

REVIEW OF THE STRUCTURAL SYSTEMIC RISK BUFFER LEVEL

Pursuant to Article 131 of the Credit Institutions Act (Official Gazette 159/2013) and Article 5 of the Decision on the application of the structural systemic risk buffer (Official Gazette 61/2014), the Croatian National Bank is obligated to review whether credit institutions having a head office in the Republic of Croatia meet the obligation of maintaining a structural systemic risk buffer in the amount of 1.5% of risk exposure or 3% of risk exposure respectively, starting from May 2014. In accordance with Article 129 of the Credit Institutions Act, the rationale behind the adoption of the Decision on the application of the structural systemic risk buffer was based on the following systemic risk indicators:

- 1) high structural macroeconomic imbalances which determine the probabilities and the intensity of a potential shock to the financial system;
- 2) low real estate market liquidity, i.e. impossibility of a quick and effective (at an appropriate price) liquidation of instruments of collateral;
- 3) high level of market concentration which is increasing financial system vulnerability;
- 4) operations of systemically important financial institutions with regard to the type, scope and complexity of operations, the associated risks of which could not be resolved by appropriate instruments.

A recent analysis of the structural elements of financial stability and an overall assessment of the risks present in the economy, regularly conducted by the CNB¹, point to a small increase in the already high financial system exposure to systemic risk, warranting the keeping of the obligation to maintain this buffer, at the determined rates (for two relevant groups of credit institutions).

The relevant systemic risk indicators point to the following:

- 1) According to Macroeconomic Imbalance Procedure, MIP, indicators, the degree of structural macroeconomic imbalances has not changed much over the past year, despite economic growth recovery and improvement in external imbalances (Figure 1). Namely, household and non-financial corporations debt remains high, prompting further private sector deleveraging present for several years and impeding the intensity of recovery of consumption and investment. In addition, structural public sector vulnerabilities, particularly those in the form of high public debt hinder any stronger economic recovery.
- 2) In such economic conditions, coupled with the significant burden of the existing loan obligations that weigh down on households, the activities and prices in the real estate markets continue to erode (Figure 2).

¹ Financial stability, No. 16, Year 9, II 2016, CNB (available at: <http://www.hnb.hr/documents/20182/521139/e-fs-16-2016.pdf/147041fe-f2d7-4450-b7c0-8e3a379df35a>).

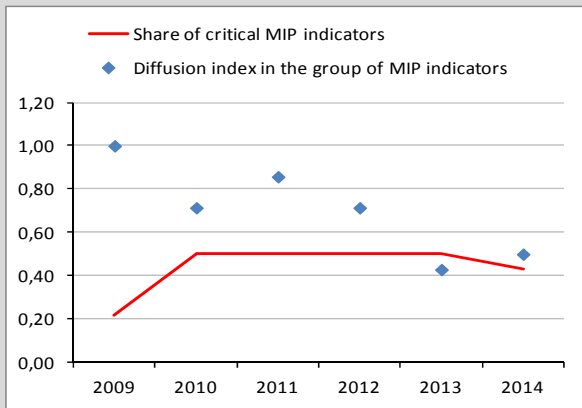
- 3) At the same time, high financial system concentration increased additionally, greatly exceeding the European average (Figure 3).

And finally, in accordance with the methodology for determining other systemically important credit institutions², the CNB has identified nine systemically important credit institutions (hereinafter: O-SIIs) for the domestic financial system which are, depending on the assessment of systemic importance based on their size, complexity, interconnectedness with the rest of the financial system and significance to the economy of the Republic of Croatia, obligated to maintain a capital buffer in the amount of 0.2% and 2%, respectively of the total amount of risk exposure. Since the buffer for other O-SIIs and the structural systemic risk buffer now apply to the total amount of risk exposure, credit institutions are obligated to maintain only the higher of the two mentioned buffer rates (Article 139, paragraphs (1) and (3) of the Credit Institutions Act). Therefore, in the case of a reduction in the structural systemic risk buffer in the part in which the risk of systemical importance of credit institutions has been covered up to now, O-SIIs would be obligated to maintain only the buffer for other systemically important institutions; i.e. the lower level of buffers relative to the level adequate for systemic risks. Accordingly, given that up to now the buffer rates for structural systemic risk have been higher than the buffer rates for other systemically important institutions, O-SIIs continue to be obligated to maintain only the structural systemic risk buffer (Figure 4).

In light of the above-mentioned, at this moment the Croatian National Bank will not change the Decision on the application of the structural systemic risk buffer of 19 May 2014 and will continue to regularly monitor the evolution of systemic risks of structural nature, and towards the end of the year will launch a revision of the Decision together with an examination of the capital buffer for O-SIIs in accordance with Articles 137 and 138 of the Credit Institutions Act.

² Available at: https://www.hnb.hr/documents/20182/121030/tf-s-sjo-spo-pdf-e-postupak_osv.pdf/41d5a956-c41b-426b-aab4-24413d35ff93

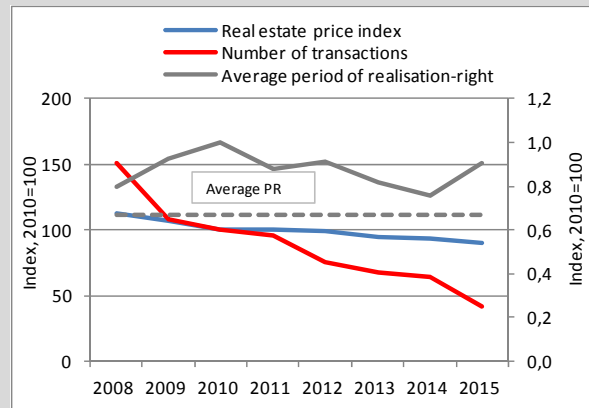
Figure 1 Structural macroeconomic imbalances are still present



Source: European Commission.

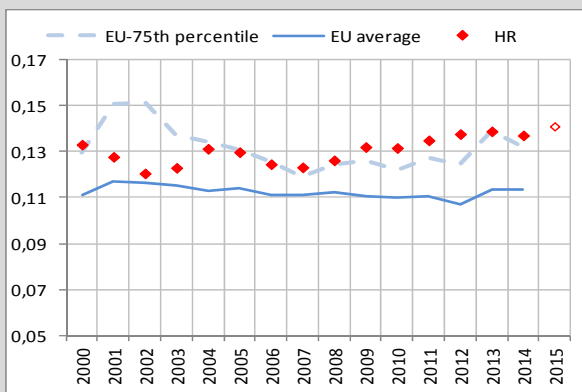
Note: For a detailed analysis of the recent structure of MIP indicators, see: *European Commission: Alert Mechanism Report 2016* (http://ec.europa.eu/europe2020/pdf/2016/ags2016_alert_mechanism_report.pdf)

Figure 2 Developments in real estate prices and their liquidity do not point to a trend reversal



Source: NBS; CNB.

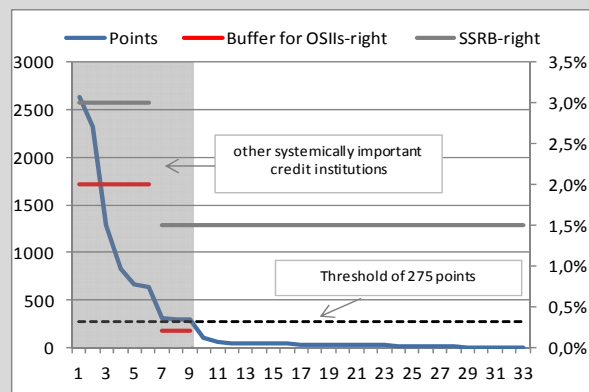
Figure 3 Level of market concentration continues to be high



Source: ECB; CNB.

Note: Data for Croatia for 2015 are based on unconsolidated preliminary reports of credit institutions.

Figure 4 Coverage of operational risks of other systemically important credit institutions



Source: CNB.

Note: In accordance with Article 139, paragraphs (1) and (3) of the Credit Institutions Act, credit institutions are obligated to maintain the higher of the structural systemic risk buffer (SSRB) and the buffer for other systemically important credit institutions. The level of 275 basis points is used as a threshold above which credit institutions are determined as O-SIIs. For more details on O-SII determination, see: https://www.hnb.hr/documents/20182/121030/tf-s-sjo-spo-pdf-e-postupak_osv.pdf/41d3a956-c41b-426b-aab4-24413d35ff93