



CROATIAN NATIONAL BANK

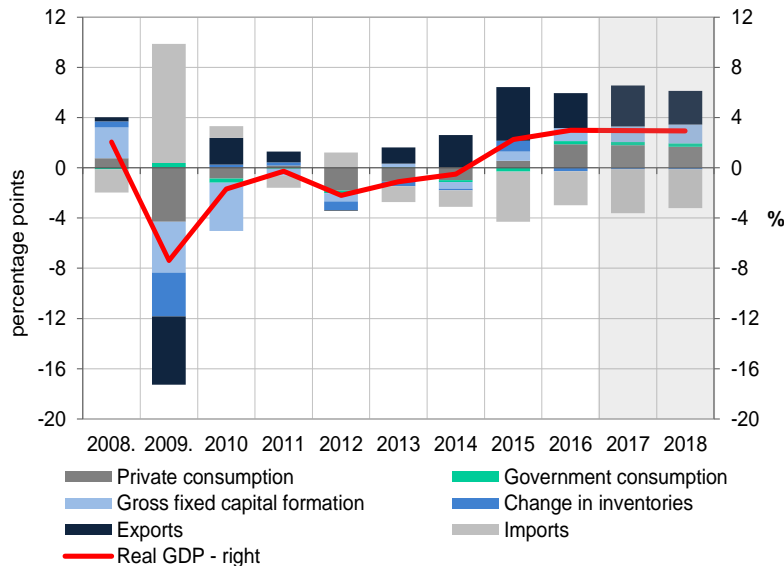
The case of AGROKOR: assessing the impact on Croatia's banking system and economy

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*the views and opinions expressed in this presentation are those of the author and do not necessarily reflect the official policy or position of Croatian National Bank

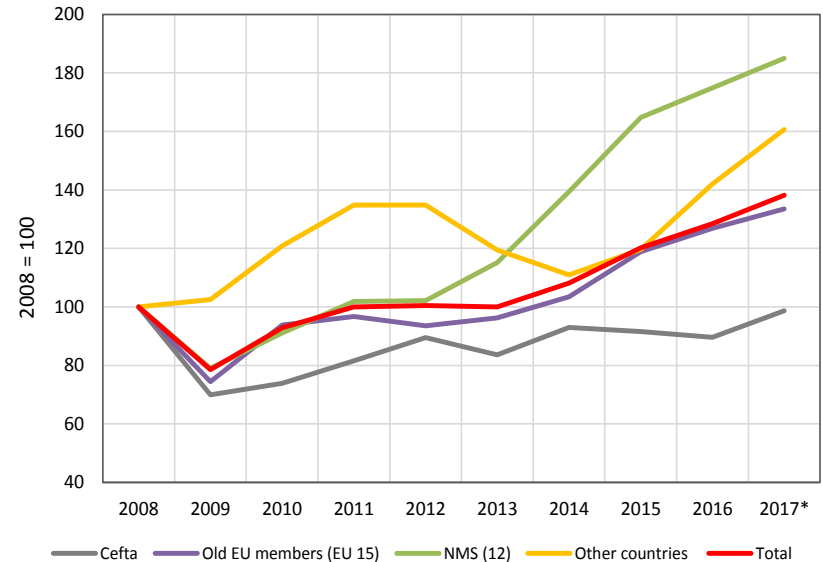
Croatian economy continues to grow

Real GDP, contributions to growth



Sources: CBS and HNB forecast (July 2017).

Merchandise exports growth, by destination



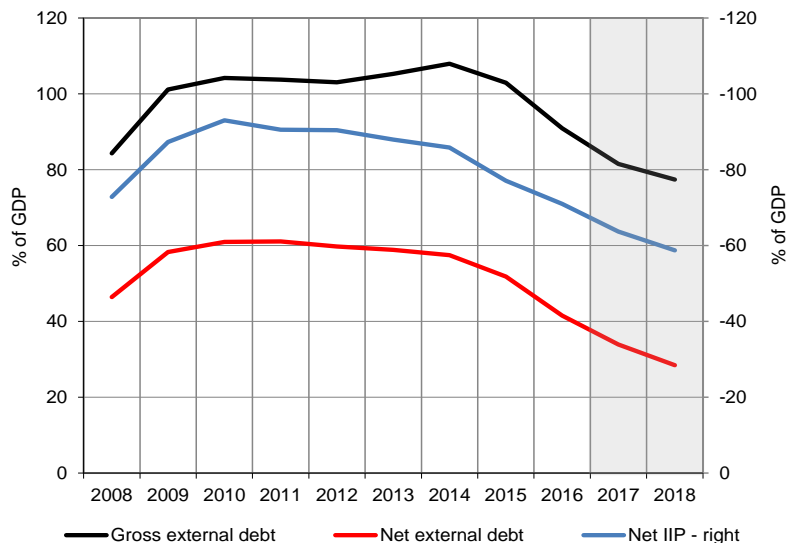
*In 2017, data available till June.

Sources: CBS.

- ❑ In the second quarter of 2017, real GDP growth accelerated on quarterly and yearly basis, and available data for July suggest intensification of growth in the third quarter.
- ❑ After EU accession favourable developments in goods export are visible.
- ❑ Tourism continues to dominate in the export of services.
- ❑ Favourable trends in the labour market are expected to continue, with a further increase in employment and wages.

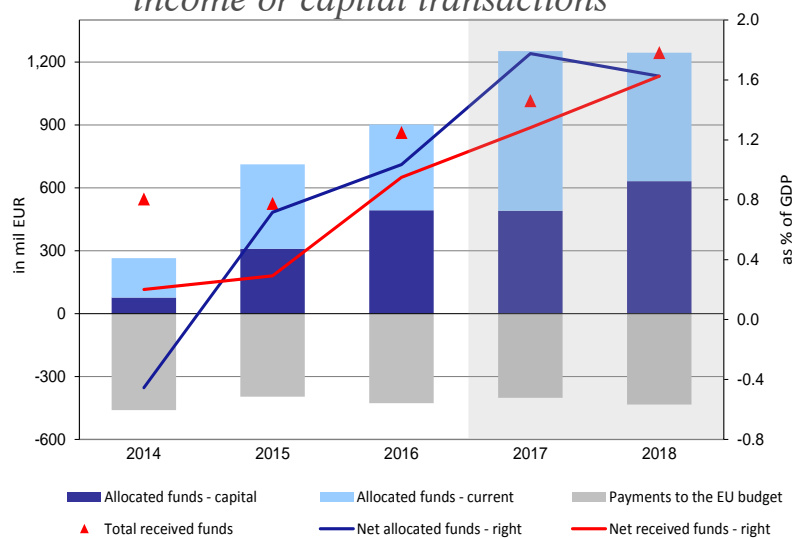
Along with stable domestic economic activity, the downward trend in external imbalances has continued

External debt indicators



Sources: CBS and HNB.

Net inflow from the EU budget: recorded as secondary income or capital transactions

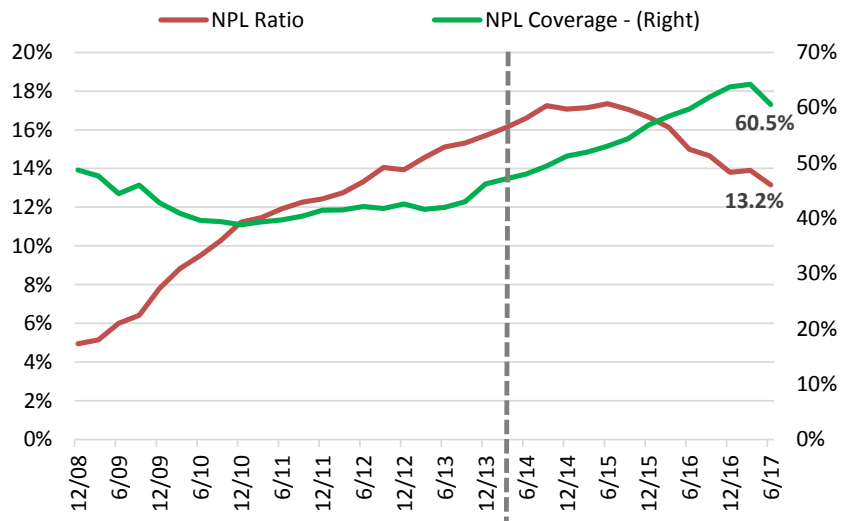


Sources: MoF and HNB.

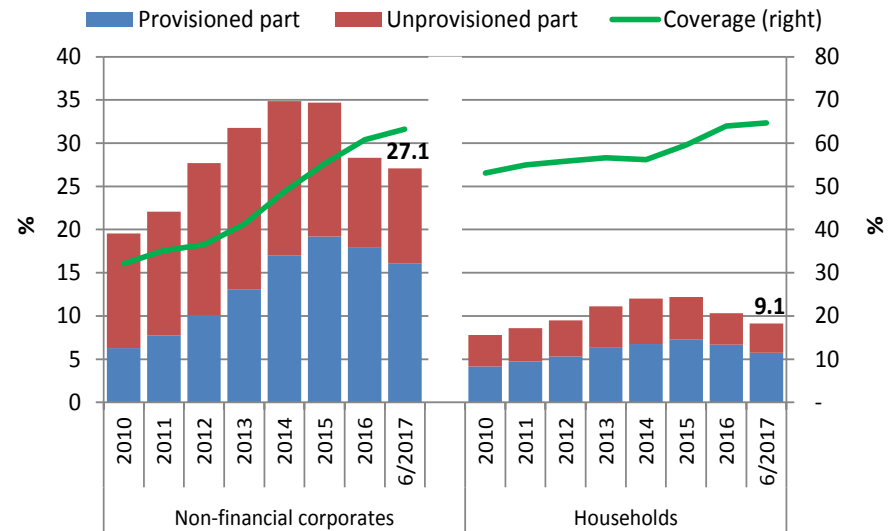
- The current account surplus, which has been recorded for the fifth year in a row, could increase further in 2017 due to:
 - the unfavourable impact of the crisis in the Agrokor Group on banks' profits, which arises from increased expenses on loss provisions for placements to that group;
 - the growth in net exports of services and;
 - transfers from the EU budget.
- Cost of external financing has decreased significantly in the last 12 months.
- Direct equity investments in Croatia are expected to recover gradually, but EU financing is increasing

Non-performing loans (1)

Asset quality improved since 2015



However, NPLs in NFC sector are still high



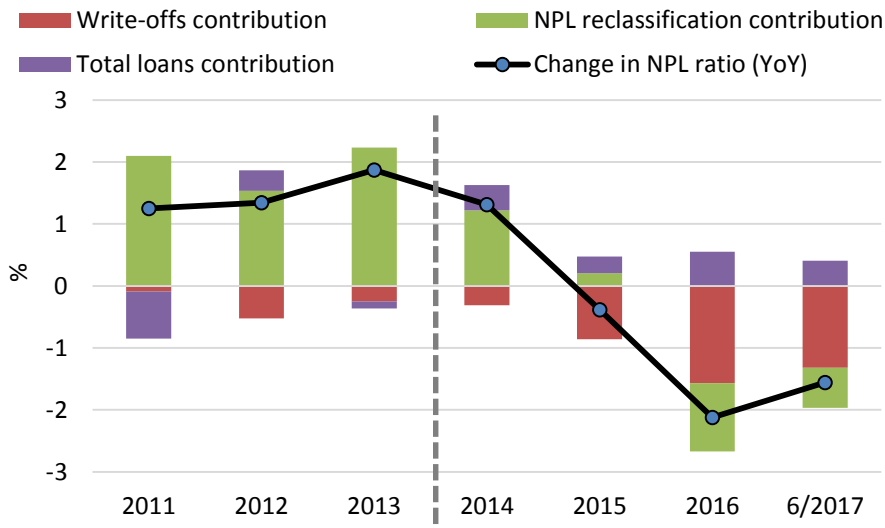
Note: Vertical line denotes the entrance of Decision on the classification of placements ad off-balance sheet liabilities of credit institutions (OG 41A/2014) into force

Source: HNB.

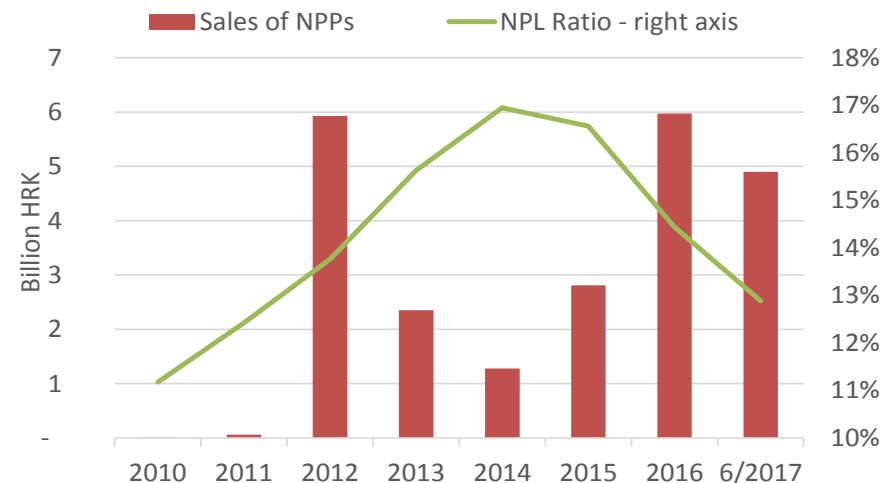
- ❑ Since the end of 2008 NPL ratio grew by 12 percentage points from 5% to as high as 17%.
- ❑ NPL coverage has been improving after the introduction of **Decision (OG 41A/2014)** in March 2014.

Non-performing loans (2)

NPLR reduction since 2014 primarily driven by NPL sales



NPL write-offs mainly driven by sales of NPLs

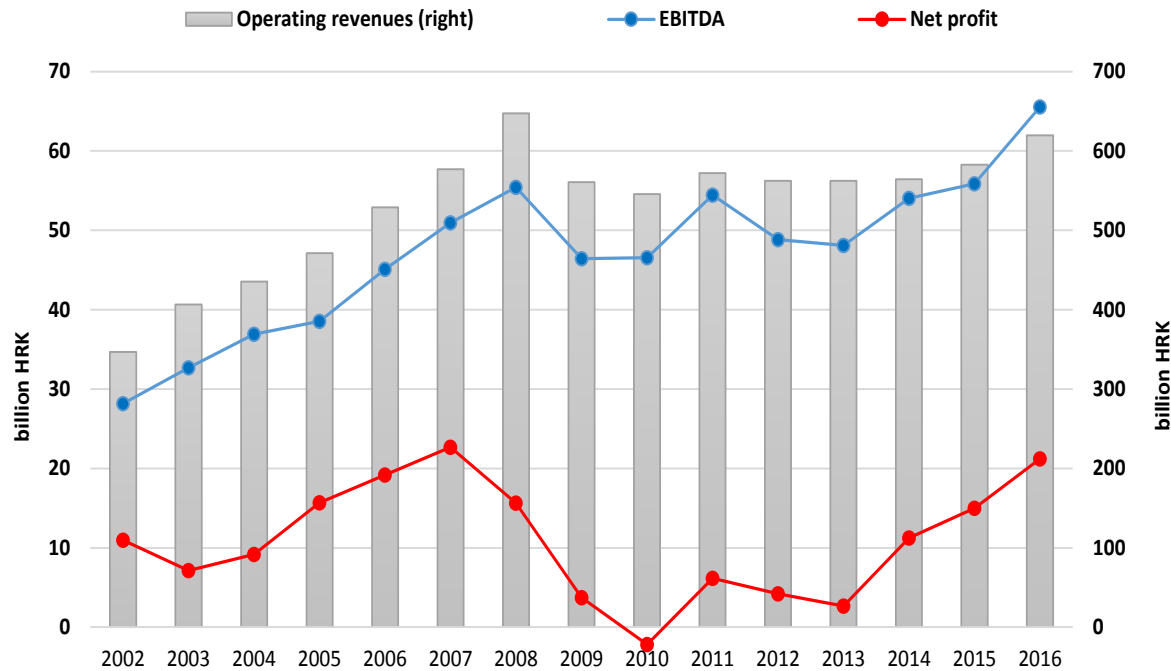


Note: Vertical line denotes the entrance of Decision on the classification of placements ad off-balance sheet liabilities of credit institutions (OG 41A/2014) into force

Source: HNB.

- ❑ An improvement in the quality of loans since 2015 was mainly driven by the intensified process of banks' balance sheet clean-up, i.e. write-offs of NPLs that were, above all, influenced by the increased sale of such placements.
- ❑ The improvement in the quality of loans is expected to continue in 2017 despite the developments with Agrokor Group.
- ❑ Banks have classified their exposures to the company in the Q1 2017 as non-performing but that increase in NPLs was offset by increased sales of NPLs.

Positive trends in non-financial corporations performance continue in 2016



- Solid performance of Croatian corporate sector (excluding Agrokor) continued in 2016.
- Operating revenues continued to increase, while EBITDA surpassed peak pre-crisis levels.
- FY 2016 net profit was close to its historical maximum (around 3.2 bn EUR).

Sources: FINA and HNB

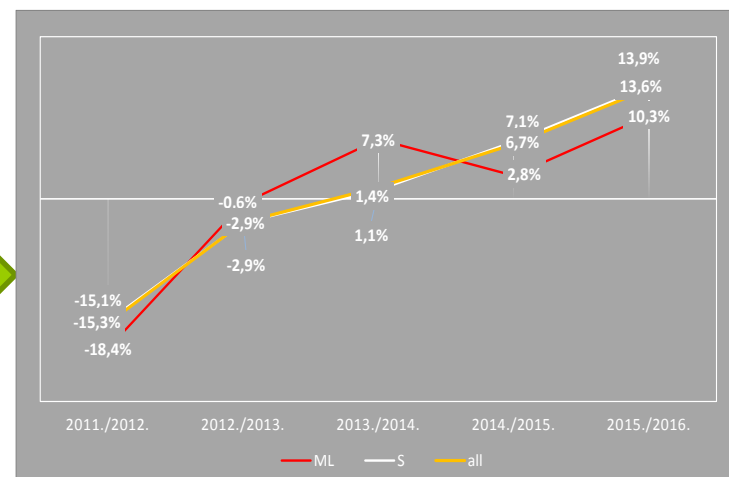
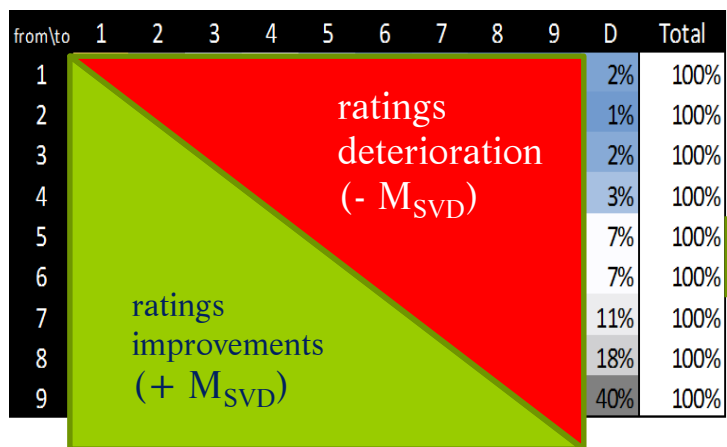
Relative size of Agrokor group (EUR billion)

	EBITDA	Net profit	Operating revenues	Capital
NFC (Total)	7.32	1.96	76.32	38.47
Agrokor	0.29	0.11	3.86	1.63
Perc.	3.93%	5.38%	5.05%	4.22%

Sources: FINA and Agrokor group annual report for 2015 fiscal year

An insight from corporate ratings migration

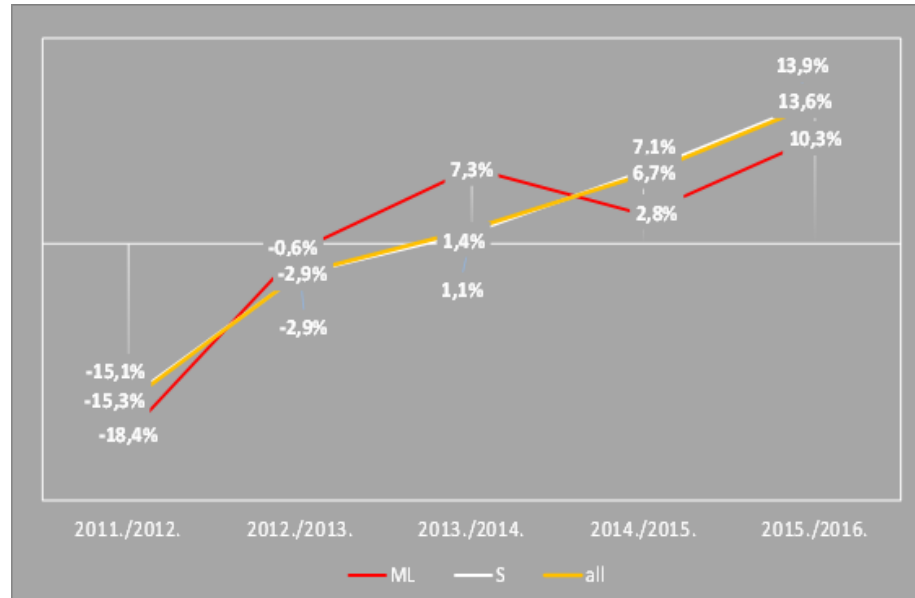
- We construct a measure (M_{SVD}) that shows average ratings change probability (weighted by number of firms that change ratings).



Source: HNB

- Ratings change intensity is the difference between ratings improvements and deterioration.
- Direction: + improvement and – worsening of credit ratings.

On average corporate ratings improve, with M&L companies leading recovery

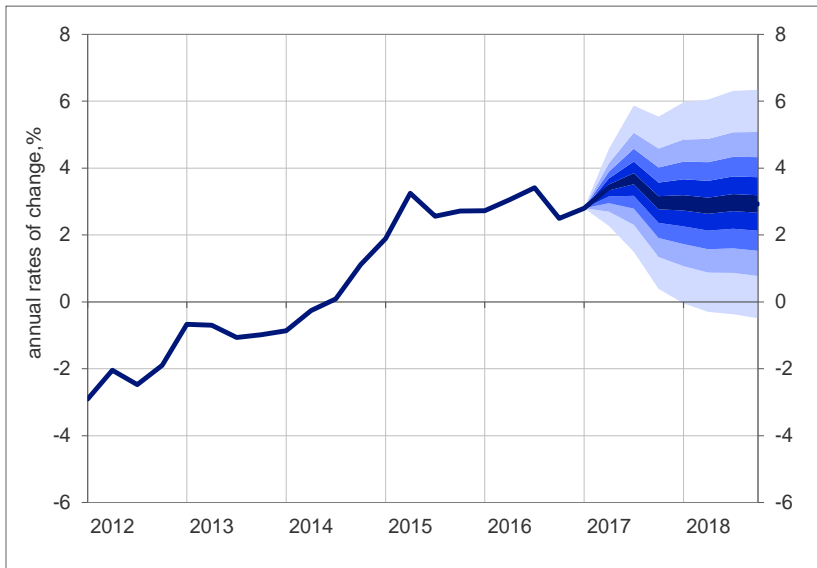


Source: HNB

- ❑ **Medium and large companies exit recession faster than small companies:** they give an initial push to the economy.
- ❑ **Small companies follow recovery of M&L segment** – spillover effect of good business results from M&L segment due to business links / interconnectedness.
- ❑ In subsequent steps ratings recovery for small companies is based on interactions with M&L companies in the economy.

Main risks to GDP projections in the projection period are balanced

GDP forecast



Sources: CBS and CNB projection (July 2017).

- Financial problems in the Agrokor Group may have a stronger adverse effect on growth rates of the main macroeconomic aggregates than currently projected.
- On the other hand, positive risks are related to a stronger than projected growth in exports of tourist services – HNB forecast incorporates slower growth of tourist income than in the previous two years.