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Announcement of the continued application of the structural systemic risk buffer of 1.5%

Based on the analysis of structural vulnerabilities and systemic risks in the domestic economy, the Croatian National Bank will maintain the structural systemic risk buffer at the level of 1.5% of the total risk exposure. This rate will be applied until the next review cycle to be conducted by end-2026 at the latest[1].

The exposure of the domestic financial system to systemic risks remained moderately elevated in 2024[2]. The major sources of risks to financial stability arise from the international environment, and the Republic of Croatia, as a small and open economy is sensitive to disruptions in the global economy. Growing geopolitical tensions and processes of geoeconomic fragmentation, including faster deglobalisation processes and rising protectionism and tensions between the major trading blocs (Figure 1 and Figure 2) are a potential source of significant disturbances in the global economy and the financial system with negative implications on the domestic economy and financial stability.

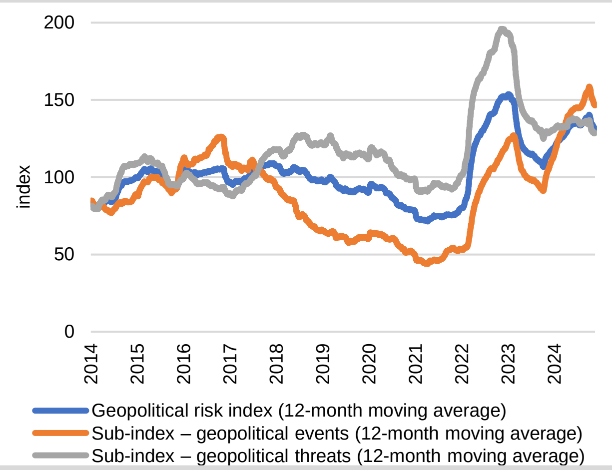
The main structural weakness of the domestic economy and the financial system continues to lie in the structural deficiency of the labour market. The labour market continues to be characterised by a low rate of labour force participation and unfavourable demographic trends, which, amid robust economic growth and the demand for labour may limit the long-term growth potential of the Croatian economy. While unemployment fell considerably, the population activity rate, despite a modest growth, remains among the lowest in the euro area and the EU (Figure 3), hampering economic growth due to labour shortage. Also, banking sector exposure to the government in relation to total banking sector assets remains relatively high, ranking among the highest in the EU (Figure 4). Such interconnectedness between the banking sector and the government facilitates the spillover of possible disturbances between systems, amplifying their effects and triggering the so-called vicious cycle of financial instability. However, a considerable fall in the public debt to GDP ratio and increasing government reliance on direct financing from households mitigate the risks to financial stability arising from high bank exposure to the government.

[1] The Croatian National Bank prescribed the obligation to maintain a structural systemic risk buffer in 2014. The currently applied buffer rate of 1.5% of the total risk exposure for all credit institutions has been in use since December 2020 when it was prescribed by the Decision on the application of the structural systemic risk buffer (Official Gazette 144/2020), pursuant to Article 129 of the Credit Institutions Act (Official Gazette 159/2013, 19/2015, 102/2015, 15/2018, 70/2019, 47/2020, 146/2020, 151/2022 and 145/2024). As provided by this Act, the Croatian National Bank reviews the systemic risk buffer rate at a minimum on a biannual basis.
[2] See CNB publications Financial Stability No. 25 and Macroprudential Diagnostics No. 24.

Despite presently favourable economic developments in the Republic of Croatia and high capitalisation, profitability and liquidity of the banking system, any economic disturbance might also negatively impact financial system stability. High bank-centricity of the domestic financial system, where banks continue to account for some two-thirds of financial system assets, highlights the importance of maintaining high capitalisation and banking sector resilience so that the system is able to withstand losses and continue to finance the economy in the event of a systemic risk materialisation.

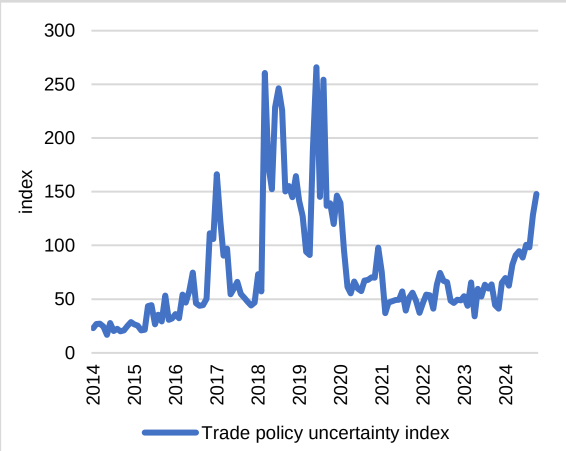
All this supports continued application of the structural systemic risk buffer of 1.5% of the total amount of risk exposure by all credit institutions, as defined in Article 3 of the Decision on the application of the structural systemic risk buffer (Official Gazette 144/2020). The Croatian National Bank will continue to regularly monitor developments in systemic risks of structural nature and will review the level of the structural systemic risk buffer as needed, and at a minimum once in every two years.

Figure 1 Geopolitical risk index has risen considerably



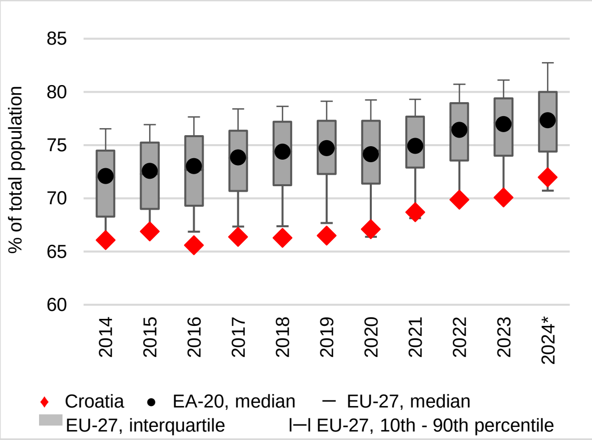
Notes: The geopolitical risk index reflects the results of an automated text-search of the electronic archives of ten newspapers. Moving average.
Source: https://www.matteoiacoviello.com/gpr.htm

Figure 2 Growing uncertainty regarding future developments in trade policies



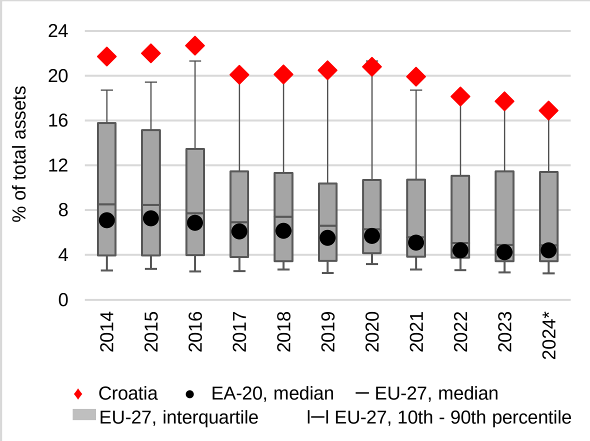
Notes: The Trade Policy Uncertainty Index – TPU index reflects the results of an automated text-search of the electronic archives of seven leading newspapers.
Source: https://www.matteoiacoviello.com/tpu.htm

Figure 3 Population activity rate ranks among the lowest in the EU



* Q2 2024 Notes: Activity rate is the percentage of active persons aged 15 – 64 in relation to the comparable total population. Active population is defined as the sum of employed and unemployed persons. Source: Eurostat

Figure 4 Banking sector exposure to the government continues to rank among the highest in the EU



* Q2 2024 Source: Eurostat