	*(per cent. of total)*	*(HRK millions)*	*(per cent. of total)*	*(HRI millior*
Agriculture, forestry and fishing	10,228	3.6	10,886	3.7	10,618	3.6	10
Manufacturing, mining and quarrying and other industries	58,437	20.8	61,747	21.2	62,777	21.0	62
Construction	14,138	5.0	14,533	5.0	14,904	5.0	15
Wholesale and retail trade, transportation, storage, accommodation and food service activities	63,365	22.5	66,126	22.7	69,655	23.3	72
Information and communication	13,146	4.7	13,569	4.7	14,135	4.7	14
Financial and insurance activities	17,995	6.4	18,184	6.2	18,513	6.2	18
Real estate activities	27,929	9.9	28,168	9.7	28,255	9.4	28
Other[(1)]	76,228	27.1	78,326	26.8	80,163	26.8	82
Total	281,466	100.0	291,540	100.0	299,006	100.0	305

(1) Category contains professional, scientific, technical, administrative and support service activities as well as public administration and defence, educa 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 2018 and 2019 ar

Source: CBS

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

	Year Ended 31 December*				
	2015	2016	2017	2018	2019
	(per cent.)				
Agriculture, forestry and fishing	2.4	6.4	(2.5)	2.2	1.2
Manufacturing, mining and quarrying and other industries	2.3	5.7	1.7	(0.5)	0.9
Construction	2.7	2.8	2.6	4.5	8.0
Wholesale and retail trade, transportation, storage, accommodation and food service activities	5.0	4.4	5.3	4.2	4.0
Information and communication	3.9	3.2	4.2	4.8	4.3
Financial and insurance activities	0.6	1.1	1.8	0.3	1.4
Real estate activities	1.1	0.9	0.3	0.6	0.9
Other[2]	0.1	3.6	2.4	2.5	2.8
Total GVA growth	2.3	3.6	2.6	2.2	2.7

(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 2018 and 2019 are provisional.

Source: CBS

Agriculture, forestry and fishing

In 2015, GVA in this sector recorded a positive trend, increasing by 2.4 per cent., year-on-year. In 2016, GVA increased again by 6.4 per cent. in comparison to 2015. However, in 2017, the trend reversed as GVA declined by 2.5 per cent. in comparison to 2016. In 2018 and 2019, GVA in this sector increased by 2.2 and 1.2 per cent., respectively.

Manufacturing, mining, quarrying, and other industries

In 2015, the GVA in this sector grew by 2.3 per cent. Positive developments continued in 2016 and 2017, when GVA in this sector recorded a real year-on-year growth of 5.7 and 1.7 per cent., respectively. In 2018, GVA in this sector declined by 0.5 per cent., year-on-year. In 2019 GVA increased by 0.9 per cent, year-on-year.

Construction

For the first time after six years, real year-on-year growth of GVA was recorded in 2015 and afterwards in this sector, amounting to 2.7 per cent. in 2015, 2.8 per cent. in 2016 and 2.6 per cent. in 2017. In 2018, GVA in this sector increased by 4.5 per cent. and in 2019 by 8.0 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 5.0 per cent. in 2015 and 4.4 per cent. in 2016. In 2017 and 2018, real year-on-year growth of GVA in this sector was 5.3 and 4.2 per cent., respectively. In 2019, GVA in this sector increased by 4.0 per cent., year-on-year.

Information and communication

The information and communication sector has recorded negative real growth rates from 2009 onwards. In 2015, 2016 and 2017, GVA finally recorded a positive trend, increasing by 3.9, 3.2 and 4.2 per cent., respectively. In 2018 and 2019, GVA in this sector increased by 4.8 and 4.3 per cent., respectively.

Financial and insurance activities

The real growth rate of GVA was positive in 2015, amounting to 0.6 per cent. In 2016 and 2017 the real growth rate of GVA was 1.1 and 1.8 per cent., respectively. In 2018, GVA in this sector increased by 0.3 per cent., year-on-year. In 2019 it increased by 1.4 per cent.

Real estate activities

GVA in the real estate activities sector increased by 1.1 per cent. in 2015.In 2016, real year-on-year growth of 0.9 per cent. was recorded. In 2017, real year-on-year growth of 0.3 per cent. was recorded. In 2018 and 2019, GVA in this sector increased by 0.6 and 0.9 per cent., year-on-year.

Other Sectors

In 2015, 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 0.1 per cent. In 2016, GVA in the other sectors experienced a real increase of 3.6 per cent. In 2017 and 2018, real year-on-year growth of 2.4 and 2.5 per cent., respectively, was recorded. In 2019, GVA in this sector increased by 2.8 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 2,087 industrial product prices for 2020. 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 CNB monetary policy. The CNB'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:

	2015	2016	2017	2018	2019
CPI (*period average*)	(0.5)	(1.1)	1.1	1.5	0.8
PPI (*domestic market, period average*)	(3.9)	(4.0)	2.1	2.4	0.8
CPI (*end of period*)	(0.6)	0.2	1.2	0.8	1.4
PPI (*domestic market, end of period*)	(4.1)	(0.1)	2.1	0.5	1.4

Due to significantly lower prices of crude oil and other commodities (mainly food products) in the world market, low inflation in the Euro Area 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 –2.7 per cent. in 2014 and –3.9 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 –1.5 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 2.4 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).

The decrease of average annual consumer price inflation from 1.5 per cent. in 2018 to 0.8 per cent. in 2019 was mainly a result of a decline in the annual growth rate of energy prices (due to a lower contribution from petroleum product prices) and of food prices (due to the reduction of the VAT rate on certain food products). CPI inflation accelerated towards the end of the year and stood at 1.4 per cent. in December due to a positive base effect stemming from a sizeable decrease in Brent crude oil prices in late 2018. Domestic inflationary pressures were relatively mild in 2019, although slightly stronger than in the previous year, which mainly is due to acceleration in the growth of personal consumption and unit labour costs as well as industrial producer prices (excluding energy). Cost pressures have not yet spilled over significantly to consumer prices, having partly been alleviated by a drop in profit margins. Imported inflationary pressures in 2019 were mostly subdued in 2019, taking into account, for instance, the fall in the price of crude oil on the global market and the low inflation in the major trading partners. The exception was the strong price increase in meat prices on the global market, mostly owing to the increase in the demand for pork in China, where the supply of pork has significantly decreased due to African swine fever. Core inflation (which does not include agricultural product prices, energy prices and administered prices) accelerated from 0.8 per cent. in 2018 to 1.0 per cent. in 2019, mainly due to the rise in the average annual growth rate in bread and cereals and tobacco products. The average annual rate of growth of industrial producer prices on the domestic market slowed down to 0.8

per cent. in 2019, compared to 2.4 in 2018, mainly as a result of the slowdown in the annual growth rate of energy prices.

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 2020

The average annual CPI inflation rate is estimated by the CNB to decline from 0.8 per cent. in 2019 to -0.1 per cent. in 2020. The Government believes that this will be the result of the expected significant decrease in the annual rate of change of energy prices (mainly due to lower expected contribution of petroleum). The average annual growth rate of the CPI excluding food and energy could decrease to 0.3 per cent. in 2020 from 0.9 per cent. in 2019. This slowdown could be the result of the decrease in demand due to the Coronavirus pandemic, especially in tourism related services (package holidays, accommodation services and transport services), recreation and culture services as well as some other goods (clothing, furniture, etc.). The Government believes that the slowdown will partially be mitigated by the increase in excise duties on tobacco, alcoholic and non-alcoholic drinks in April 2020 and an increase in unit labour cost (due to the significant decrease in labour productivity caused by the Coronavirus pandemic). Due to the Coronavirus pandemic, the annual growth rate of food prices could increase in 2020 as a result of supply chain disruptions, possibly due to trade restrictions or border delays, with food security concerns in regions affected by the Coronavirus pandemic, and export restrictions on large food exporters.

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	
	2017[(1)]	**2018**[(2)]
	(HRK thousands)	
Industry		
Croatian railways	453,749	469,700
Agriculture	3,788,197	3,845,754
Shipyards and shipbuilding	222,590	0
CBRD	14,510	14,835
Other industries[(3)]	896,386	956,510
Total subsidies	**5,375,432**	**5,289,799**

(1) Data presented in the Annual Report on State Aid for 2017.
(2) Data presented in the Annual Report on State Aid for 2018.
(3) "Other industries" includes subsidies to air transport, water transport, road transport and tourism.
Source: Ministry of Finance

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

	Twelve months ended 31 December	
	2017	2018
	(per cent.)	
Industry		
Croatian railways	0.12	0.12
Agriculture	1.04	1.00
Shipyards and shipbuilding	0.06	0.00
CBRD	0.00	0.00
Other industries[1]	0.25	0.25
Total subsidies	**1.47**	**1.38**

[1] "Other industries" includes subsidies to air transport, water transport, road transport and tourism.
Source: Ministry of Finance
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 2017 was published in the Annual Report on State Aid for 2017. Data for 2018 was published in the Annual Report on State Aid for 2018.

Croatian Bank for Reconstruction and Development

CBRD was originally established on 12 June 1992 by the Act on the Croatian Credit Bank for Reconstruction (OG 138/2006 and 25/2013) and is entirely owned by the State. CBRD 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. CBRD 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 CBRD 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, CBRD performs foreign currency payment transactions and undertakes mandated activities for and on behalf of the Government. CBRD 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 ("**CASB**"). These assets are kept separate from CBRD's assets and CBRD does not have any liabilities in respect of them.

While a high percentage of CBRD's loans are made to intermediary banks, CBRD also extends loans directly to both private and public sector customers. Loans may be granted in kuna or in foreign currencies. CBRD 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 CBRD to perform other financial transactions if, in its opinion, such transactions are in the best interests of Croatia. CBRD does not, however, carry out any banking, credit or other financial operations or other operations which would distort competition between CBRD and other ordinary or specialised credit and financial or other institutions. CBRD 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, CBRD 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, 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 8.5 per cent. In 2019 the average number of unemployed persons amounted to 118,997 (decreased by 21.84 per cent. compared to 2018), while the average unemployment rate decreased to 6.6 per cent., the lowest rate ever.

According to the Croatian Convergence Programme for 2020 and 2021, the labour market is expected to react rapidly and adversely to the disruption of economic activity. Although the Government's wage and liquidity support measures intend to mitigate the fall in employment for some sectors, employment is expected to drop sharply in sectors that are likely to experience the longest disruption such as hospitality or tourism. The decline in employment should even out towards the end of the year, resulting in an unemployment rate of 9.5 per cent. in 2020.

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

	Year ended 31 December				
	2015	**2016**	**2017**	**2018**	**2019**
	(average for the period, in per cent.)				
ILO unemployment rate	16.2	13.1	11.2	8.5	6,6

Source: CBS

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

	Year ended 31 December				
	2015	**2016**	**2017**	**2018**	**2019**
	(average for the period, in per cent.)				
Registered unemployment rate	17.0	14.8	12.1	9.7	7.6

* 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.

Source: CBS

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				
	2015	**2016**	**2017**	**2018**	**2019**
	(average for the period)				
Total employed persons	1,585,267	1,589,943	1,625,069	1,655,000	1,679,476
Total unemployed	305,900	240,112	205,131	152,250	118,997
Rate of unemployment (per cent.)	16.2	13.1	11.2	8.4	6.7
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, 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 increased in 2018 by 29,968 (or an increase of 1.8 per cent.) and reached 1,655,037 persons. In 2019, the number of employed persons further increased by 24,439 (or an increase of 1.5 per cent.) and reached 1,679,476 persons.

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

	Year ended 31 December				
	2015	**2016**	**2017**	**2018**	**2019**
	(average for the period, thousands)				
Public administration and defence, compulsory social security	108	104	117	111	118
Education	115	117	122	131	129
Human health and social work activities	106	111	100	107	127
Total	**329**	**332**	**339**	**349**	**374**

Source: CBS

In 2015, an average of 328,700 people were employed in the public sector, representing an average of 20.7 per cent. of all employed persons. An average of 332,000 people were employed in the public sector in 2016, representing 20.9 per cent. of all employed persons, while in 2017 an average of 339,300 people were employed in the public sector, representing 20.9 per cent. of all employed persons. In 2018, the average number of employed in the public sector amounted to 349,000 persons, representing 21.1 per cent. of all employed persons. In 2019, an average of 374,400 people were employed in the public sector, representing an average of 22.3 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 Act on Employers and Trade Unions Associations Representativeness (OG 93/2014 and 26/2015), in force since 7 August 2014, is a single regulation that determines the criteria and procedures for collective bargaining and the criteria for the participation in Economic and Social Council.

The New Collective Agreement for Civil Service was signed on 9 November 2017. It was concluded for a period of 4 years. It was amended in November 2017 with the aim of adjusting provisions on the reimbursement of transportation costs. Amendments in December 2018 and November 2019 agreed further increases of base salaries.

From 2019 the labour market has been regulated by the new Labour Market Act (OG 118/2018 and 32/2020) which includes placement, career guidance, education for the purpose of employability of the workforce, insurance in case of unemployment, active labour market policy measures, other activities aiming at promotion of the spatial and professional mobility of the workforce, new employment and self-employment activity, employment on temporary and occasional jobs in agriculture and organisation, management and performance of activities of the Croatian Employment Service (CES).

The priorities and objectives of the active labour market policy (“**ALMPs**”) are laid down in the Guidelines for the Development and Implementation of Active Labour Market Policy for the period 2018 – 2020 and CES is the main body for the implementation of ALMPs measures in Croatia. The three main goals of the Guidelines are to increase the employment rate, to align the supply and demand in the labour market, and to increase activities informing participants of available measures. Special attention is put on persons in particularly vulnerable situations in the labour market, long–term unemployed, low skilled, youth, women, older workers, etc. The new guidelines were the base for improvement of ALMPs measures, although the first step to improve the measures was undertaken already in 2017 when the package was structured into 9 main groups of measures and since then it includes employment and self-employment subsidies, education and training measures, job preservation subsidies and public works schemes. This new ALMPs systematization was crucial to the further implementation of the ALMPs measures, and allowed the higher effectiveness and availability of ALMPs measures. Since then, ALMPs measures have been continuously updated on a yearly basis, depending on the labour market situation, but in line with the goals determined by the Guidelines. From January 2018 the special focus of ALMPs measures was put on employment and self-employment subsidies and training programmes. During 2018 ALMPs measures included 36.935 new participants, and during 2019 ALMPs measures included 36.926 participants. In 2020, during the special circumstances caused by the Coronavirus pandemic, the focus of the ALMPs measures was put on job preservation subsidies.

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 earnings 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 2015. 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. In 2019 the average monthly net and gross earnings continued to increase. The average monthly net earnings recorded a 3.4 per cent. increase in nominal terms and a 2.8 per cent. increase in real terms, amounting to HRK 6,457, while average monthly gross earnings amounted to HRK 8,766, increasing by 3.8 and 3.0 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				
	2015[1]	**2016**	**2017**	**2018**	**2019**
Average monthly gross wages and salaries in HRK..	8,055	7,752	8,055	8,448	8,766
Average monthly net wages and salaries in HRK	5,711	5,685	5,985	6,242	6,457

	Year ended 31 December				
	2015[(1)]	**2016**	**2017**	**2018**	**2019**
Net wages and salaries in EUR (average exchange rate)	750	755	802	842	871

[(1)] Data for 2015 according to new methodology (JOPPD form).

Source: CBS, CNB

As of March 2020, average net wages increased to EUR 889 monthly[1] as compared to EUR 728 monthly in 2013. Average net wages in the Republic of Croatia have been on an upward trend since 2014. The initial impact of the Coronavirus pandemic has resulted in slower growth in salaries year-on-year, from average gross wage growth of 4.2 per cent. year-on-year in the first two months of 2020 to 1.3 per cent. in March 2020 year-on-year.

Social Security System Unemployment

The social security system in Croatia consists of the Croatian Health Insurance Fund (the "**CHIF**"), 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.

For more information on the impact of the Coronavirus pandemic on unemployment, see "*Risk Factors—Croatia's economy remains vulnerable to both internal and external economic shocks as a result of the global Coronavirus pandemic*" and *"—Measures to assist the economy due to the Coronavirus pandemic*".

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 facing the 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

[1] *Source: Croatian Bureau of Statistics*

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.

In the coming period, the process of functionally integrating hospitals will continue. The purpose is to improve the quality of healthcare and streamline the use of all resources within the hospital healthcare system (workers, equipment, premises), because concentrating medical personnel and equipment in one place leads to more efficient healthcare. The functional linking of hospitals retains four fundamental medical activities (gynaecology and obstetrics, paediatrics, general internal medicine and surgery) whilst, depending on specific needs, other medical activities are concentrated in particular hospitals under suitable conditions. With assistance from the World Bank, external experts have been engaged to assess the current implementation of functional integration and have provided recommendations and suggestions for merging the remaining general hospitals.

For more information on the impact of the Coronavirus pandemic on healthcare, see "*Risk Factors—Croatia's economy remains vulnerable to both internal and external economic shocks as a result of the global Coronavirus pandemic*" and *"—Measures to assist the economy due to the Coronavirus pandemic*".

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 (people born between 1952 and 1961 had the opportunity to elect whether they will be part of the first or second pillar and those born after 1961 will be in the 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 was multifaceted and could 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 extended the 27 per cent. supplement of the pension entitlement (it was previously 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. This measure ensured that up until the end of April 2020, more than 2.7 thousand or 41.9 per cent. of insured persons chose to receive their pension from both pillars. The minimum pension was increased by 3.13 per cent. from mid-2019 and the accumulation of a supplementary contribution period of six months per child for the calculation of the pension entitlement of the parent was introduced. On the second objective, the reform proposal included: (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).

A dedicated set of measures addressed the design of the mandatory funded second pillar. The measures aimed at increasing the efficiency and performance of the mandatory funded second pillar, as well as the voluntary third pillar. The legislative acts introduced 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 modified some of the investment rules, introducing a new investment category, which allows pension funds to invest in infrastructural projects in Croatia within prescribed limits. It also introduced obligations on pension insurance companies to invest in empowering citizen's financial literacy as regards individual capitalised savings. 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 enabled the Croatian Pension Insurance Institute to establish a public pension insurance company that would be in charge of the pay-out of annuities from the second and third pillar. On pension insurance companies, the amended legislation also introduced 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.

Despite the positive developments stemming from the comprehensive reform of the pension system, the Government of the Republic of Croatia proposed new amendments to the Pension Insurance Act to address the concerns and will of the Croatian citizens and unions expressed in the Request for the State Referendum of the Citizens' Initiative "67 is too much". The Act on Amendments entered into force on 1 January 2020 and stipulates that: (i) an insured person gains old-age pension entitlement when the insured person reaches 65 years of age and 15 years of insurance period; (ii) an insured person gains early retirement pension entitlement when the insured person reaches 60 years of age and 35 years of insurance period; (iii) old-age pension entitlement for a long-term insured person is achieved when the insured person reaches 60 years of age and 41 years of insurance period in effective duration; (iv) a decrease in penalties for early retirement; and (v) a deceleration of the equalisation of retirement age for men and women in a transitional period from 1 January 2020 to 31 December 2029.

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
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	(10.7)	45,921	(11.1)
2017	1,231,858	(0.1)	2,526	3.8	153,150	(10.8)	39,123	(17.4)
2018	1,235,642	0.3	2,619	3.6	158,014	3.1	34,771	(12.5)
2019	1,240,619	0.4	2,721	3.7	154,856	(2.0)	35,329	1.6

(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.

Source: Croatian Pension Insurance Institute, Croatian Employment Service

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				
	2015	2016	2017	2018	2019
	(*end of the period, HRK thousands*)				
Mandatory funds [1]	74,004,667	84,179,365	91,924,545	98,126,194	112,598,105
Open voluntary funds [2]	3,044,842	3,548,401	3,895,569	4,231,346	5,119,466
Closed voluntary funds [3]	681,211	777,088	849,556	908,054	1,101,694
Total	**77,730,720**	**88,504,853**	**96,669,670**	**103,265,593**	**118,819,265**

(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: AZ A1, Croatia Osiguranje, Hrvatski Lijecnicki Sindikat, AZ Dalekovod, Ericsson Nikola Tesla, AZ HKZP, HEP Grupa, T-HT, AZ Zagreb, Cestarski, HAC Raiffeisen, Auto Hrvatska, AZ Zaba, AZ Treći horizont, Nestle, Erste, Policijski, FINA and Posta

Source: Croatian Financial Services Supervisory Agency

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. In 2019, total pension expenditure amounted to HRK 40.9 billion, of which HRK 23.5 billion referred to pension contributions and the remainder (HRK 17.4 billion) was covered by tax and other non-pension contribution revenues.

National Benefit for the Elderly

In May 2020, the Parliament adopted the Act on National Benefit for the Elderly (OG 62/2020), that introduced a new kind of cash benefit for the elderly Croatians. This new national benefit is intended for Croatian citizens over 65 years of age who have had permanent residence in the Republic of Croatia for a continuous period of 20 years, who do not have a minimum insurance period of 15 years to acquire the right to an old-age pension and who have no other source of income. This benefit has the starting amount of HRK 800 per month, with adjustment of annuity payments to the consumer inflation rate once a year from 1 January 2022. The Act on National Benefit for the Elderly will enter into force on 1 January 2021.

The Social Welfare System

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, 130/2017, 98/2019 and 64/2020) 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 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. The aim is to ensure a transparent and coordinated system of social benefits with available data on the type and amount of benefits for each person or beneficiary of social welfare system rights, continuity in tracking social welfare benefits ensured at the local and state level and transparency in tracking, for the purpose of more righteous allocation of funds and reducing poverty.

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 111 million.

- *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 requested damages in the amount of EUR 64.5 million.

- *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 requested damages in the amount of EUR 163.5 million.

- *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 57.1 million. The claimants withheld the right to subsequently modify their claim for compensation. The Republic of Croatia submitted its counter-memorial on 9 March 2020.

- *Société Générale v Republic of Croatia (ARB/19/33)*

  This arbitration was instituted on the basis of the Agreement between the Republic of France 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, as such 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 claimant has not yet specified its 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**	**2019***
			(per cent.)			
Current account balance in EUR (millions)	111.1	1,452.4	993.7	1,678.6	982.1	1,570.8
Current account (as a percentage of nominal GDP)..	0.3	3.3	2.1	3.4	1.9	2.9

* Based on preliminary data
Source: Croatian National Bank, Croatian Bureau of Statistics

In 2015, the current account balance significantly increased compared to the previous year and amounted to EUR 1.5 billion or 3.3 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). Furthermore, secondary income account net revenues also increased, while merchandise trade deficit widened to 7.0 per cent.

In 2016, the current account balance decreased compared to the previous year and amounted to EUR 1.0 billion or 2.1 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 of 7.4 per cent. 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 1.7 billion or 3.4 per cent. of GDP, as a result of improvements in the primary income, services, and secondary income accounts. The primary income account improved primarily as a result of the effects of provisioning for the Agrokor Group and connected companies. 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. On the other hand, the goods account saw the merchandise trade deficit widen further to 7.9 per cent., with both export and import growth increasing significantly.

In 2018, the current account balance decreased compared to the previous year and amounted to EUR 1.0 billion or 1.9 per cent. of GDP. This reduction was mostly due to a widening merchandise trade deficit of 9.2 per cent. In addition, although to a much smaller extent, the primary income account deteriorated. On the other hand, net exports of services and secondary income account net revenues continued to increase.

In 2019, the current account balance significantly increased compared to the previous year and amounted to EUR 1.6 billion or 2.9 per cent. of GDP. This improvement was mainly driven by a strong increase in net exports of services, primarily due to an additional increase in tourism revenue. In addition, an improvement was recorded in the secondary income account balance, as significantly more funds from the EU were distributed to end users in comparison with the previous year and net revenues from personal transfers increased as well. This was partially offset by the goods account deficit further widening to 9.4 per cent. and the primary income account also deteriorating. However, in 2020 the CNB expects a roughly neutral current account balance as a result of the Coronavirus pandemic. This is mainly due to the decline in the exports of goods and services, most notably, the sharp fall in tourism revenue.

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 16.9 per cent. In 2019, trade in goods was marked by relatively faster growth in exports than imports, which led to a significant deceleration in the growth of the trade in goods deficit (which increased by only 2.7 per cent.). In the first two months of 2020 the trade in goods deficit rose by 3.8 per cent. year on year, with somewhat stronger growth in exports compared to imports.

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 29 February**
	2014	**2015**	**2016**	**2017**	**2018**	**2019**	**2020***
				(per cent.)			
Food and live animals	1,029.9	1,215.3	1,377.2	1,397.9	1,518.7	1,615.3	280.7
Beverages and tobacco	172.4	176.4	194.1	250.5	298.9	313.7	43.8
Crude materials, except fuels	827.7	895.7	917.0	1,070.2	1,098.3	1,114.9	173.2
Mineral fuels and lubricants	1,393.5	1.259.5	1,165.0	1,488.8	1,537.8	1,433.3	221.8
Animal and vegtable oils and fats	25.8	27.6	49.8	60.3	65.1	69.1	10.5
Chemical products	1,105.7	1,362.3	1,631.8	1,977.6	1,841.9	2,274.0	270.6
Manufactured goods classified chiefly by material	1,666.8	1,812.3	1,927.5	2,265.5	2,462.9	2,567.4	417.5
Machinery and transport equipment	2,279.9	2,783.1	2,897.1	3,274.2	3,416.0	3,847.4	686.5
Miscellaneous manufactured articles	1,697.3	1,860.8	2,084.2	2,172.6	2,207.4	2,075.9	333.2
Commodities and transactions, n.e	105.8	93.8	45.8	33.5	38.3	39.3	8.3
Not classified	63.9	41.2	27.1	25.8	58.2	55.0	2.5
Total	**10,368.8**	**11,527.9**	**12,316.6**	**14,016.9**	**14,543.4**	**15,406.5**	**2,449.2**

(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: Croatian 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 3.8 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.

In 2019, goods exports increased by 5.9 per cent. from 3.8 per cent. recorded in 2018. Acceleration in total goods exports was the result of growth in the narrow aggregate (excluding energy) of 7.4 per cent. The growth of the narrow aggregate was broad based, with the strongest contribution coming from the exports of medicinal and pharmaceutical products, road vehicles, other transport equipment (mostly ships) and capital products (in particular electrical machinery, apparatuses and appliances). This was partially offset by a decrease in exports of energy predominantly due to a fall in exports of petroleum and petroleum products (by 4.9 per cent.), as well as a strong decrease in the exports of gas by 37.4 per cent.

During the first two months of 2020, according to CBS data, goods exports increased by 5.5 per cent. compared to the same period of 2019. Exports of energy strongly increased (by 11.3 per cent.) as a result of a sharp increase in exports of petroleum and petroleum products (by 45.8 per cent.). Exports of the narrow aggregate (excluding energy) grew by 4.9 per cent., while the strongest contribution came from the exports of other transport vehicles, particularly boats, and capital products (especially electrical machinery, apparatuses and appliances). However, this trend is expected to reverse as a result of the Coronavirus pandemic.

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 29 February
	2014	**2015**	**2016**	**2017**	**2018**	**2019**	**2020***
				(EUR millions)			
Food and live animals	1,916.7	2,111.5	2,195.1	2,408.5	2,479.2	2,759.8	430.9
Beverages and tobacco	194.9	218.0	233.0	298.0	337.4	400.7	56.6
Crude materials, except fuels	296.0	337.0	334.3	393.1	458.5	451.6	73.7
Mineral fuels and lubricants	3,179.4	2,808.6	2,424.6	2,896.8	3,223.6	3,040.3	456.4
Animal and vegtable oils and fats	96.9	94.3	98.5	99.2	95.1	105.5	16.9
Chemical products	2,264.9	2,607.4	3,011.9	3,034.3	3,305.7	3,564.1	677.3
Manufactured goods classified chiefly by material	3,033.7	3,341.2	3,512.5	3.912.1	4,133.4	4,282.0	715.6
Machinery and transport equipment	3,852.9	4,431.5	5,050.5	5,623.3	6,291.2	6,769.3	1,017.2
Miscellaneous manufactured articles	2,264.4	2,522.0	2,839.2	3,208.7	3,403.2	3,461.7	576.9
Commodities and transactions, n.e	24.4	6.5	7.4	14.3	16.9	18.2	3.4
Not classified	5.2	4.9	4.8	3.1	3.1	3.1	0.4
Total	**17,129.4**	**18,482.9**	**19,711.9**	**21,891.6**	**23,747.6**	**24,856.3**	**4,034.3**

* The data for 2019 and 2020 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: Croatian 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 driven 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 8.5 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, capital products (in particular 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.

Growth of total goods imports strongly decelerated to 4.7 per cent. in 2019 compared to 8.5 per cent. in 2018 primarily due to a decrease in imports of energy by 5.7 per cent. This decrease was driven by lower imports of petroleum and petroleum products (by 9.0 per cent.). In relation to imports of the narrow aggregate there was an annual growth of 6.3 per cent., mainly due to larger imports of road vehicles, medicinal and pharmaceutical products as well as food products.

Increase in total goods imports during the first two months of 2020 (by 4.9 per cent.) was mainly influenced by the growth in the narrow aggregate (by 4.7 per cent.), with medicinal and pharmaceutical products, road vehicles, and textile industry products being the single largest contributors. Imports of energy increased by 6.2 per cent., as a strong decrease in imports of electric current (by 35.4 per cent.) and gas (by 22.4 per cent.) was mitigated by a sharp increase in imports of petroleum and petroleum products (by 37.4 per cent.). However, imports are expected to sharply decline with the Coronavirus pandemic.

Geographical Distribution of Croatia's Trade in Goods

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

	2014	**2015**	**2016**	**2017**	**2018**	**2019**	**Two months ended 29 February 2020***
				(per cent.)			
EU 27	63.9	66.7	66.4	64.9	68.7	68.7	72.0
Slovenia	11.4	12.3	12.5	10.8	11.1	10.6	10.7
Hungary	3.5	3.6	3.8	3.4	3.4	4.0	6.5
EU 15	42.2	43.7	43.6	43.5	46.4	45.9	47.0
Austria	6.1	6.5	6.4	6.3	6.4	5.8	5.8
Italy	13.9	13.4	13.7	13.7	14.6	13.9	12.5
Germany	11.2	11.3	11.8	12.3	13.2	13.0	12.7
CEFTA	20.2	17.9	16.4	17.4	16.9	17.8	15.7
Bosnia and Herzegovina	11.8	9.7	9.1	9.8	9.4	9.9	8.5
Serbia	4.9	4.9	4.2	4.8	4.4	4.5	4.1
EFTA(1)	1.7	1.6	1.6	1.6	1.8	1.7	1.6
Other(2)	14.2	13.9	15.6	16.1	12.6	11.8	10.7
Russia	2.6	1.7	1.5	1.3	1.0	1.0	0.5
China	0.5	0.6	0.6	0.8	0.9	0.7	0.6

* The data for 2019 and 2020 is provisional
(1) European Free Trade Association.
(2) Excluding EU 27, CEFTA and EFTA.
Source: Croatian 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).

Despite a significant slowdown in exports to Member States in 2019 compared to 2018, the Member State's share of total goods exports remained broadly unchanged (68.7 per cent.). However, exports growth to the EU-12 and EU-15 followed somewhat different dynamics. The share of exports to the EU-12 increased, mostly due to a strong increase in exports to Hungary (petroleum, petroleum products and fertilizers) and Malta (other transport equipment). On the other hand, the share of exports to the EU-15 decreased, mostly due to strong decrease in exports to Luxembourg (other transport equipment). Unlike Member States, the share of Croatian exports to CEFTA recovered in 2019, mostly due to stronger exports to Bosnia and Herzegovina (electric current, petroleum and petroleum products and road vehicles), while the share of exports to countries other than EU, CEFTA and EFTA fell significantly.

During the first two months of 2020, the share of exports to Member States strongly increased (reaching 72.0 per cent. of total goods exports), mostly as a result of higher exports to Luxembourg (other transport equipment) and Hungary (petroleum and petroleum products). During the same period, the share of Croatian exports to CEFTA decreased, predominantly due to lower exports to Bosnia and Herzegovina (electric current), while share of exports to other countries continued to decline further, as a result of a decrease in exports to Saudi Arabia (miscellaneous manufactured articles) and Russia (oil-seeds and oleaginous fruits).

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

	Year ended 31 December						Two months ended 29 February
	2014	2015	2016	2017	2018	2019	2020*
				(per cent.)			
EU 27	76.4	78.0	77.2	78.1	78.1	80.3	81.6
Slovenia	10.8	10.7	10.9	10.7	11.2	11.5	11.3
Hungary	6.6	7.8	7.1	7.6	7.7	8.4	8.3
EU 15	50.8	51.2	50.5	50.2	49.0	40.1	51.6
Austria	8.7	9.1	8.0	7.6	6.9	6.5	6.7
Italy	14.3	13.1	12.6	12.8	13.2	13.9	14.0
Germany	15.1	15.5	16.1	15.4	15.3	15.4	14.7
CEFTA	5.3	5.5	5.9	6.2	6.0	5.6	5.3
Bosnia and Herzegovina	2.7	2.7	2.9	3.1	3.1	2.8	2.6
Serbia	2.1	2.3	2.5	2.6	2.5	2.4	2.3
EFTA(1)	1.2	1.0	1.0	0.9	1.0	0.7	0.8
Other(2)	17.2	15.5	15.9	14.9	14.9	13.4	12.4
Russia	5.0	2.3	1.5	1.4	1.6	1.2	0.8
China	2.6	2.8	2.9	3.2	3.4	2.9	3.4

* The data for 2019 and 2020 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: Croatian 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.

Croatian imports from Member States increased by more than 2 percentage points in 2019 year on year, reaching 80.3 per cent. of total goods imports. Such developments were primarily the result of stronger imports from Italy (petroleum and petroleum products), Hungary (electric current), Germany (road vehicles and medicinal and pharmaceutical products) and Slovenia (road vehicles and non-ferrous metals). The proportion of imports from CEFTA only slightly decreased, mainly as a result of lower imports from Bosnia (non-ferrous metals) and North Macedonia (iron and steel and manufactures of metals), while imports from other countries saw a steep fall following the decline of imports of petroleum and petroleum products from Iraq.

In the first two months of 2020, developments in the geographical distribution of Croatian imports were consistent with 2019. The share of imports from Member States further increased amounting to 81.6 per cent. of total goods imports, mainly due to a significant increase in imports of medicinal and pharmaceutical products from Belgium. The share of total imports from CEFTA slightly declined, followed by decrease in imports of electric current from Bosnia, while the proportion of imports from other countries declined strongly, predominately due to lower imports of medicinal and pharmaceutical products from South Korea.

In 2015, net exports of services increased by 12.0 per cent. compared to 2014, with the largest positive contribution from tourism services. Tourism revenues in 2015 increased by 10.3 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 strongly increased by 12.7 per cent. compared to the previous year mainly owing to positive developments in tourism services. Tourism revenues increased by 12.2 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 7.6 per cent. compared to the previous year. The biggest contributor was the tourism sector with an annual growth rate of revenues at 10.6 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 10.6 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 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 4.9 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 6.0 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 computer services), as well as transportation services increased.

In 2019, the growth of net exports of services strongly accelerated to 11.9 per cent. compared to the previous year, mostly owing to the growth of tourism revenues by 10.9 per cent. The recorded acceleration in tourism revenues was mainly driven by rising average consumption of foreign tourists, while physical indicators rose at a much slower pace. Foreign tourist arrivals grew by 4.3 per cent. and overnight stays rose by only 1.2 per cent., with tourists from Slovenia, United States, Ukraine, Great Britain and France accounting for the strongest increase in the number of nights spent. However, the growth in overnight stays was dominated by domestic tourists, which increased by 9 per cent. compared to 2018, while the growth in overnight stays for foreign tourists increased by 1 per cent. compared to 2018. Foreign tourists accounted for approximately 92 per cent. of total overnight stays in 2019. Furthermore, net revenues from other services (especially research and development) also saw an increase from the previous year.

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

	Year ended 31 December					
	2014	**2015**	**2016**	**2017**	**2018**	**2019**
Tourism Revenue (*EUR billions*)	6.5	7.2	8.1	9.0	9.5	10.5
Per cent. GDP *(%)*	15.1	16.2	17.4	18.2	18.4	19.5
OVERNIGHT STAYS						
			(millions)			
Domestic	5.1	5.7	5.8	6.0	6.5	7.1
Foreign	61.2	65.7	72.1	80.2	83.2	84.1
Total	**66.3**	**71.4**	**77.9**	**86.2**	**89.7**	**91.2**

It is expected that in 2020 the Coronavirus pandemic will have a devastating impact on tourism amid strict containment measures, closed borders and self-quarantine requirements. However, as a popular destination for many Europeans, Croatia is expecting to save a portion of the 2020 tourist season in peak summer months.

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 CNB (external debt relations, monetary statistics and reserve assets), and estimates and statistical research carried out by the CNB.

The balance of payments tabulates the credit and debit transactions of a country with foreign countries and international institutions for a specific period. Transactions are divided into three broad groups: current account, capital account and financial account. The current account is made up of: (1) trade in goods, (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:

Balance of payments for the periods indicated (EUR millions)

	Year Ended 31 December				
	2015	**2016**	**2017**	**2018**	**2019***
			(EUR millions)		
CURRENT ACCOUNT	1,452.4	993.7	1,678.6	982.1	1,570.8
Goods, services, and primary income	(144.1)	(822.2)	(376.2)	(1,214.9)	(865.0)
Credit	21,496.3	22,172.8	25,046.4	27,900.0	30,266.2
Debit	21,640.4	22,994.2	25,423.3	29,114.9	31,131.1
Goods and services	133.8	563.7	343.6	(414.5)	(26.8)
Credit	20,727.8	22,2452.2	24,616.0	26,100.5	28,123.7
Debit	20,593.9	21,681.6	24,272.4	26,515.0	28,150.5
Goods	(7,116.8)	(7,606,9)	(8.447.9)	(9,638.9)	(10,345.7)
Credit	10,193.5	10,510.6	11.712.1	12,233.8	12,848.2
Debit	17,310.3	18,117.6	20,160.1	21,872.7	23.193.9
Services	7,250.6	8,170.6	8,791.6	9,224.5	10,319.9
Credit	10,534.3	11,734.6	12,903.9	13,866.7	15,275.5
Debit	3,283.7	3,564.0	4,112.3	4,642.2	4.956.5
Manufacturing services on physical inputs					275.8
owned by others	251.3	264.4	258.2	251.9	
Credit	277.0	300.9	302.0	300.8	323.7
Debit	25.6	36.6	43.9	49.0	47.9
Transport	438.9	510.1	504.3	554.1	542.6
Credit	1,018.2	1,077.5	1,147.0	1,223.9	1,237.9
Debit	579.3	567.4	642.6	669.8	695.3
Travel	6,537.5	7,244.7	7,757.7	8,066.1	8,964.3
Credit	7,219.2	8,098.2	8,959.6	9,501.2	10,539.1
Debit	681.8	853.5	1,201.9	1,435.1	1,574.8
Other Services	23.0	151.5	271.4	352.5	536.1
Credit	2,019.9	2,257.9	2,495.3	2,840.8	3,174.8
Debit	1,997.0	2,106.5	2,223.9	2,488.3	2,638.7
Primary income	(278.0)	(1,385.8)	(720,6)	(800.4)	(838.2)
Credit	768.5	(72.5)	430.4	1,799.5	2,142.4
Debit	1,046.5	1,313.4	1,151.0	2,599.9	2,980.6
Secondary income	1,596.5	1,815.9	2,055.5	2,197.0	2,435.7
Credit	2,720.2	3,013.2	3,274.1	3,490.6	3,873.7
Debit	1,123.7	1,197,3	1.218.6	1,293.6	1,438.0
CAPITAL ACCOUNT	335.2	702.4	537.8	729.8	1,117.1
FINANCIAL ACCOUNT	1,798.2	1,485.5	2,381.9	1,786.9	2,417.0
Direct investment	(209.8)	(1,999.1)	(1,133.2)	(774.4)	(1,012.2)
Assets	(179.7)	(1,629.1)	(672.8)	261.5	225.0
Liabilities	30.1	370.0	460.4	1,040.9	1,237.2
Portfolio investment	(148.0)	1,359.5	391.4	885.5	526.0
Assets	151.5	(123.6)	430.4	336.4	1,1774
Liabilities	299.5	(1,483.1)	39.0	(549.1)	651.4
Financial derivatives	(130.0)	(149.1)	(371.5)	84.4	(113.2)
Other investment	1,540.7	2,539.0	901.9	51.4	2,026.7
Assets	(12.3)	367.5	506.1	(558.8)	(602.6)
Liabilities	(1,552.9)	(2,171.5)	(395.8)	(610,2)	(2,629.3)
Reserve Assets	745.3	(264.7)	2,593.1	1,545.0	989.6
NET ERRORS AND OMISSIONS[1]	10.5	(210.5)	165.5	75.0	(270.8)

* Preliminary data

(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.

Source: Croatian National Bank

The negative balance on the primary income account declined by 67.9 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 banks and the effect of revisions to the financial statements of multinational companies, 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 48.0 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 other foreign-owned non-financial firms, in particular those engaged in the manufacture of refined petroleum products and architectural and engineering services, were recorded. In 2018 the negative balance on the primary income account deteriorated by 11.1 per cent. compared to the previous year, spurred by the increasing expenditures from equity investments. More specifically, banks' profits increased strongly after negative one-off credit impairments in the previous year as well as profitability of other foreign-owned non-financial companies, mostly in real estate, information and communication activities and arts, entertainment and recreation. On the other hand, unfavourable developments were offset by the improvement of the balances of 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. In 2019 the negative balance of the primary income account slightly deteriorated by 4.7 per cent. compared to the previous year, mostly as a result of the rising profitability of banks and other foreign-owned non-financial companies, primarily in the pharmaceutical sector and trade. However, these unfavourable developments were once again offset by decreasing interest expenditures on foreign liabilities as well as strong increases in remittances.

Net revenues on the secondary income account increased noticeably (by 41.0 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 13.7 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 13.2 per cent., due to an increase funding from the EU budget and other transfers. Positive trends continued in 2018 when net revenues in the secondary account increased by 6.9 per cent. The positive balance in the secondary income account continued to increase in 2019 (by 10.9 per cent.) due to other transfers as well as further strong improvement in EU funds absorption.

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 2019 significant increase in the withdrawal of funds was recorded and the overall positive balance on the capital account reached EUR 1.1 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 2017,1.8 per cent. of GDP in 2018 and finally 2.6 per cent. of GDP in 2019.

Financial Account

In 2015, net capital outflow (financial account excluding the net international reserves[2]) increased to EUR 2.2 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 Act on Amendments to the Act 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 0.9 billion (as the unfavourable impact of cross-currency changes and other adjustments was EUR 1.1 billion) and stood at EUR 48.2 billion or 108.0 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 net international reserves) amounting to EUR 1.5 billion. Net inflow of foreign direct investment intensified compared to the 2015, mainly driven by a considerable improvement of the reinvested earnings in the banking 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 3.5 billion and stood at EUR 44.7 billion or 95.9 per cent. of GDP at the end of 2016.

In 2017 net capital outflow (the financial account excluding net international reserves) amounted to EUR 0.5 billion. Net inflow of foreign direct investment was considerably 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 1.3 billion, the stock of gross external debt declined by EUR 1.0 billion and stood at EUR 43.7 billion or 88.9 per cent. of GDP at the end of 2017.

In 2018, a small net capital inflow (the financial account excluding the net international reserves) of EUR 0.2 billion was recorded, 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 decelerated as the net foreign position of banks remained almost unchanged after several years of strong improvements. On the other hand, strong deleveraging by the government sector and other domestic sectors (due to strong deleveraging towards affiliated creditors) continued. Accordingly, while the impact of cross-currency changes and other adjustments was unfavourable and rather small (EUR 0.1billion), the stock of gross external debt declined by EUR 1.0 billion and stood at EUR 42.7 billion or 82.7 per cent. of GDP.

Unlike the previous year, in 2019 a net capital outflow (the financial account excluding the net international reserves) of EUR 1.0 billion was recorded. The recorded net outflow of capital in the financial account can primarily be attributed to the fall in liabilities in the account of other investments as a result of domestic sectors and government deleveraging. Net equity flows were lower compared to 2018, while deleveraging of domestic sectors slightly intensified, mainly driven by the government and other domestic sectors. On the other hand, the net foreign position of banks deteriorated for the first time after 2011. The stock of gross external debt declined by EUR 1.8 billion (as the unfavourable impact of cross-currency changes and other adjustments was EUR 0.3 billion) and stood at EUR 40.9 billion or 75.7 per cent. of GDP at the end of 2019. In January 2020 the stock of gross external debt increased by EUR 0.2 billion, mostly as a result of deterioration in net foreign position of banks and CNB. Gross international reserves stood at EUR 16.0 billion as at 30 April 2020, representing a decrease of EUR 2.6 billion compared to 31 December 2019. This was mostly the result of foreign exchange interventions by CNB during the Coronavirus pandemic. As at 30 April 2020, international reserves were sufficient to cover 122.4 per cent. of base money (MO) and 85.2 per cent. of money supply ("**M1**"). Absolute amount of gross international reserves declined only slightly by end of May 2020 to EUR 15.8 billion.

Foreign Direct Investment

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

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

	Year ended 31 December				
	2015	2016	2017	2018	2019*
			(EUR millions.)		
Assets	(179.7)	(1,629.1)	(672.8)	261.5	225.0
Liabilities	30.1	370.0	460.4	1,040.9	1,237.2
Direct Investment	**(209.8)**	**(1,999.1)**	**(1,133.2)**	**(779.4)**	**(1,012.2)**
Direct Investment as a percentage of GDP	**(0.5)**	**(4.3)**	**(2.3)**	**(1.5)**	**(1.9)**

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 tobacco industry, management consultancy and real estate activities.

Net foreign direct investment inflow in Croatia increased significantly in 2016 and amounted to EUR 2.0 billion (4.3 per cent. of GDP). Excluding the effect related to the revised financial statements of a multinational company, this was mainly driven by relatively large reinvested earnings on the liabilities side, in line with the much higher profitability for domestic banks that was accompanied by 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 1.1 billion (2.3 per cent. of GDP), mostly due to a recovery of foreign direct investment abroad. On the liability side, equity investments were lower compared to the previous year, with new investments mostly taking 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. Lower equity investment and retained earnings were more than offset by increased debt liabilities.

Net foreign direct investment inflow dropped from 2.4 per cent. of GDP to 1.3 per cent. in 2018. Excluding the effect related to the revised financial statements of a multinational company in 2017, this was 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 on the liabilities side 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 similar to the last year and were mostly recorded in the real estate sector.

Net FDI inflow increased from 1.3 per cent. of GDP in 2018 to 1.9 per cent. of GDP in 2019 mostly due to much lower deleveraging of the corporate sector to affiliated borrowers on the liabilities side. Reinvested earnings in 2019 remained almost unchanged compared to 2018, as the large increase in corporate sector retained earnings (in particular in the pharmaceutical industry) was offset by a decrease in retained earnings by banks. On the other hand, equity investments, excluding debt to equity swaps were somewhat lower compared to last year and were mostly recorded in 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 "**CNB**"), expressed as kuna per euro.

	2015	2016	2017	2018	2019	2020
		(HRK/EUR)				
January	7.679826	7.652777	7.534989	7.440202	7.424741	7.440038

	2015	2016	2017	2018	2019	2020
February	7.709544	7.636668	7.450718	7.434137	7.411951	7.447267
March	7.648124	7.566498	7.419710	7.436512	7.416254	7.548351
April	7.594858	7.494619	7.441166	7.418312	7.426090	7.596097
May	7.553892	7.494223	7.433633	7.388816	7.413388	7.569279
June	7.565026	7.511915	7.405667	7.376993	7.406491	
July	7.579293	7.489517	7.405674	7.388817	7.386686	
August	7.554396	7.477713	7.398765	7.412997	7.381077	
September	7.574467	7.490070	7.450196	7.422715	7.395688	
October	7.622835	7.502932	7.501332	7.418863	7.426955	
November	7.598376	7.513263	7.544639	7.425220	7.438456	
December	7.634682	7.534257	7.543915	7.401281	7.436526	
Yearly average	7.609601	7.529383	7.460100	7.414111	7.413605	

Source: CNB

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 CNB 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 CNB 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 CNB 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 EUR/HRK 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 CNB 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 CNB 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 CNB 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 CNB 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 EUR/HRK 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 CNB 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 CNB 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 CNB 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 EUR/HRK 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 CNB 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 CNB during 2017 resulted in a net foreign exchange purchase of EUR 1,787.6 million (creating HRK 13.4 billion of reserve money). The CNB 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 EUR/HRK 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, CNB 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.

In 2019, kuna continued appreciating until late August 2019, when the trend reversed and the kuna depreciated back to the levels observed in the beginning of the year. Looking at 2019 as a whole, the nominal exchange EUR/HRK rate recorded a modest depreciation of 0.3 per cent., rising from HRK 7.42 to EUR 1 at the end of 2018 to HRK 7.44 to EUR 1 at the end of 2019. In order to prevent excessive appreciation of the domestic currency, the CNB intervened in the foreign exchange market three times in 2019: once in February 2019, by buying a total amount of EUR 450.3 million worth of foreign currency from banks, and twice in August 2019, by purchasing from banks EUR 306.5 million and EUR 332.1 million, respectively. In 2019, the CNB also net purchased EUR 228.1 million worth of foreign currency from the central Government. There were no transactions done with the European Commission.

The outbreak of the Coronavirus pandemic affected the foreign exchange market in the first four months of 2020. The nominal EUR/HRK exchange rate, after stagnating in the beginning of the year, started to depreciate in late February 2020, rising from 7.44 to EUR 1 on 25 February 2020 to a maximum of 7.63 to EUR 1 on 10 April 2020 (a 2.5 per cent. depreciation). However, depreciation pressures mostly abated during the second half of April 2020 and the exchange rate returned to 7.55 to EUR 1 by end of April 2020 (a 1.5 per cent. appreciation from the end of 2019). The average exchange rate in the first four months of 2020 was 7.51 to EUR 1 (1.3 per cent. higher than the 2019 average exchange rate). The CNB prevented excessive depreciation by intervening strongly on the FX market. In March the CNB sold a total of EUR 2.5 billion worth of foreign reserves, followed by additional EUR 50 million of out of auction sales in April 2020. Regarding other FX transactions, in the first four months of 2020 the CNB net purchased from the Ministry of Finance EUR 183.3 million. Altogether, in all FX transactions during the first four months of 2020, the CNB sold a total of EUR 2.4 billion, thus withdrawing HRK 18.1 billion of reserve money. This was compensated by provision of kuna liquidity through other monetary instruments (for an overview of other instruments, see "*Monetary Policy Developments January 2014 – April 2020*").

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
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
2019	6.649911	6.622347	6.797439	6.439358
January 2020	6.753753	6.701245	6.762194	6.639568
February 2020	6.758732	6.827949	6.895643	6.720237
March 2020	6.876225	6.822262	7.113125	6.561214
April 2020	6.957730	6.988266	7.053179	6.940310
May 2020	6.812199	6.955290	7.019839	6.834387

Note: Calculations based on mid exchange rate.
(1) Average of daily rates.
Source: CNB

The kuna depreciated against the U.S. dollar in 2015, 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. In 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. The U.S.$/HRK exchange rate increased by 2.8 per cent., from 6.47 at the end of 2018 to U.S.$/HRK 6.65 at the end of 2019. During the first four months of 2020 depreciation of the kuna against the U.S. dollar further intensified. At 30 April 2020, the exchange rate stood at U.S.$/HRK 6.96, depreciating by 4.6 per cent. compared to the level observed at the end of 2019.

After somewhat 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 depreciated by 1.8 per cent. in 2014 and by 4.0 per cent. in 2015. The average real effective kuna exchange rate deflated by consumer prices depreciated in 2014. This almost entirely reflected favourable price developments in Croatia relative to Croatia's main trading partners. 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 3.1 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. The average real effective kuna exchange rate deflated by consumer prices was also broadly unchanged in 2016. 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 appreciated 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 2019 real effective exchange rates deflated by consumer and producer prices depreciated slightly, mainly as a result of the favourable price developments in Croatia relative to its main trading partners. Regarding the indicators of cost competitiveness, the real effective kuna exchange rate deflated by unit labour costs in the whole economy and in industry depreciated in 2014. In 2015, the real effective kuna exchange rate deflated by unit labour costs in the whole economy and in industry depreciated further, reflecting favourable developments in cost competitiveness of Croatia compared to its main trading partners. In 2016, depreciation of the real effective kuna exchange rate, deflated by unit labour costs, continued, both in the whole economy and in industry. In 2017, depreciation of the real effective kuna exchange rate deflated by unit labour costs in the whole economy continued, but at a slower pace than in the previous year. At the same time, the real effective kuna exchange rate deflated by unit labour costs in industry appreciated, both as a result of the nominal effective exchange rate appreciation of the kuna and unfavourable domestic cost 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. In 2019, the real effective kuna exchange rate deflated by unit labour costs in the whole economy and in industry depreciated as a result of favourable domestic cost trends compared to main trading partners.

MONETARY DEVELOPMENTS, INTERNATIONAL RESERVES AND FINANCIAL SYSTEM

Monetary Policy and Instruments

Despite the negative effects of the COVID-19 pandemic, the CNB 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 CNB 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 2020*".

Monetary Policy Developments January 2014 – April 2020

The CNB continued to implement the expansionary monetary policy together with maintaining the stable nominal euro/kuna (EUR/HRK) exchange rate. The expansionary monetary policy stance in 2014 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. In 2019 excess liquidity rose further to HRK 32.2 billion, while in the first four months of 2020 it reached a historically high level of HRK 35.8 billion. Favourable liquidity conditions contributed to the lowering and maintaining of overnight interest rates on bank demand deposit trading at exceptionally low levels (only 0.03 per cent. on average in 2019 and in the first four months of 2020, down from 0.06 per cent. in 2018). 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 0.06 per cent. throughout the first four months of 2020, which makes it lower than an average of 0.08 per cent. in 2019 and 0.10 per cent. in 2018 and more than six times lower compared to an average of 0.45 per cent. recorded in 2017.

Reserve money creation has mainly been driven by foreign currency transactions. In 2014, due to seasonal depreciation pressures the CNB 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 CNB continued conducting foreign currency transactions with the Ministry of Finance and European Commission. In the period from January to December 2014, the CNB 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 CNB 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 CNB 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 CNB 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 CNB continued with an accommodative monetary policy while keeping the exchange rate stable. The CNB 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 CNB 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 CNB, 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 CNB 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

CNB 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 Act on Amendments to the Act 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 CNB 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 CNB implemented a set of monetary policy measures in September and October 2015. Firstly, in order to alleviate depreciation pressures on the kuna, the CNB intervened on the FX market by selling EUR 268.3 million on 30 September 2015, thus withdrawing HRK 2 billion. The CNB also provided additional kuna liquidity by resuming weekly reverse repurchase operations. Additionally, the CNB abolished the mandatory holding of CNB 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 CNB widened the list of securities eligible for collateral and reduced the CNB 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 CNB abolished the requirement to allocate the foreign exchange component of the reserve requirement to a separate account with the CNB 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 CNB 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 euroization in the banking system and, in turn, of the currency risk exposure of the economy and consumers. However, a more pronounced reduction of euroization is conditional on changing the currency structure of bank deposits in favour of kuna deposits.

Foreign exchange transactions of the CNB 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 CNB further intervened in December 2016, twice in foreign exchange auctions and twice out of auction. In 2016 as a whole, the CNB 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, CNB'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 CNB conducted a number of FX purchases from banks (both through auctions and outside of auctions). In 2017, the CNB 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, CNB 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 CNB 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 CNB purchased EUR 18,089 million 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.

In 2019, the CNB continued to conduct FX purchases from banks to alleviate appreciation pressures on the kuna. In an auction in February, the CNB purchased EUR 450.3 million from banks, and in two auctions conducted in August it purchased from banks EUR 306.5 million and EUR 332.1 million. During the same year the CNB also net purchased EUR 228.1 million from the Ministry of Finance. In all of the FX transactions during 2019, the CNB net purchased EUR 1.3 billion, thus creating HRK 9.7 million of reserve money.

The first four months of 2020 were characterised by the negative effects of the outbreak of the COVID-19 pandemic. Uncertainty caused by the pandemic increased the demand for liquid euro assets which led to intensified depreciation pressures on the kuna in late February and March. Demand was largely fuelled by withdrawals from Euro investment funds, and subsequent transfers to foreign currency deposits held with domestic banks. To prevent excessive depreciation, the CNB conducted a number of FX sales transactions both through and outside of auctions. In five auctions conducted in March, the CNB sold a total of EUR 2.2 billion to banks, while in seven auction transactions in March and three in April the CNB sold an additional EUR 0.3 billion in aggregate. Regarding other FX transactions, in the period January to April 2020, the CNB net purchased EUR 183.3 million from the Ministry of Finance. Therefore, in all FX transactions during the first four months of 2020, the CNB sold a total of EUR 2.4 billion, withdrawing HRK 18.1 billion of reserve money.

The withdrawal of kuna liquidity through FX transactions was offset by other monetary policy instruments aimed at releasing kuna liquidity. The long-term liquidity was granted to credit institutions through structural operations. At an auction held in mid-March 2020 (the first structural auction since December 2018) the CNB allocated to banks HRK 3.8 billion at a rate of 0.25 per cent. and maturity of five years, which was the biggest amount ever allocated through this instrument. In mid-March 2020, the CNB also started to place funds through regular weekly operations for the first time since December 2017. The average daily amount of funds allocated to banks through weekly operations during March and April was HRK 1.0 billion, while the repurchase rate was reduced from 0.3 per cent. in the first auction in March to 0.05 per cent. in the following auctions.

With the aim to stabilise the domestic bond market stressed by the fire sales of investment banks' assets, in March 2020 the CNB started purchasing securities of the Republic of Croatia. Also, the list of potential participants in the securities purchase and sale operations was expanded beyond banks, and now includes pension fund management companies, pension insurance companies, open-end investment fund management companies, insurance companies and housing savings banks. Since mid-March the CNB conducted three auctions, in which it purchased government bonds with the nominal value of HRK 13.8 billion (HRK 0.2 billion and HRK 4.1 billion on the two auctions conducted in March, respectively, and HRK 9.5 billion on the auction conducted in April), thereby creating HRK 15.9 billion of liquidity (note that the last auction conducted on 28 April 2020 was settled three working days later, so the effect on liquidity is recorded in the beginning of May).

In March 2020, the CNB also reduced the reserve requirement rate from 12 to 9 per cent. The reduction of the reserve requirement rate lowered the overall amount of the reserve requirement by HRK 10.45 billion, of which HRK 6.33 billion was transferred from the banks' required reserve account to their settlement accounts with the CNB.

Altogether, the measures implemented by the CNB to maintain monetary and financial stability alleviated the effects of shocks in the financial markets. Domestic interest rates remained very low and banking system liquidity very high. The average banks' excess liquidity in domestic currency during April stood at HRK 32.8 billion, while the overnight interest rates on bank demand deposit trading rose slightly to 0.07 per cent. in April, and the yield on 1-year kuna T-bills remained unchanged at 0.06 per cent. in April. As of the end of April 2020, the CNB had HRK 98.6 billion of reserve money compared to HRK 108.4 billion at the end of 2019 and to HRK 101.8 billion at the end of 2018.

Reserve Requirements and Credit Schemes

At the end of 2013, the CNB 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 CNB bills from the released funds of a total amount of HRK 3.9 billion. On a monthly basis, the CNB redeems compulsory bills in the amount of half of the increase in a bank's placements to domestic non-financial corporations in the previous month. From 31 December 2013 to 31 December 2014, the CNB 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 CNB abolished it in 2015 and repurchased the remaining amounts held by banks, thus releasing HRK 3.4 billion in October 2015. In the period from 2016 to April 2020 the CNB did not introduce any new credit support schemes.

In the 2016-2019 period, the reserve requirement rate remained unchanged at 12 per cent. In March 2020, the CNB reduced the reserve requirement rate from 12 per cent. to 9 per cent. with the aim of releasing additional liquidity following the liquidity withdrawal conducted through FX transactions. The reduction of the reserve requirement rate lowered the overall amount of the reserve requirement by HRK 10.45 billion (of which HRK 9.05 billion was in HRK and the rest in FX). As banks hold 70 per cent. of required kuna reserves in HRK on their blocked required reserve accounts with the CNB and 30 per cent. on their settlement's accounts with the CNB, the amount of HRK 6.33 billion was transferred from the banks' required reserve accounts to settlement accounts with the CNB.

Foreign Currency Liquidity and Reverse Operations

At the beginning of 2011, the CNB 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 CNB reduced regulatory costs for banks. In early 2012, the CNB 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 CNB 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 CNB 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 CNB 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 CNB 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 CNB 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 CNB continued to include it in the minimum required liquid foreign currency claims of banks. 455-day EUR-linked T-bills issued in January 2019 were refinanced in April 2020 with a 364-day EUR-linked T-bills to the amount of EUR 1,035.2 million at 0.06 per cent, and the CNB again continued to include those T-bills 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 CNB 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 CNB provided HRK 1.2 billion at the rate of 0.80 per cent. The CNB 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. During 2018 and 2019, the CNB 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. However, in March 2020 excess liquidity shrank because of large FX sales amid the Coronavirus pandemic, thus prompting the CNB to start providing short-term liquidity through regular weekly operations again. On the first auction held on 16 March, CNB placed HRK 750 million at a fixed repurchase rate of 0.30 per cent. On the following auctions the rate was reduced to 0.05 per cent., while the placed amounts ranged between HRK 350 million and HRK 1,520 million. From mid-March to the end of April the average daily value of funds placed through weekly operations amounted to HRK 1.0 billion.

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 CNB 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 CNB 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 CNB 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 CNB held no additional auctions for long-term funding until mid-March 2020, when it allocated HRK 3.8 billion to banks, which was the largest amount ever allocated through structural operations. Compared to the December 2018 auction, the fixed rate was reduced from 1.2 per cent. to 0.25 per cent., while maturity was unchanged at five years. At end-April 2020 the balance of structural operations stood at HRK 4.3 billion, after HRK 1.9 billion at end-2019, which was influenced by partial early repayments of previous loans granted through this facility. The collateral accepted by the CNB 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 CNB’s list of eligible collateral. The introduction of structural repurchase operations expectedly lowered the kuna yield curve.

In September 2017 the CNB 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 CNB'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 CNB accepts collateral.

In April 2020, the CNB established a precautionary currency swap line with the European Central Bank allowing for the exchange of the kuna for the euro up to the amount of EUR 2 billion. This swap line gives the CNB the space to provide additional euro liquidity to Croatian financial institutions, should they need it, without using its own international reserves. The currency swap line will remain in place until 31 December 2020, and can be extended if necessary.

In April 2020, the CNB established a special lending programme during the COVID-19 pandemic with the objective to provide loans with maturities of one to five years to domestic credit institutions, foreign credit institutions' branches in Croatia, pension funds, pension insurance companies, companies for the management of open-ended investment funds with a public offering (UCITS funds), insurance companies and housing savings banks.

Legal Framework

Pursuant to the Act on the CNB (OG 75/2008, 54/2013 and 47/2020) and the Decision on Reserve Requirements (OG 136/2015, 55/2016 and 36/2020) (the "**Reserve Requirement Decision**"), credit institutions are required to maintain with the CNB certain reserves in the settlement account, or in a separate account with the CNB. Reserve requirements apply to banks founded in Croatia and branches of foreign banks in Croatia and do not apply to special purpose saving banks (housing saving banks), banks that are regulated by a special law or to CBRD. The reserve requirement comprises two parts, kuna and foreign exchange. The kuna base for calculating reserve requirements consists of the kuna sources of funds which include received kuna deposits and loans, issued kuna-denominated debt securities, kuna-denominated hybrid and subordinated instruments and other kuna-denominated financial liabilities. The kuna sources of funds excluded from the reserve requirement calculation include funds received from the CNB and CBRD, 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 CNB and CBRD, 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 CNB, the CNB'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 CNB’s credit operations; and (c) introduce discretionary measures that CNB is authorised to take regarding eligibility and the obligations of CNB’s counterparties. The Decision on monetary policy implementation sets out, in particular: (a) an overview of the operations and instruments of CNB’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 CNB by the competent authorities and branches of third country credit institutions that have been authorised by CNB), eligible assets, eligible securities, valuation and risk control and CNB’s eligible assets pooling system for collateralisation of CNB’s credit operations; (c) the discretionary measures which CNB 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 CNB; and (d) additional rules for conducting the monetary policy operations of CNB, including reporting obligations and the protection of confidential data. The Decision on monetary policy implementation was amended in March and April 2020 (OG 31/2020 and 46/2020) to expand the list of counterparties allowed to participate in monetary policy operations by means of the purchase and sale of securities to pension funds, pension insurance companies, companies for the management of open-ended investment funds with a public offering ('UCITS funds'), insurance companies and housing savings banks with head offices in the Republic of Croatia that have been authorised by the competent authority of the Republic of Croatia.

On 8 April 2020 the CNB introduced a Decision establishing a special lending programme during the COVID-19 pandemic (OG 46/2020) with the objective of providing collateralised loans with a maturity of one to five years to domestic credit institutions, foreign credit institutions' branches in Croatia, pension funds, pension insurance companies, companies for the management of UCITS funds, insurance companies and housing savings banks. Eligible collateral for this loan programme is the same as for other monetary operations, in accordance with the Decision on monetary policy implementation.

In order to align the terminology and regulations introduced by the Decision on monetary policy implementation with other monetary policy-related decisions, the CNB'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); and (iii) the Decision on the abolishment of the Decision on intraday loans (OG 94/2017); and abolished the Decision on the general conditions of foreign currency purchase and sale for the purpose of interventions in the foreign exchange market, which became part of the new Decision on monetary policy implementation. 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 CNB 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. In January 2019, the CNB amended the Decision on the minimum required amount of foreign currency claims (OG 12/2019) to exclude from the foreign currency claims the matured treasury bill (ISIN: HRRHMFT906X3) and to replace it with the new treasury bill issued in January 2019 (ISIN: HRRHMFT019X5). In November 2019, the CNB amended the Decision on the minimum required amount of foreign currency claims (OG 101/2019) to include a new type of loans (operative loan) in the foreign currency liabilities. In April 2020, the CNB amended the Decision on the minimum required amount of foreign currency claims (OG 53/2020) to exclude from the foreign currency claims the matured treasury bill (ISIN: HRRHMFT019X5) and to replace it with the new treasury bill issued in April 2020 (ISIN: HRRHMFT118F2).

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
	2015	**2016**	**2017**	**2018**	**2019**	**2020[(1)]**
Ratio of Nominal GDP/M4	1.2	1.2	1.2	1.2	1.2	1.2

(1) Nominal GDP data refers to 2019.
Sources: CBS and CNB

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
	(HRK millions)					
	2015	**2016**	**2017**	**2018**	**2019**	**2020**
Reserve money (M0)[(1)]	63,748.5	73,263.6	86,397.9	101,817.6	108,384.8	104,511.6
Money (M1)[(2)]	70,623.3	83,468.6	99,436.3	119,994.8	137,156.7	140,131.4
Broad money (M4)[(3)]	287,328.4	300,897.3	307,243.8	324,030.2	333,306.5	345,037.6
Net domestic assets[(4)]	194,176.8	196,243.0	185,408.3	194,082.3	192,404.7	206,110.8
Domestic credit[(5)]	230,005.1	221,511.0	218,933.3	223,237.0	229,528.1	237,807.6

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

(2) Money (Ml) comprises currency outside credit institutions, deposits with the CNB 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.
Source: CNB

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 (Tobacco Factory 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 2019 credit activity continued to grow. Total placements increased by 4.2 per cent. in 2019, with placements to enterprises and households increasing by 0.4 per cent. and 7.4 per cent., respectively (all data based on transactions). Slower growth in corporate placements compared to 2018 was primarily due to the reduction of Agrokor Group claims due to the operational implementation of the settlement. The activation of government guarantees for loans to shipyards also negatively affected the growth of placements to enterprises in 2019, but much less than the Agrokor settlement, as most guarantees were activated at the end of 2018. The reclassification of almost all money market funds from the monetary financial institutions sector to the sector of non-money market investment funds occurred during March 2019, as a result of the harmonization 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 caused a nominal increase of placements to non-money market investment funds. The nominal stock of total placements increased by 2.8 per cent. in 2019, which was slower than the growth based on transactions (4.2 per cent.), as a result of loan sales and write-offs, primarily of loans to enterprises. During 2019 the growth of main monetary aggregates decreased compared to 2018. The annual growth of M1 stood at 14.3 per cent. in 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 decreased by 7.5 per cent. whilst FX deposits decreased by 0.5 per cent. (excluding the exchange rate effect). The annual growth of M4 in 2019 stood at 3.5 per cent. (based on transactions, i.e. excluding the exchange rate effect and the effect of reclassification of money market funds).

During the first quarter of 2020, total credit activity continued to grow as a result of corporate credit demand. Total placements increased by 2.6 per cent. in the period January to March 2020, with placements to enterprises and households increasing by 5.1 per cent. and 0.8 per cent. respectively (all data based on transactions). The economic uncertainty caused by the Coronavirus pandemic influenced credit activity during the first three months of 2020 as the needs of enterprises for liquidity grew and household demand and optimism slumped. The growth of nominal stock of total placements during the first quarter of 2020 was larger than the growth based on transactions and stood at 3.6 per cent. which was the result of the 2.2 per cent. depreciation of the kuna against the euro in the respective period. The main monetary aggregates recorded a strong increase in the period January to March 2020. The annual growth of M1 stood at 17.2 per cent. in March 2020, while kuna savings and time deposits decreased by 11.9 per cent. on an annual basis. Of the M4 components, FX deposits recorded the largest increase in absolute terms during the first three months of 2020 with their annual growth rising to 5.1 per cent. in March 2020 (excluding the exchange rate effect). The annual growth of M4 stood at 7.6 per cent. in March 2020 (excluding the exchange rate effect).

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 31 December 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 31 December 2015, amounting to HRK 73.3 billion. The increase in 2016 was the result of the surge in credit institutions' deposits with the CNB 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 31 December 2016, mainly due to increased credit institutions' deposits with the CNB, 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 31 December 2017 which was again mostly due to increased credit institutions' deposits with the CNB, reflecting expansionary monetary policy. As at 31 December 2019, M0 amounted to HRK 108.4 billion, up by 6.5 per cent. compared to 31 December 2018, which was due to increases in credit institutions' deposits with the CNB and currency held outside of credit institutions. As at 31 March 2020, M0 amounted to HRK 104.5 billion, down by 3.6 per cent. compared to the 31 December 2019, which was due to decreases in credit institutions' deposits with the CNB amid sales of FX by the CNB and the reduction of the reserve requirement rate from 12 per cent. to 9 per cent. in March 2020.

International Reserves Management

The CNB manages the international reserves of Croatia based on the principles of liquidity and safety of investment in accordance with Article 19 of the Act on the CNB. 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.

The CNB 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 CNB 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 CNB 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 CNB 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	
	2018	**2019**
	(EUR millions)	
Total international reserves	17,438.76	18,562.37
Statutory reserves in foreign currency	0.00	0.00
Central Government and European Commission foreign currency deposits	4.49	9.43
Holdings of SDRs	371.81	377.37
Repurchase Agreements (plus outstanding amount)	1,242.45	805.90
Net international reserves[(1)]	15,820.01	17,369.66
Imports of goods & services (months)	7.8	8.0

(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.

Source: CNB

Total international reserves amounted to EUR 18,562.37 million at 31 December 2019, representing an increase of EUR 1,123.61 million as compared to 31 December 2018. At the same time, net international reserves increased by EUR 1,549.66 million to EUR 17,369.66 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 purchases of foreign currency from Ministry of finance, 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 CNB 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 CNB 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 CNB'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 2018, there was an increase in 2019 in the share of investments, government bonds, covered bonds and securities guaranteed by German federal states and a decrease in collateralised deposits.

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/AAA rating according to Moody's/Fitch and S&P stood at 39.5 per cent. at 31 December 2019. Investments rated Aa1/AA+, Aa2/AA and Aa3/AA- accounted for 36.2 per cent. of total international reserves, while investments rated A1/A+, A2/A and A3/A- were at 11.7 per cent. Investments rated Baa1/BBB+, Baa2/BBB and Baa3/BBB- amounted to 8.3 per cent. The remaining 4.3 per cent. of total international reserves at 31 December 2019 were invested with the IMF and the Bank for International Settlements and foreign currency cash at the CNB.

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

	Twelve months ended 31 December	
	2018	**2019**
	(per cent.)	
Government bonds	65.0	67.3
Financial instruments of central banks and international financial institutions	22.5	22.2
Collateralised instruments	10.1	4.2
Non-collateralised instruments	0.0	0.0
Covered bonds and securities guaranteed by German federal states	2.4	6.3
Total net international reserves	100.0	100.0

Source: CNB

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 (solely for payment operations purposes); 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 67.3 per cent. at 31 December 2019 from 65.0 per cent. at 31 December 2018. The share of investments with central banks and international financial institutions was almost unchanged, at 22.2 per cent. as of 31 December 2019 compared to 22.5 per cent. at 31 December 2018. Collateralised investment decreased to 4.2 per cent. at the end of 2019 from 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 2019. The remaining 6.3 per cent. of net international reserves were invested in covered bonds and securities guaranteed by German federal states up from 2.4 per cent. at the end of 2018.

As of 31 December 2019, the share of reserves in euro in net international reserves stood at 84.5 per cent. and was lower compared to 31 December 2018 when it was 86.1 per cent. At the same time the share of reserves in U.S. dollar was 15.5 per cent., higher than the 13.9 per cent. held at 31 December 2018.

In 2018, the annual rates of return on CNB held-for-trading euro portfolio and U.S. dollar portfolio stood at -0.36 per cent. and 2.03 per cent., respectively. The euro-denominated investment portfolio yielded a return of 0.93 per cent., while the U.S. dollar denominated investment portfolio yielded a return of 1.75 per cent. The U.S. dollar funds entrusted to an external manager yielded 1.95 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 62.1 million in 2018.

In 2019, the euro held-for-trading portfolio generated a rate of return of –0.40 per cent., while the U.S. dollar held-for-trading portfolio generated a rate of return of 2.80 per cent. The euro-denominated investment portfolio yielded a return of 0.91 per cent., while the U.S. dollar denominated investment portfolio yielded 1.83 per cent. The U.S. dollar funds entrusted for management to an international financial institution yielded a rate of return of 2.88 per cent. in 2019.

Investments of net international reserves generated a total income of EUR 59.9 million in 2019.

Banking System

Banking Regulation and Supervision

Act on the Croatian National Bank (OG 75/2008, 54/2013 and 47/2020) ("**Act on the CNB**" and The Credit Institutions Act (full text: OG 159/2013, 19/2015, 102/2015, 15/2018, 70/2019 and 47/2020) (the "**Credit Institutions Act**") as well as the Act on the Resolution of Credit institutions and investment firms (OG 19/2015, 16/2019 and 47/2020) (the "**Act on the Resolution of Credit institutions and investment firms**") are fully harmonised and compatible with European legislation, as applicable in EU member states.

The Croatian National Bank (CNB) is responsible for conducting comprehensive supervision of, inter alia, banks, savings banks, housing savings banks and credit unions. The supervisory tasks of the CNB 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 CNB's methodology and in line with the annual supervisory plan adopted at the end of each calendar year for the following year. On-site examinations are performed at the banks' premises using original documentation and internal reports. In large banks targeted on-site examinations are performed, while in medium-sized and small banks full-scope examinations are performed in tandem with targeted examinations. The supervision department makes assessments of banks' risk profiles based on information provided in compulsory reports that banks submit to the CNB, on-site supervision findings and other relevant information. If violations or irregularities are established, the CNB issues regulatory orders that require banks to implement remedial measures.

In order to enter into the ERM II and subsequently to the euro area, the Republic of Croatia submitted a request to the European Central Bank for the establishment of close cooperation between the European Central Bank and the CNB in the exercise of supervisory tasks over credit institutions within the Single Supervisory Mechanism. The Republic of Croatia intends to simultaneously enter into close cooperation with the European Central Bank and into the ERM II. The procedure is expected to be finalised during the second half of 2020. For more information see, "*The Economy – Plans for Adoption of the Euro*". In that respect, to enable that process, three mentioned legal acts have been further amended: the Credit Institutions Act (changes in OG No 70/2019 and 47/2020), Act on the CNB and the Act on the Resolution of Credit Institutions and Investment Firms. The Credit Institutions Act which, *inter alia*, implemented Basel II and Basel III, ensures a more stringent regulatory framework on bank capital adequacy, stress testing, market and liquidity risk and aligns Croatian legislation in that area with the relevant EU directives and regulations. Namely, through the adoption of the Credit Institutions Act that entered into force in January 2014 (OG 159/2013), Croatian banking legislation has been harmonised with the Regulation (EU) No 575/2013 (the "Capital Requirements Regulation")(CRR) and Directive 2013/36/EU (the "Capital Requirements Directive) ("CRD IV"). This has given the CNB a new set of instruments that are designed to enable it to address risk more efficiently.

According to the Credit institutions Act, where a credit institution is either in breach of a law or other regulation or its financial position makes its continued operation uncertain, the CNB may abolish authorisation to provide particular financial services (partial abolishment), 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 CNB 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.

Furthermore, according to the Credit Institutions Act, both direct and indirect acquisition of a bank's shares or an increase in the holding of a bank's shares must be approved by the CNB 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 CNB monitors not only the legal position of a potential acquirer, but also the acquirer's financial health and other relevant factors.

The Credit Institutions Act, which entered into force in January 2014, brought changes in the area of capital adequacy meaning that minimum regulatory capital adequacy is 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 CNB adopted a new Decision on the application of the structural systemic risk buffer in August 2017 (OG 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 the two sub-groups. In January 2015 the CNB adopted the Decision on the countercyclical buffer rate (OG 9/2015) in which the buffer rate 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 2020 the CNB updated its announcement that the same countercyclical capital buffer rate of 0 per cent. would continue to be applied in the second quarter of 2021. 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 December 2019, the CNB 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, including the reassessment of the buffer rates in accordance with the "equal expected impact" approach. The review identified a total of seven other systemically important institutions to which, depending on its estimated systematic importance, a capital buffer of 0.5 per cent., 1 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 2020), 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 on credit institutions to calculate and maintain adequate liquidity buffers for amortisation of potential short-term 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 period of 30 days. In October 2015, the LCR was introduced as an obligatory ratio, with gradual implementation by 2018, when it was fully introduced. Alongside the LCR, since January 2016, credit institutions are obliged to ensure that long term obligations are adequately met with a diversity of stable funding instruments under both normal and stressed conditions. Presently, there is also 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 as a mandatory ratio was introduced with CRD IV package and will enter into the force as of June 2021. 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 maturity ladder, the concentration of funding by counterparty and product type, concentration on counterbalancing capacity, prices for various length of funding and roll over of funding.

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 Act on the Resolution of Credit Institutions and Investment Firms was adopted and entered into force on 28 February 2015. Parts of the BRRD related to recovery plans, early intervention measures and group financial support arrangements were implemented in the Act on the amendments to the Credit Institutions Act published in the OG 19/2015. In addition, regarding the investment firms, parts of the BRRD related to recovery plans, early intervention measures and group financial support arrangements were implemented in the amendments to the Capital Market Act published in the OG 18/2015. The New Capital Market Act (OG 65/2018 and 17/2020) was adopted in 2018 and further amended in 2020 in order to fully harmonise the Croatian regulatory framework related to the capital market, ensuring the implementation of the provisions of Regulation (EU) 2017/1129 and repealing Directive 2003/71. In 2019, the Act on the

Resolution of Credit Institutions and Investment Firms was amended for the purpose 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 legislation and came into effect as of 23 February 2019. By establishing close cooperation with the ECB, the Republic of Croatia will also become a participating Member State within the Single Resolution Mechanism and from the date of establishing close cooperation the provisions of the Regulation (EU) No 806/2014 ("**the SRM Regulation**") will start to apply. Therefore, the Act on the Resolution of Credit Institutions and Investment Firms was amended again in 2020 for the purpose of changing those provisions that were misaligned with the SRM Regulation. In particular provisions related to powers of the National Resolution Authorities over institutions for which the Single Resolution Board will become directly responsible, and provisions related to resolution funds due to mutualisation of contributions to the Single Resolution Fund. ln addition, since there are several National Resolution Authorities in the Republic of Croatia, their powers and obligations in the process of implementing decisions and instructions taken by the Single Resolution Board for institutions under its direct responsibility had to be specified.

According to the amendments to the Act on the Resolution of Credit Institutions and Investment Firms 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 introduces early intervention measures which the CNB 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 related to banking operations, to the extent that the liquidity, solvency or viability of operations of a credit institution is jeopardised. During early intervention the CNB 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 administer to the credit institution; and
- appoint a special administration to the credit institution.

Among the other amendments to the Credit Institutions Act (OG 19/15), 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 CNB in the area of supervision of credit institutions was modified to allow CNB, to the extent that the CNB 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 CNB 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 Systematic Risk Board.

Classification of Placements

A classification scheme that affects the level and dynamics of loan loss provisions was implemented in October 2013. The classification scheme regulates exposure 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 CNB adopted a new Decision on the classification of exposures into risk categories and the method of determining credit losses (OG 114/2017 and 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 CNB issued a Decision on governance arrangements (OG 96/2018 and 67/2019) 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 CNB acts as a central bank but does not engage in commercial banking.

At the end of 2019, the Croatian banking system comprised 20 banks, three housing savings banks and CBRD. The downward trend in the number of credit institutions present since 2010 continued in the 2019. Compared with the end of 2018, the number of credit institutions was reduced by two, after the merger of Jadranska banka and HPB-Stambena štedionica with Hrvatska poštanska banka ("**Croatian Postal Bank**"). Two banks remained state owned — Hrvatska poštanska banka and Croatia banka.

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		
	2017	**2018**	**2019**
		(per cent.)	
State ownership[1]	6.1	6.2	6.1
Private domestic ownership	3.7	3.6	3.6
Foreign bank ownership	90.1	90.2	90.3
Total	100.0	100.0	100.0

[1] State owned and privately owned but where at least 50 per cent. of the private owner is owned by the Republic.
Source: CNB

The banking system in Croatia is highly concentrated with the two largest banks (Zagrebačka banka and Privredna banka Zagreb) holding 48.2 per cent. of total assets as at 31 December 2019 (an increase from 45.5 per cent. at the end of 2017 and 48.0 per cent. at the end of 2018). The majority of the commercial banks' assets are controlled by foreign shareholders. As at 31 December 2019, 11 entities were majority owned by foreign shareholders, seven by private domestic shareholders and two 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 2019 (which together had a 94.0 per cent. market share at 31 December 2019):

	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.	2.8	0.5	96.7	27.6	27.7
Privredna banka Zagreb d.d.	0.8	0.1	99.1	20.5	24.6
Erste&Steiermärkische Bank d.d.	0.0	0.0	100.0	15.0	14.1
OTP banka Hrvatska d.d.	0.0	0.0	100.0	10.3	10.4
Raiffeisenbank Austria d.d.	0.0	0.0	100.0	8.0	7.9
Hrvatska poštanska banka d.d.	25.2	74.6	0.2	5.6	4.0
Addiko Bank d.d.	0.0	0.0	100.0	4.2	5.1
Sberbank d.d.	0.0	0.0	100.0	2.6	2.0
Aggregate weighted by market share	2.4	4.3	87.3		
Aggregate weighted by share in shareholders' equity	2.0	3.1	90.5		

[1] Measured by the Banks assets as a proportion of total banking sector assets
Source: CNB

At the end of 2019 there were seven other systemically important credit institutions ("**O-SIIs**"), i.e. the same number as at the end of 2018. O-SIIs assets accounting for 91.4 per cent. of total banking system assets as at 31 December 2019, whereas assets of other banks accounted for the remaining 8.6 per cent.

The following table sets forth the structure of bank peer group assets, as a percentage of their assets, as at 31 December 2019:

	Cash, cash balances at central banks, other demand deposits	Loans and advances	Debt securities	Equity investments	Other
			(per cent.)		
O-SIIs	15.3	66.4	14.2	0.3	3.8
Other banks	14.9	63.2	17.4	1.2	3.3
Banking system	15.3	66.1	14.4	0.4	3.8

Source: CNB

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 2019:

	Equity	Deposits	Debt securities issued	Provisions	Other liabilities
			(per cent.)		
O-SIIs	14.3	82.7	0.2	0.9	1.9
Other banks	10.4	87.3	0.5	0.4	0.4
Banking system	14.0	83.1	0.2	0.8	1.9

Source: CNB

At the end of the 2019, bank assets amounted to HRK 425,8bn, an increase of 4.2 per cent. relative to the end of 2018. The increase was mostly driven by domestic sectors deposits, especially at mid-year, under the seasonal influences of tourist activity. In 2019, the upward trend of the kuna component in the currency structure of the banks' balance sheet continued. At 31 December 2017, the currency structure of 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. At the same date, the currency structure of liabilities and capital was 49.6 per cent. kuna, 48.1 per cent. foreign currency and 2.3 per cent. indexed to foreign currency. The kuna share in the banks' balance sheet currency structure increased further in 2018, to 51.4 per cent. of assets and 51.7 per cent. of liabilities and capital. At the end of the 2019 the currency structure of the assets consisted of 54.8 per cent. kuna assets, 27.8 per cent. foreign currency indexed assets and 17.4 per cent. foreign currency assets. On the liabilities and capital side, ratios were 53.1 per cent. kuna, 2.4 per cent. kuna indexed to foreign currency and 44.5 per cent. foreign currency.

Capitalisation

The banks' capital to assets ratio in Croatia remained stable since 2010, at approximately 14 per cent. The one-year decrease in 2015, to 12.7 per cent. was 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 related to the recapitalisation of one bank, which occurred due to a take-over of another bank. The merger of those two banks slightly weakened banks' capital to asset ratio, which was also diminished by the introduction of IFRS 9, which led to HRK 1.4 billion losses being recorded in retained earnings. As at 31 December 2019, the banks' capital to asset ratio remained 14.0 per cent., due to an increase in capital to HRK 59.6 billion (4.4 per cent. compared to the end of 2018). A major contributor to the increase in capital in 2019 was the rise in accumulated other comprehensive income related to the structure of the securities portfolio, which is dominated by the portfolio of financial assets measured through other comprehensive income. The downward trend in the non-performing loans coverage ratio until the end of 2016, when this ratio reached 63.7 per cent. came to a halt. As at 31 December 2019 the coverage indicator grew to a high 68.0 per cent. This was a result of its increase in the non-financial corporations sector, mainly influenced by the sale of non-performing claims with under-average coverage.

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 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. in 2015, 1.8 per. cent. growth in 2016, 0.3 per cent. in 2017 and 4.6 per cent. in 2018. The compounded growth rate from December 2010 to December 2018 amounted to 17.6 per cent.

Risk-Based Capital Requirements, Solvency and Profitability Ratios

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 (a decrease of 0.7 per cent. compared with the end of 2013). 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 23.1 per cent. at the end of 2018. The common equity tier 1 capital ratio, as well as the tier 1 ratio, stood at 22.1 per cent. The bank capital to un-weighted assets ratio at the end of 2018 stood at approximately 13.1 per cent. At 31 December 2019, the regulatory capital of Croatian banks totalled HRK 59.3 billion, an increase of 9.9 per cent. compared with the end of 2018. Strong increases in regulatory capital were mainly caused by the retention of 2019 profit, in line with the measures imposed by CNB as a response to the disruption of the economy caused by the COVID-19 pandemic. Thus, the total capital ratio at 31 December 2019 went up to 24.8 per cent. The common equity tier 1 capital ratio stood at 23.9 per cent. and the tier 1 ratio stood at 24.0 per cent.

The following table sets out an overview of the assets and total credit risk exposure (debt instruments other than held for trading, in line with IFRS 9) as at the dates indicated:

	Year ended 31 December			
	2016	2017	2018	2019
	(HRK millions)			
Total assets	388,721.9	391,336.4	408,667.3	425,806.8
Total credit risk exposure	360.471,7	383.474,4	401,558.1	410,617.1

Source: CNB

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 2019 total credit risk exposure increased as a result of the ongoing increase in lending to households, investments in securities and deposits at Central Bank.

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 5.6 billion. Return on equity rose from 5.9 per cent. in 2017 to 8.5 per cent. at the end of 2018. At the end of December 2019, pre-tax profits increased by 18.1 per cent. and amounted to HRK 6.6 billion. Profit growth was mostly the result of an increase in dividend income and lower levels of value adjustments due to the credit risk. Adverse influences on 2019 profit came from a significant increase in provisions for litigation costs, primarily due to an increase in new consumer lawsuits against banks, launched by users of loans with a currency clause in Swiss francs. Return on equity rose to 9.9 per cent.

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. In 2019 loans to households increased by 7.9 per cent, particularly through continued growth in general-purpose cash loans and growth in housing loans, spurred by further government subsidy program. Sale of claims in 2019 resulted in slight increase in loans to corporates, by 1.9 per cent. Loans in kuna steadily trended up, and the share of the kuna component in total loans rose to 44.6 per cent.

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 nonperforming loans standing at 12.2 per cent. At the end of 2017 the share of non-performing loans decreased further to 8.8 per cent. The downward trend continued and at the end of 2018 the share of non-performing loans stood at 7.6 per cent. as banks focused on improving asset quality, particularly by means of NPL sales. At the end of 2019 the share of non-performing loans decreased to 5.5 per cent., mainly influenced by further NPL sales and implementation of the Agrokor Group settlement.

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

	As at 31 December			
	2016	**2017**	**2018**	**2019**
		(per cent.)		
Non-performing loans	12.2	8.8	7.6	5.5
Non-performing loans to households	10.8	8.3	6.9	5.9
Non-performing loans to enterprises	28.1	22.1	20.4	13.6

Source: CNB

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 10.3 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. The trend has continued in 2019, with residential real estate prices recording an average annual increase of 10 per cent. Disaggregated by regions, data reveals that prices grew most strongly in the City of Zagreb (14.7 per cent.), in the Adriatic they grew by 6 per cent. while the growth in the rest of the country was stronger than in previous years, averaging at 7.4 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. Favourable trends continued and housing non-performing loans ratio fell to 5.2 per cent. at the end of 2018 and 3.9 per cent. at the end of 2019.

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 0.5 per cent. of total bank loans (gross) and to only 0.4 per cent. at the end of 2019.

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., 4.9 per cent. and 4.6 per cent. at December of 2011, 2012, 2013,2014, 2015, 2016, 2017, 2018 and 2019 respectively. As of March 2020, this interest rate fell to 4.4 per cent.

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

	As at 31 December					
	2014	**2015**	**2016**	**2017**	**2018**	**2019**
			(per cent.)			
Currency breakdown of total loans						
Euro	64.0	62.8	62.7	59.7	57.9	54.6
Swiss franc	8.3	7.3	1.0	0.7	0.5	0.4
Other foreign currencies	0.9	1.1	1.8	0.9	1.1	0.5
kuna	26.8	28.9	34.5	38.8	40.5	44.6

Source: CNB

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.). At 31 December 2019 total value adjustments and provision expenses remained unchanged, under the impact of decreased levels of value adjustments due to credit risk and increased provisions for litigation costs.

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. At 31 December 2019 loans to households reached HRK 123.1 billion, an increase of 7.9 per cent. compared to 31 December 2018. Growing steadily for several years, general purpose cash loans amounted to 40.9 per cent. of total loans to households (net) at the end of 2019.

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 non-residents 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.). In 2019 total deposits increased by 3.5 per cent. due to the growth in domestic deposits, especially households deposits (4.6 per cent). Government deposits significantly increased (36.0 per cent.), as did corporate deposits (6.3 per cent.). At 31 December 2019 household deposits amounted to 61.3 per cent. of total deposits, mainly as a result of further growth in household transaction account deposits. The downward trend in deleveraging by foreign parent banks continued, with a decrease in non-residents deposits (8.4 per cent).

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

	As at 31 December				As at 31 December			
	2016	**2017**	**2018**	**2019**	**2016**	**2017**	**2018**	**2019**
	(HRK millions)				*(percentage change over end of previous year)*			
Loans	235,954.5	226,674.1	237,092.4	245,478.2	(4.5)	(3.9)	4.6	3.5
Households	104,570.0	107,990.7	114,333,3	123,397.5	(5.4)	3.2	5.9	7.9
Enterprises	67,544.4	69,651.8	70,756.7	72,118.5	(2.8)	3.1	1.6	1.9
Government	50,857.2	39,778.5	40,542.7	41,814.7	(11.4)	(2.8)	1.9	3.1
Financial institutions	5,076.1	3,528.3	4,227.6	3,523.1	1.5	(30.5)	19.8	(16.7)
Non-residents	7,906.9	5,724.8	7,232.1	4,624.4	75.9	(27.6)	26.3	(36.1)
Deposits	295,302.8	297,746.3	318,447.5	329,559.8	0.4	0.8	7.0	3.5
Households	186,466.7	183,263.6	197,661.0	206,701.6	0.8	0.4	5.4	4.6
Enterprises	58,008.1	62,851.8	67,040.7	71,245.0	9.2	8.3	6.7	2.2
Government	9,503.0	11,204.4	12,840.0	17,457.7	10.3	17.9	14.6	36.0
Financial institutions	17,108.8	17,251.4	19,442.9	14,493.6	8.8	0.8	12.7	(25.5)
Non-residents	24,216.1	19,000.5	21,463.0	19,661.9	(24.0)	(21.5)	13.0	(8.4)

Source: CNB

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. As the years-long downward trend in the share of time deposits in total bank deposits continued, this share fell to a historical low of 37.0 per cent. at the end of 2019. As a result, the share of deposits in transaction accounts continued to grow and reached 57.7 per cent. 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 151.9 per cent. as of 31 December 2019, compared to the notional minimum of 100 per cent.). Kuna deposits increased by 6.6 per cent., reaching 44.8 per cent. of total deposits at the end of 2019. Deposits in foreign currencies accounted for 54.3 per cent. and deposits in kuna indexed to foreign currency accounted for 0.9 per cent. of total deposits.

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. As at 31 December 2019, the total amount lent to the central Government increased by 7.7 per cent. and stood at HRK 85,0 billion. This was a result of a significant increase in debt securities (12.5 per cent.), mainly due to an increase in investments in Government bonds and Ministry of Finance T-bills (15.9 per cent). Loans to the central Government increased slightly (2.0 per cent.). Central Governments deposits increased by 55.9 per cent. and reached HRK 12.1 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. Lower levels of value adjustments due to credit risk and increases in dividend income increased banks' earnings in 2019 banks' by 18.1 per cent. and they recorded pre-tax profit of HRK 6.6 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. 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). In 2019 parent bank funding decreased by 18.0 per cent. as a result of a decrease in deposits. As at 31 December 2019 it totalled HRK 9.7 billion, and the level of parent bank funding fell further. As at 31 December 2017 it stood at 2.4 per cent., as at 31 December 2018 it stood at 2.9 per cent. and as at 31 December 2019 and it stood at 2.3 per cent. of total assets.

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.

The ratio of foreign currency liabilities to foreign currency claims of the banking system has been fairly stable, fluctuating around a five-year average of 24.1 per cent. As of March 2020, it stood at 24.0 per cent., falling from 26.6 per cent. at the end of 2017 and rising 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 of 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 CNB 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. By the end of 2019, the total stock of subscribed kuna-denominated T-bills decreased to HRK 17.2 billion, while at the end of April 2020 it reached HRK 17.4 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 2019 it decreased to EUR 1.2 billion and subsequently fell slightly to EUR 1.1 billion by the end of April 2020. 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 25.8 billion by the end of 2019, after which it increased slightly to HRK 26.0 billion by the end of April 2020.

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 decreased to 0.05 per cent. at the auction in August 2019 (last auction in 2019), while the weighted interest rate on 365-day T-bills fell to 0.06 per cent. in October 2019 and remained at that level until April 2020. 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. This interest rate decreased further to 0.03 per cent. at the auction in May 2019 (last auction in 2019).

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 until August 2019, when it fell to –0.05 per cent. 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, which was subsequently refinanced at the auction in April 2020 with the 365-day EUR-linked T-bills to the same amount at 0.06 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 several years. Such developments continued in 2019 and first three months of 2020 when the highest liquidity surplus of the financial system was recorded, recovering economic activity continued and country risk premium decreased. The COVID-19 outbreak in March has produced rising pressures in domestic government bond markets, but they were contained by central bank interventions. 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 December 2019, after which it fell to 2.72 per cent. in March 2020. 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 the following three years this trend continued, with interest rates reaching 3.64 per cent. in December 2017 and 3.09 per cent. in December 2018, and continued falling to 2.19 per cent. by the end of 2019, after which it slightly increased to 2.48 per cent. in March 2020. 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. By the end of 2019, this interest rate declined to 6.96 per cent, after which it increased slightly to 7.03 per cent. in March 2020. 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 2019 the downward trend continued with the interest rate reaching 3.55 per cent. in December 2019, while it remained almost unchanged in March 2020.

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 0.32 per cent. in December 2019 and declined further to 0.11 per cent. in March 2020. 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 0.48 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 0.36 per cent. in December 2019 and declined further to 0.10 per cent. in March 2020. 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, and declined further to 0.02 per cent. in December 2019, at which level they remained until March 2020.

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. As of March 2020, there were two market specialists and 14 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 consisted 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.

In February 2019, ZSE launched a new share index, the CROBEXprime, whose constituents include shares listed in the Exchange's top tier. Furthermore, in June, ZSE and Ljubljana Stock Exchange began publishing a joint index, the ADRIAprime, consisting of shares admitted to trading on their prime markets. In November, the Exchange Rules were amended, including, among others, amendments aimed at harmonisation with the technical capabilities of the new version of the XETRA T7 trading system, which was fully implemented in December. Additionally, the Exchange Rules now lay down in detail the method for checking compliance with post-admission requirements in all market segments, for the purpose of increasing transparency surrounding issuers with financial instruments admitted to trading on the regulated market. In December, the Croatian Financial Services Supervisory Agency authorised the registration of the Zagreb Stock Exchange as a benchmark administrator for its CROBEX, CROBEXtr, CROBEX10, CROBEXprime and ADRIAprime indices. As a result, the Zagreb Stock Exchange was entered in the register of administrators and benchmarks compiled and maintained by the European Securities and Markets Authority (ESMA).

2017 to 2019 trading summary

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 45.1 per cent. loss. Meanwhile, CROBEXkonstrukt rose 3.4 per cent., with CROBEXturist 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.

In comparison to recent years, 2019 has seen a mild increase in trading volatility with the second half of the year recording a mostly positive trend, and parts of the market regaining most of the ground lost in recent years. Some of the trading indicators improved: order book trading turnover rose by 9 per cent. with share trading growing 38 per cent. Market value, measured by market capitalisation, increased by 13 per cent. in total, with share market capitalisation up 11.5 per cent. and the Prime Market trading recording the strongest increase of 70.6 per cent. CROBEXkonstrukt, CROBEXturist and CROBEXtransport recorded a loss in value, while others advanced at a two-digit pace. CROBEXnutris led the way, recording growth of 38 per cent., CROBEXtr recorded a rise of 19.4 per cent., reflecting a strong dividend yield, followed by CROBEX10 at 18 per cent., CROBEXplus with 17 per cent., CROBEXprime at 16 per cent. and CROBEX at 15 per cent. The new regional ADRIAprime index rose almost 11 per cent.

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

	2015	**2016**	**2017**	**2018**	**2019**
Regular volume	251,377,241	366,642,948	320,351,558	542,561,085	318,227,272
of which Stocks	35,426,627	33,007,384	38,647,825	30,250,322	53,487,731
of which Bonds	208,868,268	331,556,378	281,703,733	512,310,763	264,739,541
of which Rights	4,834,324	0	0	0	0
of which Commercial Paper	0	0	0	0	0
of which Structured Products	2,248,022	2,079,186	0	0	0
Block volume[1]	1,586,948	4,262,524	5,594,906	3,835,666	3,108,073
Reported volume[2]	190,148,664	215,504,042	60,000,000	44,000,000	0
Institutional volume[3]	15,372,876,700	19,443,889,656	14,508,293,018	9,337,332,802	8,381,807,258
Total number of trades	177,943	133,177	181,134	92,538	108,156
Number of securities traded	294	233	163	157	145
Number of trading days	248	251	250	247	247
Daily average volume	1,763,338	2,336,293	1,543,786	2,390,270	1,300,953

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

Source: Zagreb Stock Exchange

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 3.3 per cent. in 2015, which was significantly lower in relation to the originally planned amount of 2.6 of GDP, and 5.3 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, reaching 1.6 per cent. of GDP, according to the 2020 Spring Forecast of the European Commission. 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 163.2 billion or 46.5 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 166.5 billion or 47.4 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 Act 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 169.1 billion or 46.1 per cent. of GDP, due to positive effects of the comprehensive tax reform. Taxes on production and import amounted to 19.5 per cent. of GDP and registered a year-on-year increase of 5.8 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 0.5 per cent., which was the consequence of a reduction in revenues from income tax due to the implemented tax reform. The revenues from other current and capital transfers that include revenues from EU funds were also significant and amounted to 3.2 per cent. of GDP.

The total expenditures of the general government budget in 2017 were realised in the amount of HRK 166.2 billion or 45.3 per cent. of GDP in 2017, a reduction of 0.2 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 intermediate consumption were 8 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 1.5 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 10 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 were 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 2.8 per cent. of GDP, a decrease of 12.4 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 3 percentage points or to the level of 77.8 per cent. of GDP. Furthermore, during 2017, savings on interest amounted to HRK 1.1 billion. For the years 2016 and 2017 combined, the share of public debt in GDP decreased by 6.6 percentage points while the savings on interests amounted to HRK 2 billion, compared to 2015.

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 46.1 per cent. 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 1 January 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 21 June 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 per cent. of GDP and registered a year-on-year increase of 7.2 per cent.. Within this category, most income derived from value added tax which was 6.8 per cent. 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 per cent., which in 2018 amounted to 12 per cent. 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 6.5 per cent. 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 per cent. of GDP, with revenues from EU funds registering an increase of 41.3 per cent. at the annual level.

Total expenditures of the general government budget were executed at the level of HRK 177.3 billion or 46.3 per cent. of GDP in 2018.

Compensation of employees register the level of 11.8 per cent. of GDP and they increased by 8 per cent.. This increase is primarily the result of a full-year effect of the increase of 6 per cent. for public and civil servants in 2017, corrections for years of service by 0.5 per cent., 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 8.1 per cent. 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 1.6 per cent. 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 per cent. 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 per cent. 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 15.5 per cent. 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 per cent. 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 0.9 per cent. and as of 1 July 2018, by 2.7 per cent. 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 per cent. 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 98/2019) 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 per cent. of GDP and are reduced due to the application of the Act on Amendments to the Child Allowance Act (OG 94/2001, 138/2006, 107/2007, 37/2008, 61/2011, 112/2012, 82/2015 and 58/2018) 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 per cent. of GDP. Within this category of expenditure, the full-year effect of the Amendments to the Maternity and Parental Benefits Act (OG 5/2008, 110/2008, 34/2011, 54/2013, 152/2014, 59/2017 and 37/2020), 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 per cent. 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 per cent. 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, 61/2018 and 66/2019), which came into force on 19 July 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 3.4 per cent. 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 per cent. of GDP, which was an increase of 33.7 per cent. 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 per cent. of GDP, which represents a significant improvement in relation to the initially planned deficit of 0.5 per cent. 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 per cent. 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.

Fiscal developments in 2019

The Government adopted the 2019 budget plan and projections for 2020 and 2021 in November 2018. In November 2019, 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. The most significant reduction in expenditures was recorded on interest and expenses for the acquisition of non-financial assets, and reductions were also recorded in certain expenditures on social benefits and social transfers. This provided funds for increased allocations for pensions, compensation of employees and for financing the first phase of the project to construct a floating terminal for liquefied natural gas on the island of Krk. In addition, expenditures for rights from the social welfare system (personal disability allowance and allowance for help and care) and for additional maternity leave increased. Additional funds were also provided for health care institutions and for government guarantees for Uljanik Group. Taking all of the aforementioned into account, the projected deficit was lower than originally planned for 2019 for 0.2 percentage points.

In 2019, total general government budget revenue register at the level of HRK 190.1 billion or 47.5 per cent. of GDP as a result of positive macroeconomic developments, effects of the tax reform from 2018 and 2019, strengthened absorption of resources from EU funds.

Taxes on production and imports amounted to 20.3 per cent. of GDP and registered a year-on-year increase of 6 per cent. Within their structure, the largest revenue is the value added tax which was by 6.8 per cent. higher than in the previous year. The collected revenues from VAT are the result of the 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 3.2 per cent., which in 2019 amounted to 11.8 per cent. of GDP, as a result of favourable labour market trends. Current income and wealth taxes, which include personal income tax and corporate income tax, are up 7.6 per cent. due to the aforementioned positive trends in the labour market and good results of businesses operations of enterprises and banks. In addition to tax revenues, there are also significant revenues from other current and capital transfers, including resources from EU funds, and in 2019 they amounted to 3.3 per cent. of GDP, whereby the revenues from EU funds register an increase by 35 per cent. at the annual level.

Total expenditure of the general government budget was executed at the level of HRK 188.5 billion or 47.1 per cent. of GDP in 2019.

Employee compensation amounted to 11.9 per cent. of GDP in 2019; an increase of 5.2 per cent. relative to the previous year. This increase was the result of the increase in the basis for the calculation of salaries of 5 per cent.

for public and civil servants based on collective agreements (3 per cent. as of January, and 2 per cent. as of September 2019), corrections for years of service by 0.5 per cent., and the effect of the change of sector collective agreements in certain public service activities. In addition, these expenditures also included increased allocations for the Republic of Croatia's presidency of the EU Council that the Republic of Croatia took over as of 1 January 2020, and for which a certain number of employees were already in 2019 assigned to the Permanent Representation of the Republic of Croatia in Brussels.

Intermediate consumption expenditures amounted to 8.3 per cent. of GDP in 2019. This category includes material expenditures of all units of the general government sector, including, inter alia, the cost of medicines and medical and sanitary materials for healthcare institutions. Major allocations were also registered on expenditures on materials and energy and on expenditures for services.

Expenditure for subsidies amounted to 1.6 per cent. of GDP in 2019. A significant segment (0.7 per cent. of GDP) of those subsidies relates to subsidies from the Croatian Energy Market Operator ltd. ("**HROTE**") to producers of energy using renewable sources, for producing energy from renewable sources. This category also includes subsidies for direct agricultural payments and measures for the arrangement of the agricultural products market, allocations for concession contracts, stimulation of maritime and air passenger transport, and allocations for the active labour market policy programme.

Expenditure on property income, which is determined by trends in the interest expenditure, stood at 2.2 per cent. of GDP, and in relation to the previous year decreased by 0.1 percentage point of GDP. Such trends are the result of the continuation of responsible fiscal policy management, followed by an active policy of public debt management, which had reduced public debt servicing costs.

Social benefits and social transfers represent the most significant category of total general government expenditure and amounted to 15.6 per cent. of GDP in 2019. These expenditures are greatly determined by trends in expenditure on pensions, prescription medications, maternity benefits, social welfare benefits, child allowance and unemployment benefits. Expenditure for pensions and retirement benefits stood at the level of 10.2 per cent. of GDP, which is primarily the result of the adjustment of pensions under the general regulations and special regulations, as of January 2019 (by 1.15 per cent.) and 1 July 2019 (by 2.44 per cent.). Allocations for child allowance amounted to 0.3 per cent. of GDP, maternity benefits amounted to 0.7 per cent. of GDP, while unemployment benefits amounted to 0.2 per cent. of GDP. Social welfare benefits amounted to 0.6 per cent. of GDP. This category includes, along with guaranteed minimum benefit, expenditures relating to the implementation of the Act on the Amendments to the Social Care, pursuant to which the amount of personal disability allowance and allowance for help and care was increased. In addition, through the implementation of the Act on the Amendments to the Housing Loan Subsidies Act, the subsidizing of loans for the purchase of a flat or a house, i.e. for the house construction, was enabled.

Other expenditure, mostly related to current and capital transfers, amounted to 3.2 per cent. of GDP. This mostly related to activities financed from EU funds as well as the payment of the Republic of Croatia's own contribution to the EU budget. Expenditure on electoral activities also fell within this category, of which the most significant expenditures were the elections for the European Parliament and the election for the President of the Republic of Croatia. In addition, a one-off expense related to guarantees for the Uljanik Group was also included in the category of capital transfers, in the amount of HRK 2 billion, i.e. 0.5 per cent. of GDP, paid during 2019. Furthermore, financing of the first phase of the project of the floating terminal for liquefied natural gas on the island of Krk cost 0.1 per cent. of GDP.

Gross fixed capital formation expenditure registers the level of 4.3 per cent. of GDP, with a year-on-year increase of 27.6 per cent. This category of expenditure relates to expenditure on the construction of road, utility and railway infrastructure, the most significant part of which was financed with resources from EU funds.

Following the realised revenues and executed expenditures, the general government budget in 2019 registered a surplus of HRK 1.6 billion or 0.4 per cent. of GDP compared to the general government budget in 2018, which saw a surplus of 0.2 per cent. of GDP, according to the ESA 2010 methodology.

Overview of the 2020 budget

Before the outbreak of the Coronavirus pandemic, the fiscal policy of the Government of the Republic of Croatia, primarily oriented towards the economic growth, was focused on further strengthening fiscal sustainability, reflected by budget surpluses and strong decreases in the share of public debt to GDP. Such policy creates fiscal space for tax unburdening of citizens and entrepreneurs, which is, along with the improvement of the structure and efficiency of public expenditures, an additional stimulus for strengthening economic growth. Becoming aware that the Coronavirus pandemic will lead to significant negative social-economic consequences, the Government of the Republic of Croatia used the fiscal space it has created to provide fast and strong fiscal support for maintaining employment and supporting the entire economy.

In this context, two packages of measures were adopted, intended primarily to aid citizens and the economy, along with a series of measures directed towards mitigating negative consequences in individual sectors. Thus, entrepreneurs suffering a 20 per cent. or greater decline in their profits or who had estimated that they would face such a decline, were provided, by the amendments to tax regulations, with a possibility of interest-free postponement and instalment payment of direct taxes and contributions. In addition, the April package of economic measures strengthened this measure and thus entrepreneurs with an annual revenue of less than HRK 7.5 million (accounting for 93 per cent.), having a decline in their revenue higher than 50 per cent., will be completely exempt from paying direct taxes and contributions that are due in April, May and June 2020. In the same period, companies with revenue in excess of HRK 7.5 million, with a decline in their revenue higher than 50 per cent., will be partially exempt from paying these levies depending on the decline in revenues. Currently, tax liability has been postponed for almost 70 thousand taxpayers to the amount of HRK 1.4 billion. The largest part of the postponed tax liability relates to pension insurance (42 per cent.), health insurance (30 per cent.) and the income tax (15 per cent.). Furthermore, the possibility of paying VAT upon invoices that have been paid and invoices the payment of which has been collected has been introduced, with an aim of providing additional liquidity of economic operators. In order to preserve jobs in the most vulnerable sectors affected by the Coronavirus, a subsidy measure was adopted via which salaries may be financed to the amount of HRK 3,250 per employee in March, while the amount for April and May is increased to HRK 4,000, and the cost of employer contributions for pension and health insurance will be borne by the state budget. Currently, there are 84 thousand employers covered by this measure for 485,000 job positions. In addition, besides direct budget subsidies through the postponement or write-off of public levies or through subsidies for job preservation, over HRK 15 billion has been provided for possible loans to entrepreneurs through CBRD and CASB BICRO programmes.

In April 2020, the Government of the Republic of Croatia adopted the Convergence programme of the Republic of Croatia for 2020 and 2021, which outlined new fiscal trends in accordance with the outbreak of the Coronavirus pandemic.

In 2020, total general government budget revenues are planned to stand at 46.4 per cent. of GDP. They are based on the expected decline in economic activity due to the Coronavirus pandemic, tax policy measures implemented by the Government of the Republic of Croatia in order to provide support to the economy and citizens, and fiscal effects of the tax unburdening in 2019, having their full-year effect in 2020, as well as tax amendments in 2020. These amendments refer primarily to the tax unburdening within the system of VAT, personal income tax and corporate income tax, while some changes were also made in the system of excise duties. Taxes on production and imports represent the most significant category of total revenue. They are projected to stand at 18.4 per cent. of GDP. Value-added tax revenue is projected to stand at 12.1 per cent. of GDP based on previously described macroeconomic projections. Besides that, the effects of the decrease in the general VAT rate from 25 per cent. to 13 per cent. for the preparation and servicing of food within the catering activity has also been included in the calculation. Along with 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 imports. Revenues from excise duties are projected to amount to 4.4 per cent. of GDP, including the expected decrease in the consumption of excise products, and the effects of changes in regulations within the excise system, first of all in excise duties on tobacco, alcohol and non-alcoholic beverages. The second most significant group of general government budget revenues are social contributions, projected to be 12 per cent. of GDP. Their dynamics are determined by currently unfavourable trends in the labour market, but also by the estimated effects of the write-off of contributions to pension and health insurance (one of the measures to assist the economy). Estimated revenue from current taxes on income and wealth will be 6.1 per cent. of GDP. The personal income tax revenue is planned based on expected labour market trends, taking into account the effects of the adopted measure writing-off income tax as well as the increase in the basic personal deduction from HRK 3800 to 4000 as of 1 January 2020. Corporate income tax revenue is projected at the level of 1.7 per cent. of GDP, taking into account the expectations for the entrepreneurs' business operations in 2020 and the measures adopted by the Government of the Republic of Croatia in order to mitigate negative consequences for the economy. The category of other current and capital transfers, which projected to be 4.2 per cent. of GDP, and increase by 13.3 per cent. relative to the previous year, also include revenue from grants provided by EU institutions and bodies, that are directly linked with projects financed from the EU budget, but also with resources allocated to the Republic of Croatia from EU funds within the framework of support for financing the consequences of the Coronavirus. It should be pointed out here that part of these resources will be redirected to the supply of the healthcare material and equipment, financing measures for job preservation and ensuring the liquidity of entrepreneurs through CBRD and CASB BICRO programmes.

In 2020, total general government expenditure is planned to stand at 53.3 per cent. of GDP. Compensation of employees is projected to be 13.3 per cent. of GDP as a result of the increased base for the calculation of salaries in civil and public services since the beginning of 2020, increased coefficient and bonuses in certain civil and public services and the increase for regular years of services. In addition, the projection of this category takes into account the Conclusion of the Government of the Republic of Croatia limiting the expenditures of budgetary and extra-budgetary users of the state budget due to changes in economic circumstances. Intermediate consumption expenditure is planned to be 9.5 per cent. of GDP. The increase in this category of expenditure is primarily a result of increased allocation for medicines and consumables and sanitary material for healthcare institutions, but also for the supply of medical and protective equipment for the fight against the Coronavirus epidemic. In 2020, expenditure for subsidies is projected to be 3.5 per cent. of GDP. This category of expenditure also includes subsidies to entrepreneurs for the preservation of job positions to the sum of HRK 6.8 billion. Furthermore, a significant part of subsidies, to the sum of 0.9 per cent. of GDP, relates to the subsidies of the Croatian Energy Market Operator (HROTE) for producers of energy from renewable sources, for stimulating electricity production from renewable sources. In addition, this category also includes subsidies in agriculture financed from national funds, concession contracts and subsidies for the promotion of maritime and air passenger transport. Property income expenditure, which is largely determined by trends in interest expenditure in line with the conditions on financial markets, i.e. the costs of public debt service, is expected to be 2.1 per cent. of GDP in 2020. Social benefits and social transfers are planned to be 17.7 per cent. of GDP, including expenditure for pensions and pension receipts accounting for 11.7 per cent. of GDP. The development thereof in 2020 is affected by the transferred cumulative effect of changes in the number and structure of pension beneficiaries and the adjustment of pensions. Maternity benefits are planned at the level of 0.8 per cent. of GDP, the allocations for child allowances amount to 0.4 per cent. of GDP, and unemployment benefits at the level of 0.3 per cent. of GDP. Social welfare benefits are planned to be 0.7 per cent. of GDP. The payment of contributions for the second pension pillar as part of subsidies for job preservation is included in this category. Other expenditure, mostly related to current and capital transfers, is planned to be 3.1 per cent. of GDP, and will be 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. Gross fixed capital formation expenditure is planned to be 4.1 per cent. of GDP. A large part of such investment is financed from EU funds, and the most significant projects are the continuation of the construction of the Pelješac Bridge and the construction of road, railway, water management and utility infrastructure.

Following the projected revenue and expenditure, the general government budget is expected to register a deficit of 6.8 per cent. of GDP in 2020, which is the result of the implementation of economic measures on both the revenue and expenditure sides of the budget. Due to the unfavourable economic trends, a significant decline in the revenues from indirect taxes is expected, mostly from VAT and excise duties having a direct impact on the level of the budget deficit.

In May 2020, the Government of the Republic of Croatia adopted a revision of the budget taking into account the negative impact of the Coronavirus pandemic on economic activity, the adopted measures to assist the economy as well as the expected decline in revenues. It should be noted that the expenditure of the state budget remains at the same level as originally planned for 2020, while significant reallocations were made in order to ensure financial funds needed for the implementation of measures for addressing the negative impact of the Coronavirus pandemic are available. To finance these measures, savings were generated from each expenditure category of the Budget. The largest savings came from the Ministry of Finance, the Ministry of Science and Education, the Ministry of Defence and the Ministry of the Interior. Furthermore, on 22 March 2020, Zagreb was hit by the strongest earthquake in Croatia in the last 140 years causing large infrastructural damages and additional pressure on the public services. Therefore, the revised budget funds were also provided for the critical first phase of renovations for family houses and residential buildings damaged in the earthquake. For more information, see "*General Information – Authorisations*".

Table: General Government budget, ESA 2010 methodology

	ESA Code	**2019**	**2019**	**2020**	**2021**
		(level, HRK billion)	***(per cent. of GDP)***	***(per cent. of GDP)***	***(per cent. of GDP)***
1. General Government..........................	S.13	1.6	0.4	(6.8)	(2.4)
General government (S13)					
6. Total revenue.....................................	TR	190.1	47.5	46.4	47.8
7. Total expenditure................................	TE	188.5	47.1	53.3	50.2
8. Net lending/borrowing.......................	EDP B.9	1.6	0.4	(6.8)	(2.4)

	ESA Code	2019 (level, HRK billion)	2019 (per cent. of GDP)	2020 (per cent. of GDP)	2021 (per cent. of GDP)
9. Interest expenditure	EDP D.41	8.9	2.2	2.1	2.0
10. Primary balance		10.4	2.6	(4.7)	(0.4)
11. One-off and other temporary measures1		0.0	0.0	0.0	0.0
Selected components of revenue					
12. Total taxes (12=12a+12b+12c)		108.0	27.0	24.5	26.4
12a. Taxes on production and imports	D.2	81.3	20.3	18.4	20.2
12b. Current taxes on income, wealth, etc.	D.5	26.7	6.7	6.1	6.2
12c. Capital taxes	D.91	0.0	0.0	0.0	0.0
13. Social contributions	D.61	47.4	11.8	12.0	12.3
14. Property income	D.4	3.5	0.9	0.9	0.7
15. Other		31.3	7.8	9.1	8.5
16. Total revenue	TR	190.1	47.5	46.4	47.8
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)		155.3	38.8	36.4	38.6
Selected components of expenditure					
17. Compensation of employees + intermediate consumption	D.1+P.2	80.8	20.2	22.8	22.1
17a. Compensation of employees	D.1	47.5	11.9	13.3	12.8
17b. Intermediate consumption	P.2	33.3	8.3	9.5	9.4
18. Social payments (18=18a+18b)		62.2	15.5	17.7	17.1
of which Unemployment benefits		0.9	0.2	0.3	0.2
18a. Social transfers in kind supplied via market producers	D632	9.0	2.2	2.6	2.5
18b. Social transfers other than in kind	D.62	53.2	13.3	15.1	14.6
19. Interest expenditure	EDP D.41	8.9	2.2	2.1	2.0
20. Subsidies	D.3	6.2	1.5	3.5	1.6
21. Gross fixed capital formation	P.51	17.2	4.3	4.1	4.4
22. Capital transfers	D.9	7.5	1.9	1.6	1.7
23. Other		5.7	1.4	1.5	1.4
24. Total expenditure	TE	188.5	47.1	53.3	50.2
p.m.: Government consumption (nominal)	P.3	79.3	19.8	22.6	21.9

Source: CBS, Ministry of Finance

Resulting fiscal trends in the Budgetary Central Government for the three months ended 31 March 2020

According to preliminary data and the National Chart of Accounts methodology, the total revenue of the Budgetary Central Government amounted to HRK 32.1 billion. Tax revenues, as the most significant revenue category, amounted to HRK 18 billion. Among tax revenues, revenue generated through VAT amounted to HRK 12.1 billion; corporate tax revenue amounted to HRK 1.9 billion. Revenue generated from excise duties was HRK 3.4 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 146.9 million.

The total expense of the Budgetary Central Government amounted to HRK 37.4 billion. The largest share of the total expense related to compensation to citizens and households and amounted to HRK 12.7 billion. Compensation of employees amounted to HRK 5.4 billion, grants to HRK 7.4 billion, financial expense to HRK 3.4 billion, material expense to HRK 3.4 billion, subsidies to HRK 2.4 billion and other expenses to HRK 1.4 billion. Expense for the acquisition of nonfinancial assets was realised in the amount of HRK 1.3 billion.

The deficit of the Budgetary Central Government in first three months of 2020 stood at HRK 5.3 billion or 1.5 per cent. of GDP, according to the National Chart of Accounts methodology.

Fiscal Responsibility Act

The old Fiscal Responsibility Act (OG 139/2010 and 19/2014), 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 Fiscal Responsibility 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 (OG 40/2011 and 156/2013) (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 old 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 and 41/2020) was adopted by the Parliament in December 2018.

The Fiscal Responsibility Act came into force on 1 January 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 per cent. reference value. If the share exceeds this value, the difference between public debt in GDP and the 60 per cent. 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 Croatian Bureau of Statistics, Zagreb Institute of Economics, Institute of Public Finance, the CNB, 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.

Regulation on Preparation and Submission of the Fiscal Responsibility Statement and Reports on the Application of Fiscal Rules

Based on the Fiscal Responsibility Act, the Regulation on Preparation and Submission of the Fiscal Responsibility Statement and Reports on the Application of Fiscal Rules was adopted in October 2019.

The Regulation stipulates the format and content of the Fiscal Responsibility Statement, the manner of maintenance of the Register of Companies and Other Legal Persons Required to Provide the Fiscal Responsibility Statement, the procedure and deadlines for preparing and submitting the statement as well as the manner and deadlines for reporting to the Ministry of Finance (the "**MF**") concerning identified irregularities during verification of the content of the Statements. Furthermore, the Regulation also stipulates the content of reports on the application of the fiscal rules, which provide a description of the methodology and elements upon which the calculation of the fiscal rules are based, including a presentation on their fulfilment. This improves the fiscal responsibility of budgetary and extra-budgetary users including companies owned by the Republic of Croatia as well as local and regional self-government units ("**LRSU**"), where the application of fiscal rules is transparently and comprehensively reported. The Reports on Compliance with fiscal rules are submitted along with all key budget documents, for example, with the convergence programme, draft state budget and financial plans of extra-budgetary users, draft amendments to the state budget and financial plans of extra-budgetary users and the draft annual report on budget execution.

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 (OG 87/2008, 109/2007, 136/2012 and 15/2015) 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.

For the purpose of improving the fiscal framework and fiscal discipline, an effective system for financial and statistical planning as well as reporting on extra-budgetary users from the transport sector has been established. These users include Hrvatske autoceste d.o.o (Croatian Motorways), Autocesta Rijeka-Zagreb d.d. (Rijeka-Zagreb Motorway), Hrvatske željeznice Infrastruktura d.o.o (Croatian Railways Infrastructure) and Hrvatske željeznice Putnički prijevoz d.o.o. (Croatian Railways Passenger Transport). Based on EU statistical methodology rules (ESA 2010) these users are classified into the general accounts sector, and are considered extrabudgetary users in accordance with the Budget Act.

In November 2019, the Parliament gave its approval to the financial plans of extrabudgetary users from the transport sector for the first time along with adoption of the 2020 State Budget ("**SB**") for the Republic of Croatia, and SB projections for 2021 and 2020. This means that the planning procedure by these companies was harmonised with the planning procedure relevant for existing extrabudgetary users, and the actual procedure for reporting on execution of financial plans has been harmonised since 1 January 2020.

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

The implementation of an ex-post evaluation of outcomes for selected activities in sectors relating to healthcare, water management and environmental protection was introduced with the aim of continually improving the budgetary planning system and better controlling the utilisation of funds from public sources.

The MF conducted a procedure involving the ex-post evaluation of the regular maintenance and renewal of tributaries, water facilities and water assets as well as the management of particular categories of waste, in accordance with the methodology, which up until now has been used in undertaking controls when executing the state budget. However, in 2020 external associates will be engaged for the project “Review of Expenditure in the Area of Water and Waste Management”, which will be financed from the European Commission’s Structural Reform Support Programme (SRSP), and which will, taking into account the results of the previously mentioned analysis, conduct a more comprehensive ex-post evaluation of all activities, where special attention will be given to their justification, cost expediency, optimisation and sustainability of results. In terms of the project, external associates will devise a methodology for conducting the ex-post evaluation and hold a course for employees from the MF and other ministries on conducting the ex-post evaluation of outcomes from activities/projects of budgetary and extra-budgetary users of the state budget. In addition, a team from the World Bank, in cooperation with the CHIF and the MF, conducted a project for ex-post evaluation of fiscally important activities within the healthcare system, specifically for prescription drugs and particularly expensive drugs.

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) (the "**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 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. After the public consultations finished in April 2020, final steps towards the adoption of the Budget Act will be conducted after the parliamentary elections.

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 co-funded by the 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 per cent. 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 per cent. 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 and on individual Government decisions on granting state guarantees, as well as on contracts that are concluded on the basis of such decisions, 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. Generally, 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 and alcoholic beverages, manufactured tobacco, energy products and electricity; 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 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. However, from 1 January 2020 the level of basic personal allowance has increased from HRK 3,800 to HRK 4,000.

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).

Also a reduction of tax liability for young people has been prescribed as of 1 January 2020. Young people under the age of 25 are entitled to a reduction of 100 per cent. tax liability, while young people from 26 to 30 years of age are entitled to a reduction of 50 per cent. tax liability, calculated on part of the tax base up to the amount of HRK 360,000 on which annual tax is paid at a rate of 24 per cent.

Advance payment of income tax from employment shall be paid at rates of 24 per cent. to the amount of the tax base 30,000.00 HRK and 36 per cent. of the monthly tax base over 30,000.00 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 (OG 115/2016,106/2018, 121/2019 and 32/2020) 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; and
    - 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 750.00 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 following changes were prescribed as of 1 January 2020:

- the possibility of untaxed payment of the costs of additional and supplementary health insurance up to HRK 2,500 per year;

- a tax exception, such that the affiliation of income tax on the basis of earned income from renting and organizing tourist accommodation, which is determined in a lump sum, is determined by the place where the property or accommodation unit is located, not according to the residence/habitual residence of the taxpayer;

- it is stipulated that fees for pupils during dual education as well as rewards to pupils during practical work and apprenticeships do not fall within the remuneration taken into account when determining the right to an increased personal allowance for dependents;

- income is not considered to be aid and support paid by non-profit organisations to members of the immediate family of a deceased non-profit member;

- the tax treatment of write-offs of individual income tax payers who carry out an independent activity (trades) is equated with write-offs of receivables from corporate tax payers; and

- the characteristics of independent work for the purposes of taxation are prescribed by determining the relevant criteria, namely the control of conduct, financial control and the relationship of the parties, i.e. that the proceeds resulting from the use of tax advantages are contrary to the purpose of the law laid down in the regulation governed by the general tax procedure considered to be remuneration on the basis of employment.

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, 80/2010, 146/2008, 22/2012, 148/2013, 143/2014, 50/2016, 115/2016, 106/2018, 121/2019 and 32/2020) and is aligned with acquis communautaire.

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.

However, from 1 January 2020, a reduced tax rate of 12 per cent. can be applied by a taxpayer if, during the taxation period, they have not generated revenue in excess of HRK 7,500,000. 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.

Currently, 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; and

- natural persons are profit tax taxpayers if in the previous taxation period they received receipts greater than HRK 7,500,000.

This includes, 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.

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 the provisions of the Profit Tax Act. Taxpayers who in the preceding tax period generated revenues not 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 method of accounting.

However, from 1 January 2020, the tax base according to the cash method of accounting can be determined by a taxpayer who in the preceding tax period received receipts not greater than HRK 7,500,000.

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.

From 1 January 2020, the tax base in a lump sum can be determined by non-profit legal entities engaged in economic activity if their generated revenues on the basis of their economic activity in the preceding tax period did not exceed the amount of HRK 7,500,000.

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, sketches, plans, 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.

Exceptionally, a rate of withholding tax of 20 per cent., was payable on the above remunerations and fees for services rendered by service providers which had their registered seat (or the place of actual management or supervision) in countries which were considered to be a tax heaven or financial centres. The withholding tax at the rate of 20 per cent. also applied to other services that were not previously listed. However, that special rate did not apply to Member States and countries with which Croatia had concluded and, therefore, applied 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 now a new provision applies which prescribes an efficient defensive measure according to which withholding tax is paid at the rate of 20 per cent. 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 per cent. 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 and in such case this 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.

From 1 January 2020, exit taxation was introduced following Council Directive (EU) 2016/1164, as well as Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries.

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 should have 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.

The Value Added Tax Act was further amended, and new provisions came into force, on 1 January 2020. The provision on reducing standard VAT rate from 25 per cent. to 24 per cent. was planned to enter into force on 1 January 2020, however the standard VAT rate of 25 per cent. has been retained. The reduced VAT rate of 13 per cent. applies to: (i) preparing and serving food and desserts in and outside of hospitality facilities under special regulations; and (ii) services and related copyright of phonogramic rights. The amended Act prescribes abolition of conditions relating to the generation and distribution of profits for the application of VAT exemption for other persons who are not granted public authority who perform activities of public interest. The threshold for applying the taxation procedure according to charged fees has been raised from HRK 3,000,000 to 7,500,000. Provisions on the harmonisation and simplification of certain rules in the VAT system for the taxation of trade between Member States in accordance with Council Directive 2018/1910/EU entered into force on 1 January 2020.

At the end of 2012, excise duties on manufactured tobacco (cigarettes and fine cut tobacco) were increased in order to achieve the minimum level of excise duties required by the EU. Besides changes which entered into force in November 2012, as part of Croatia's obligation to ensure that the overall excise duty on cigarettes is at least 57 per cent. of the weighted average retail selling price of cigarettes released for consumption and a minimum of EUR 64 per 1,000 cigarettes irrespective of the weighted average retail selling price, further adjustments of excise duty on cigarettes were implemented in June 2013. Excise duties on fine cut tobacco and other smoking tobacco were also increased. Also, in July 2013 adjustments of excise duties on cigars and cigarillos were implemented.

In March 2014 further adjustments of excise duty on cigarettes were implemented as part of Croatia's obligation to ensure that the minimum excise duty on cigarettes should be EUR 77 per 1,000 cigarettes irrespective of the weighted average retail selling price. Also, excise duties on fine cut tobacco and other smoking tobacco were increased.

In April 2015, excise duty on cigarettes was increased 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 and a minimum of EUR 90 per 1,000 cigarettes irrespective of the weighted average retail selling price. Also, excise duties on fine cut tobacco and other smoking tobacco were increased.

In December 2016, further adjustments of excise duty on cigarettes were implemented as part of Croatia's obligation to achieve the minimum level of excise duties required by the EU. Also, excise duties on fine cut tobacco and other smoking tobacco were increased.

In December 2017, the minimum level of excise duties on cigarettes required by the EU was achieved. At the end of 2018, excise duty on cigarettes was increased since the change in the weighted average retail selling price brought the overall excise duty below the required 60 per cent. level. For the same reason, excise duty on cigarettes was also increased from 1 April 2020. Specific excise duty on cigarettes amounts to HRK 370 per 1,000 pieces and ad valorem 34 per cent. of retail selling price. Minimum excise duty amounts to HRK 824 per 1,000 pieces. Excise duty on:

- fine cut tobacco on rolling of cigarettes amounts to HRK 800.00 /1 kg;
- other smoking tobacco amounts to HRK 800.00 /1 kg;

- cigars amounts to HRK 800.00 /1,000 pieces; and
- cigarillos amounts to HRK 800.00 /1,000 pieces.

In September 2015, special control measures on raw tobacco were introduced. Where it has been established that raw tobacco is the subject of unlawful action all quantities of raw tobacco that are the subject matter of such actions will be subject to the calculation and payment of excise duty according to rate prescribed for fine cut tobacco.

Excise duty on heated tobacco products, e-liquids and novel tobacco products has been introduced as of 1 January 2017. The excise duty for e-liquids is calculated as a specific excise duty prescribed for 1 millilitre and amounts HRK 0.00. From 1 April 2020 excise duty on heated tobacco products amounts HRK 800/1kg and excise duty on novel tobacco products amounts HRK 800/1 kg.

From 23 July 2013, the excise duties 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 duties on natural gas and electricity were introduced. The excise duty 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 fuel 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 duty 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 2019, a refund of part of the excise duty paid on diesel fuel for commercial transport of goods and passengers by rail, and excise duty exemption on electricity for commercial transport of goods and passengers by rail and tram, was introduced.

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 old Excise Duties Act (OG 22/2013, 32/2013, 81/2013, 100/2015, 120/2015 and 115/2016) 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 (50 per cent. of the standard national rate) produced from small distilleries, for commercial purposes, with production limited to 10 hl of pure alcohol per year.

On 1 January 2019, the new Excise Duties Act (OG 106/2018 and 121/2019) entered into force.

From 1 April 2020, the amount of excise duty on alcohol and alcoholic beverages has been regulated by the Regulation on the amount of excise duty on alcohol and alcoholic beverages (OG 33/2020). This Regulation increases the amount of excise duty on ethyl alcohol from HRK 5,300.00 per hl of pure alcohol to HRK 6,000 per hl of pure alcohol.

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 CO_2 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). In addition, from 1 January 2019, the tax by value component was further reduced, in order to place greater emphasis on CO2-based taxation, so that for motor vehicles with a selling price above HRK 150,000, the tax burden was reduced by an average value criterion 19.1 per cent. for vehicles with a petrol engine, while for vehicles with a diesel engine the tax burden was reduced by an average of 20.6 per cent. Overall, this change reduced the total tax burden by approximately 6.8 per cent.

At the beginning of 2020, amendments to the special tax for non-alcoholic beverages modernised the taxation system for non-alcoholic beverages in the Republic of Croatia. The former linear taxation system for non-alcoholic beverages, which was based exclusively on their volume, was replaced with a system based on the volume and additionally on the content of sugars, methyl-xanthine and taurine. With this new system that entered into force on 1 April 2020, non-alcoholic beverages with smaller sugar content pay a smaller amount of special tax. Non-alcoholic beverages with a 100-percent content of fruits and/or vegetables, not containing added sugars, sweetening matter and sweeteners, and beverages containing products falling within CN codes 0401 to 0404, but not containing methyl-xanthine or taurine, are non-taxable, while for fruit juices a reduced amount (depending on fruit content) of special tax is paid.

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 293.0 billion as at 31 December 2019, corresponding to 73.2 per cent. of the GDP. The majority of general Government debt as at 31 December 2019 was internal debt, which amounted to HRK 197.2 billion or 67.3 per cent. (47.7 per cent. long-term debt securities, 15.3 per cent. loans and 4.2 per cent. T-bills), whereas external debt amounted to HRK 95.8 billion or 32.6 per cent. (18.5 per cent. long term securities and 14.1 per cent. loans) of total general Government debt. Total Government guarantees (including internal and external guarantees and guarantees in respect of CBRD) stood at HRK 4.4 billion as at 31 December 2019, corresponding to 1.1 per cent. of the GDP.

As of 31 January 2020, the general Government debt stood at HRK 291.6 billion. The majority of general Government debt as of 31 January 2020 was domestic debt (HRK 195.3 billion), while external debt represented a 33 per cent. of the total general Government debt. Due to the impact of numerous macroeconomic events in 2020, including but not limited to the Coronavirus pandemic and the Zagreb earthquake, the general Government debt to GDP ratio is expected to increase in 2020 and 2021 to approximately 86.7 per cent. and 83.2 per cent., respectively.

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				
	2015	**2016**	**2017**	**2018**	**2019**
General Government Debt (HRK billion)	286.4	283.8	284.9	286.1	293.0
— as a percentage of GDP	84.3	80.8	77.8	74.7	73.2
Government Guarantees (HRK billion)	6.5	9.4	9.8	5.3	4.4
— as a percentage of GDP	1.9	2.7	2.7	1.4	1.1

Source: Ministry of Finance and CNB

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				
	2015	**2016**	**2017**	**2018**	**2019**
			(HRK millions)		
1. Domestic General Government Debt (1)	166,150	173,401	173,019	181,338	197,197
1.1 Central Government	161,278	168,852	168,623	175,760	191,283
Securities other than shares, short-term	15,368	12,754	12,630	11,909	12,380
Securities other than shares, long-term	92,053	108,609	119,414	126,436	140,584
Loans	53,857	47,489	36,579	37,416	38,319
1.2 Central Government Funds	2	1	0	1	6
Securities other than shares, short-term	0	0	0	0	0
Securities other than shares, long-term	0	0	0	0	0
Loans	2	1	0	1	6
1.3 Local Governments Debt	5,141	4,882	4,840	6,111	6,633
Securities other than shares, short-term	0	0	0	0	0
Securities other than shares, long-term	59	13	0	0	0
Loans	5,081	4,869	4,840	6,111	6,633
2. External General Government Debt	120,260	110,352	111,901	104,800	95,823
2.1 Central Government	119,846	109,977	111,550	104,452	95,459
Securities other than shares, short-term	63	13	150	5	0
Securities other than shares, long-term	68,126	58,451	61,840	57,610	54,468
Loans	51,658	51,512	49,561	46,838	40,991
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	414	375	351	348	364
Securities other than shares, short-term	0	0	0	0	0
Securities other than shares, long-term	65	31	0	0	0
Loans	348	344	351	348	364

	Twelve months ended 31 December				
	2015	**2016**	**2017**	**2018**	**2019**
			(HRK millions)		
3. Total (1+2)	**286,410**	**283,753**	**284,920**	**286,138**	**293,020**
Supplement: General Government Guarantees	6,539	9,356	9,761	5,295	4,387
Domestic	3,258	5,246	6,222	3,824	3,091
External	3,281	4,110	3,539	1,470	1,296

Note: Exchange rate as at the end of period
(1) Domestic General Government Debt=1.1+1.2+1.3-consolidation elements
Source: CNB

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:

	31 December				
Debt item	**2016**	**2017**	**2018**	**2019**	**Maturity**
			(HRK thousands)		
G Bonds - Series 07 D-19	7,557,787	7,513,648	7,417,575	0	2019
G Bonds - Series 12 D-17	5,500,000	0	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	7,557,787	7,513,648	7,417,575	7,442,580	2020
G Bonds - Series 15 D-17	4,000,000	0	0	0	2017
G Bonds - Series 17 D-22	7,557,787	7,513,648	7,417,575	7,442,580	2022
G Bonds - Series 18 D-18	6,000,000	6,000,000	0	0	2018
G Bonds - Series 19 D-24	10,580,902	10,519,107	10,384,605	10,419,612	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	10,000,000	10,000,000	10,000,000	10,000,000	2026
G Bonds - Series 22 D-21	6,000,000	6,000,000	6,000,000	6,000,000	2021
G Bonds - Series 23 D-22	0	3,000,000	3,000,000	3,000,000	2022
G Bonds - Series 24 D-28	0	5,500,000	5,500,000	5,500,000	2028
G Bonds - Series 25 D-32 I	0	3,000,000	3,000,000	3,000,000	2032
G Bonds - Series 26 D-23	0	5,800,000	11,300,000	11,300,000	2023
G Bonds - Series 27 D-29	0	0	5,000,000	10,000,000	2029
G Bonds - Series 28 D-22				3,721,290	2022
G Bonds - Series 29 D-24				3,500,000	2024
G Bonds - Series 30 D-34 I				7,500,000	2034
Long term loans (HRK)	5,709,488	4,960,090	6,095,561	8,799,538	
Long term loans (EUR)	15,452,039	13,149,252	13,668,125	11,564,777	
Long term loans (USD)	302,989	25,957	0	0	
Long term debt	97,218,779	101,495,349	107,201,015	120,190,377	
Treasury Bills	16,807,000	16,952,000	18,074,000	17,807,000	
Treasury Bills indexed to eur	790,545	467,349	968,735	788,913	
Treasury Bills FX	11,336,681	11,270,472	11,126,363	7,800,940	
Other short term debt	0	0	0	0	
Short term debt	28,934,225	28,689,821	30,169,098	26,396,853	
Total debt	126,153,004	130,185,170	137,370,113	146,587,230	

Source: Ministry of Finance

G-Bonds are bullet bonds issued through a syndicate of domestic banks and listed on the ZSE. Long term 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	2019
			(per cent.)		
364 days HRK	1.50	0.97	0.45	0.09	0.08
364 days EUR	0.40	0.17	0.02	0.00	-0.04

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

As of 31 December 2019, the average maturity of Croatia's domestic medium and long-term central Government debt was 4.8 years.

Domestic bank syndicated loans amounting to HRK 4.7 billion and domestic bonds amounting to HRK 12.6 billion are scheduled to mature in 2020. The bonds have already been fully paid out at maturity in March 2020.

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	203
								(HRK thousands)				
Redemption of principle	16,792.6	12,197.3	18,888.8	14,960.7	14,899.1	6,137.3	10,096.7	75.8	5,541.3	1,062.9	37.8	0
Bonds – Series 13 D-20	5,000.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0
Bonds – Series 14 D-20	7,442.58	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0
Bonds – Series 17 D-22	0.00	0.00	7,442.58	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0
Bonds – Series 19 D-24	0.00	0.00	0.00	0.00	10,419.61	0.00	0.00	0.00	0.00	0.00	0.00	0
Bonds – Series 20 D-25	0.00	0.00	0.00	0.00	0.00	6,000.00	0.00	0.00	0.00	0.00	0.00	0
Bonds – Series 21 D-26	0.00	0.00	0.00	0.00	0.00	0.00	10,000.00	0.00	0.00	0.00	0.00	0
Bonds – Series 22 D-21	0.00	6,000.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0
Bonds – Series 23 D-22	0.00	0.00	3,000.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0
Bonds – Series 24 D-28	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	5,500.00	0.00	0.00	0
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
Bonds – Series 26 D-23	0.00	0.00	0.00	11,300.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0
Bonds – Series 27 D-29	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	10,000.00	0.00	0
Bonds – Series 28 D-22	0.00	0.00	3,721.29	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0
Bonds – Series 29 D-24	0.00	0.00	0.00	0.00	3,500.00	0.00	0.00	0.00	0.00	0.00	0.00	0
Bonds – Series 30 D-34 I	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0
Long term Loans (HRK)	2,268.25	2,611.75	2,484.25	368.65	909.12	84.57	43.96	25.48	3.50	0.00	0.00	0
Long term Loans (EUR)	2,081.80	3,585.57	2,240.63	3,292.05	70.33	52.77	52.77	50.36	37.77	62.95	37.77	0
Interest payments	3,654.6	3,073.4	2,748.3	2,150.1	1,915.5	1,286.3	1,010.0	579.2	494.8	415.7	173.6	17
Bonds – Series 13 D-20	168.75	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0
Bonds – Series 14 D-20	241.07	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0
Bonds – Series 17 D-22	483.77	483.77	483.77	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0
Bonds – Series 19 D-24	599.13	599.13	599.13	599.13	599.13	0.00	0.00	0.00	0.00	0.00	0.00	0
Bonds – Series 20 D-25	270.00	270.00	270.00	270.00	270.00	270.00	0.00	0.00	0.00	0.00	0.00	0
Bonds – Series 21 D-26	425.00	425.00	425.00	425.00	425.00	425.00	425.00	0.00	0.00	0.00	0.00	0
Bonds – Series 22 D-21	165.00	165.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0
Bonds – Series 23 D-22	67.50	67.50	33.75	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0
Bonds – Series 24 D-28	158.13	158.13	158.13	158.13	158.13	158.13	158.13	158.13	79.06	0.00	0.00	0
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
Bonds – Series 26 D-23	197.75	197.75	197.75	197.75	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0
Bonds – Series 27 D-29	237.50	237.50	237.50	237.50	237.50	237.50	237.50	237.50	237.50	237.50	0.00	0
Bonds – Series 28 D-22	18.61	18.61	9.3	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0
Bonds – Series 29 D-24	8.75	8.75	8.75	8.75	8.75	0.00	0.00	0.00	0.00	0.00	0.00	0
Bonds – Series 30 D-34 I	75.00	75.00	75.00	75.00	75.00	75.00	75.00	75.00	75.00	75.00	75.00	75
Long term Loans (HRK)	154.19	107.73	57.93	34.28	19.15	6.80	3.68	0.88	0.04	0.00	0.00	0
Long term Loans (EUR)	286.12	162.09	94.85	47.03	25.32	16.35	13.24	10.19	5.69	5.66	1.12	0
Total debt service	**20,447.2**	**15,270.8**	**21,637.1**	**17,110.8**	**16,814.5**	**7,423.6**	**11,106.8**	**655.0**	**6,036.1**	**10,478.6**	**211.4**	**17**

Note: Exchange rate: Mid exchange rate of the CNB as of 31 December 2019
Source: Ministry of Finance

Overview of external Central Government debt stock and redemptions

		Amount in (EUR*)	2020. (EUR*)	2021 (EUR*)	2022. (EUR*)	2023. (EUR*)	2024. (EUR*)	2025. (EUR*)	2026. (EUR*)	2027. (EUR*)
USD 1,250,000.000......................................	Principal	1,116,869,251	**1,116,869,251**							
6.625 %, Maturity: 2020...............................	Interest		73,992,588							
USD 1,500,000,000......................................	Principal	1,340,243,101	0	**1,340,243,101**						
6.375% Maturity: 2021................................	Interest		85,440,498	42,720,249						
EUR 1,250,000,000......................................	Principal	1,250,000,000	0	0	**1,250,000,000**					
3.875%, Maturity: 2022................................	Interest		48,437,500	48,437,500	48,437,500					
USD 1,500,000,000......................................	Principal	1,340,243,101	0	0	0	**1,340,243,101**				
5.500% Maturity: 2023	Interest		73,713,371	73,713,371	73,713,371	36,856,685				
USD 1,750,000,000......................................	Principal	1,563,616,951	0	0	0	0	**1,563,616,951**			
6.000% Maturity: 2024	Interest		93,817,017	93,817,017	93,817,017	93,817,017	46,908,509			
EUR 1,500,000,000......................................	Principal	1,500,000,000	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		
EUR 1,250,000,000......................................	Principal	1,250,000,000	0	0	0	0	0	0	0	**1,250,000,000**
3.000%, Maturity: 2027................................	Interest		37,500,000	37,500,000	37,500,000	37,500,000	37,500,000	37,500,000	37,500,000	37,500,000
EUR 750,000,000	Principal	750,000,000	0	0	0	0	0	0	0	0
2.700%, 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
EUR 1,500,000,000......................................	Principal	1,500,000,000	0	0	0	0	0	0	0	0
1.125%, Maturity: 2029................................	Interest		16,875,000	16,875,000	16,875,000	16,875,000	16,875,000	16,875,000	16,875,000	16,875,000
EUR 1,275,000,000......................................	Principal	1,275,000,000	0	0	0	0	0	0	0	0
2.750%, Maturity: 2030................................	Interest		35,062,500	35,062,500	35,062,500	35,062,500	35,062,500	35,062,500	35,062,500	35,062,500
Principal Repayment (EUR*)			1,116,869,251	1,340,243,101	1,250,000,000	1,340,243,101	1,563,616,951	1,500,000,000	0	1,250,000,000
Interest Payment (EUR*)			530,088,473	413,375,636	370,655,388	285,361,202	201,596,009	154,687,500	109,687,500	109,687,500
Total Servicing Costs (EUR*)			1,646,957,724	1,753,618,738	1,620,655,388	1,625,604,304	1,765,212,960	1,654,687,500	109,687,500	1,359,687,500
Total Principal Outstanding (at year end) (EUR*)			**11,769,103,154**	**10,428,860,053**	**9,178,860,053**	**7,838,616,951**	**6,275,000,000**	**4,775,000,000**	**4,775,000,00 0**	**3,525,000,000**

** Exchange rate: Mid exchange rate of the CNB as of 31 December 2019*

External Debt

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

	2015	2016	2017	2018	2019
Total outstanding external debt/GDP	108.0	95.9	88.9	82.7	75.7
General government external debt/GDP.........................	36.3	32.5	30.1	27.0	23.9

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:

	2015	2016	2017	2018	2019
Ratio of debt service to exports of goods & services......	44.0	35.7	33.1	27.1	29.7

(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: Croatian National Bank

As of 31 January 2020, the average remaining maturity of Croatia's external central Government debt (according to BPM6) was 6.2 years.

As of 31 December 2019, Croatia had hedging arrangements in place in respect of all of its four 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 totalling 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 and in July 2018 bonds amounting to EUR 750 million were repaid, while in June 2019 bonds amounting to EUR 1.5 billion were issued. In November 2019, U.S. dollar bonds amounting to 1.5 billion were fully repaid.

Relations with the IMF

The Republic of Croatia's IMF quota amounts to a Special Drawing Right ("**SDR**") of 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 arrangements 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 millions:

	As at 31 December					As at 31 January
	2015	**2016**	**2017**	**2018**	**2019**	**2020**
			(EUR millions)			
General government........................	**16,214**	**15,144**	**14,769**	**13,953**	**12,899**	**12,965**
Short-term..	8	2	85	21	0	0
Currency and deposits.................................	0	0	0	0	0	0

Debt securities	8	2	20	1	0	0
Loans	0	0	65	20	0	0
Trade credit and advances	0	0	0	0	0	0
Other debt liabilities	0	0	0	0	0	0
Long-term	16,206	15,142	14,684	13,933	12,899	12,965
Currency and deposits	0	0	0	0	0	0
Debt securities	10,106	8,992	8,728	8,423	8,030	8,121
Loans	6,100	6,151	5,956	5,509	4,870	4,843
Trade credit and advances	0	0	0	0	0	0
Other debt liabilities	0	0	0	0	0	0
Central bank	**1,692**	**1,419**	**2,039**	**1,657**	**1,238**	**1,500**
Short-term	1,307	1,030	1,676	1,288	862	1,121
Currency and deposits	51	80	76	45	56	102
Debt securities	0	0	0	0	0	0
Loans	1,238	950	1,600	1,243	806	1,020
Trade credit and advances	0	0	0	0	0	0
Other debt liabilities	18	0	0	0	0	0
Long-term	385	389	363	370	376	379
Special drawing rights (allocations)	385	389	363	370	376	379
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	**6,125**	**4,555**	**3,769**	**4,073**	**3,937**	**4,452**
Short-term	1,697	1,765	1,654	2,269	2,086	2,678
Currency and deposits	1,603	1,704	1,521	2,140	1,914	2,196
Debt securities	0	0	0	0	0	0
Loans	66	25	97	91	130	443
Trade credit and advances	0	0	0	0	0	0
Other debt liabilities	29	36	35	38	43	39
Long-term	4,428	2,789	2,116	1,804	1,850	1,774
Currency and deposits	2,846	1,780	1,286	924	895	822
Debt securities	2	14	10	20	64	65
Loans	1,579	993	817	858	863	858
Trade credit and advances	0	0	0	0	0	0
Other debt liabilities	2	2	2	2	28	28
Other sectors	**18,345**	**17,381**	**16,272**	**16,665**	**16,663**	**15,965**
Short-term	3,401	3,555	3,712	4,169	4,043	3,700
Currency and deposits	0	0	0	0	0	0
Debt securities	68	76	83	83	83	83
Loans	494	360	412	385	282	235
Trade credit and advances	2,840	3,119	3,218	3,702	3,678	3,382
Other debt liabilities	0	0	0	0	0	0
Long-term	14,943	13,826	12,559	12,495	12,620	12,266
Currency and deposits	0	0	0	0	0	0
Debt securities	1,640	1,488	1,018	996	2,144	2,164
Loans	13,133	12,011	11,215	11,301	10,340	10,090
Trade credit and advances	170	328	326	198	136	12
Other debt liabilities	0	0	0	0	0	0
Direct investment: intercompany lending	**5,854**	**6,214**	**6,833**	**6,361**	**6,140**	**6,222**
Debt liabilities of direct investment enterprises to direct investors	3,947	4,295	5,037	4,793	4,903	4,913
Debt liabilities of direct investors to direct investment enterprises	216	289	279	291	313	348
Debt liabilities to fellow enterprises	1,691	1,630	1.517	1.277	924	961
Gross external debt position	**48,230**	**44,714**	**43,683**	**42,710**	**40,877**	**41,104**

(1) Exchange rate as at 31 December in the relevant year.
Source: Croatian National Bank

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 2020:

	Gross External Debt as at 31 January 2020	Immediate Arrears	2020*	2021	2022	2023	2024	2025	2026	2027	2028	2029	Other
						(EUR millions)							
Public sector	**15,532**	**0**	**3,353**	**1,643**	**1,722**	**1,240**	**1,368**	**1,151**	**459**	**1,042**	**741**	**1,225**	**1,587**
Other investment	15,531	0	3,353	1,641	1,722	1,240	1,368	1,151	459	1,042	741	1,225	1,587
Short-term	1,426	0	1,425	1	0	0	0	0	0	0	0	0	0
Long-term	14,104	0	1,928	1,640	1,722	1,240	1,368	1,151	459	1,042	741	1,225	1,587
Direct investment	2	0	0	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	0	2	0	0	0	0	0	0	0	0	0
Publicly guaranteed private sector	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Other investment	0	0	0	0	0	0	0	0	0	0	0	0	0
Short-term	0	0	0	0	0	0	0	0	0	0	0	0	0
Long-term	0	0	0	0	0	0	0	0	0	0	0	0	0
Direct investment	0	0	0	0	0	0	0	0	0	0	0	0	0
Non-publicly guaranteed private sector	**25,572**	**3,869**	**10,696**	**3,003**	**1,935**	**1,154**	**858**	**445**	**466**	**520**	**336**	**212**	**2,078**
Other investment	19,352	3,591	8,330	1,924	1,222	861	577	329	363	250	187	154	1,564
Short-term	6,073	258	5,793	23	0	0	0	0	0	0	0	0	0
Long-term	13,278	3,333	2,537	1,902	1,222	861	577	329	363	250	187	154	1,564
Direct investment	6,220	277	2,367	1,079	714	293	281	116	103	271	149	58	514
Short-term	888	25	799	64	0	0	0	0	0	0	0	0	0
Long-term	5,332	253	1,567	1,015	714	293	281	116	103	271	149	58	514
Total	**41,104**	**3,869**	**14,050**	**4,646**	**3,657**	**2,395**	**2,226**	**1,596**	**925**	**1,562**	**1,077**	**1,437**	**3,665**

* Repayments made until January 2020 and projected repayments for the following months.
Note: Exchange rate as at 31 January 2020
Source: CNB

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 2020:

	Gross External Debt as at 31 January 2020	Immediate Arrears	2020*	2021	2022	2023	2024	2025	2026	2027	2028	2029	Other
						(EUR millions)							
Public sector	**15,532**	**0**	**233**	**325**	**284**	**188**	**153**	**119**	**86**	**91**	**59**	**59**	**68**
Other investment	15,531	0	233	325	284	188	153	119	86	91	59	59	68
Short-term	1,426	0	0	0	0	0	0	0	0	0	0	0	0
Long-term	14,104	0	233	325	284	188	153	119	86	91	59	59	68
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	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Other investment	0	0	0	0	0	0	0	0	0	0	0	0	0
Short-term	0	0	0	0	0	0	0	0	0	0	0	0	0
Long-term	0	0	0	0	0	0	0	0	0	0	0	0	0
Direct investment	0	0	0	0	0	0	0	0	0	0	0	0	0

	Gross External Debt as at 31 January 2020	Immediate Arrears	2020*	2021	2022	2023	2024	2025	2026	2027	2028	2029	Other
						(EUR millions)							
Non-publicly guaranteed private sector	**25,572**	**3,869**	**247**	**254**	**238**	**158**	**81**	**67**	**61**	**33**	**52**	**38**	**229**
Other investment	19,352	3,591	199	186	164	111	45	37	32	14	23	26	74
Short-term	6,073	258	1	0	0	0	0	0	0	0	0	0	0
Long-term	13,278	3,333	199	186	164	111	45	37	32	14	23	26	74
Direct investment	6,220	277	48	68	74	46	36	30	28	19	30	12	155
Short-term	888	25	2	0	0	0	0	0	0	0	0	0	0
Long-term	5,332	253	46	68	74	46	36	30	28	19	30	12	155
Total	**41,104**	**3,869**	**480**	**579**	**522**	**345**	**234**	**186**	**147**	**123**	**111**	**97**	**297**

* Repayments made until end-January 2020 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, 106/2018, 121/2019 and 32/2020) 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, 106/2018, 121/2019 and 32/2020) 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 (who 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

Banca IMI S.p.A. (acting through its London Branch and in cooperation with another member of the Intesa Sanpaolo Group - Privredna banka Zagreb d.d.), Barclays Bank PLC, Deutsche Bank AG, London Branch and J.P. Morgan Securities plc (together, the "**Joint Lead Managers**") have, in a subscription agreement (the "**Subscription Agreement**") dated 15 June 2020, jointly and severally agreed to subscribe and pay for, or to procure subscriptions and payment for, the Notes at their issue price of 98.572 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 CNB in accordance with Article 87 of the Credit Institutions Act or to CFFSA pursuant to Article 147 of the Capital Market Act, respectively, 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) or outside of the territory of the Republic of Croatia, in each case on a reverse inquiry basis.

Any Joint Lead Manager having arranged for the relevant "passport" notification to the CNB or CFFSA, respectively, 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 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 2 of the Prospectus Regulation and any applicable provision of Legislative Decree No. 58 of 24 February 1998, as amended (the "**Financial Services Act**") and Italian CONSOB regulations; or

(ii) in other circumstances which are exempted from the rules on public offerings pursuant to Article 1 of the Prospectus Regulation, Article 34 ter of CONSOB Regulation No. 11971 of 14 May 1999, as amended from time to time, and the applicable Italian laws.

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 € 7,200.

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 12 June 2020 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 12 June 2020 (Class:450-08/20-01/3, Reg. No. 513-10-20-1), passed in accordance with the Act on Execution of the State Budget of the Republic of Croatia for the year 2020 and the Budget Act.

On 18 May 2020, the Parliament amended the State Budget of the Republic of Croatia for 2020 and adopted the Act on Amendments to the 2020 State Budget Execution Law to, *inter alia*, increase permitted borrowings in foreign and domestic money and capital markets under the budget financing account from HRK 26,855,578,351 to HRK 62,499,411,233, which increase was intended to finance, inter alia, measures at alleviating the COVID-19 pandemic, supporting the economy and repaying USD 1.25 billion of the Republic's bonds maturing on 14 July 2020. Following the dissolution of the Parliament on 18 May 2020 and the announcement of parliamentary elections to be held on 5 July 2020, the authority of the current Government of Croatia to enter into agreements prior to the formation of a new government is governed by the Law on Transfer of Powers (OG 94/2004, 17/2007, 91/2010 and 22/2013) (the "**LTP**"). Article 5 of the LTP provides that:

"... From the date of announcement of the elections, the government may not enter into agreements of a significant value, except if a failure to enter therein would cause considerable damages, i.e. if entry therein is necessary for fulfilment of international obligations, of the Republic of Croatia and for which transactions it is assumed they will be finalised before the new government takes over the powers, after the parliamentary elections being conducted. Contracts entered into contrary to the above provision are null and void ..."

Accordingly, the Ministry of Finance has authorised the issuance of the Notes pursuant to Article 5 of the LTP for the purposes set forth in "*Use of Proceeds*" and to avoid the occurrence of material damage in the event of any potential delay in procuring necessary financing.

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 2019.

Clearing Systems

The Notes have been accepted for clearance through Euroclear and Clearstream, Luxembourg. The relevant identification numbers are set forth below:

Common code:	219020198
ISIN:	XS2190201983
CFI:	DBFNFR, as updated on the website of the Association of National Numbering Agencies (ANNA) or alternatively sourced from the responsible National Numbering Agency that assigned the ISIN
FISN:	REPUBLIC OF CRO/EUR NT 20310617, as updated on the website of the Association of National Numbering Agencies (ANNA) or alternatively sourced from the responsible National Numbering Agency that assigned the ISIN

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 98.572 per cent. of their principal amount, the yield on the Notes is 1.643 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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