

Croatia

Back to growth in savings as capital markets revive

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- Following an unprecedented drop in net wealth in 2008, the recovery observed in the performance of capital markets should have supported a mild improvement in households' financial conditions throughout 2009, resulting in some marginal increase in the accumulation of financial assets. Higher volatility and uncertainty as well as significantly higher interest rates stimulated individuals to switch to safer financial instruments, mainly in the form of FX bank deposits
- Financial liabilities, on the other hand, continued their decreasing trend started at the end of 2008, mainly due to much lower consumption of households (resulting in diminishing demand for car, credit card and other consumer loans). Net household financial wealth, as a consequence of those divergent trends, in 2009 is anticipated to have increased by 10 % to reach almost 40 % as a percentage of GDP
- Looking ahead, household indebtedness is expected to slightly increase in 2010, partly due to the higher availability of banking loans, which was limited during most of 2009 because of the crowding out arising from the government's public sector borrowing requirement. Financial wealth accumulation is also expected to further consolidate, as capital markets revive. Nevertheless, the net financial wealth of households in 2010 and 2011 is still not likely to reach the level recorded at the end of 2007

Table 1: Household real and financial indicators

	2006	2007	2008	2009 e	2010 f	2011 f
Per capita net financial wealth (€)	3,573	4,829	3,651	4,067	4,251	4,695
Monthly wage (€)	906	961	1,044	1,050	1,074	1,112
Monthly wage (% YoY LC)	6.2	6.2	7.0	2.5	2.6	3.2
Unemployment rate (%) ⁽¹⁾	11.2	9.6	8.4	9.4	10.0	9.6
Home ownership (%)	88.4	n.a.	n.a.	n.a.	n.a.	n.a.
Household financial assets (% YoY LC)	25.2	27.5	-8.4	4.0	4.3	7.4
Household financial liabilities (% YoY LC)	22.7	18.9	12.6	-1.7	1.9	5.0
Household financial saving ratio (% GDP)	8.7	12.9	-11.0	3.7	2.6	3.9
Household net financial wealth (% GDP)	40.7	50.0	34.9	39.9	41.6	43.7
Housing affordability index (house price per sqm over gross monthly wage)	1.6	1.8	1.8	1.6	1.4	1.4
Mortgage in % GDP	14.3	16.0	17.0	18.1	18.2	18.3
FX indexed / denominated loans (% total)	77.7	67.3	67.4	77.0	80.0	78.0
Households NPLs ratio (%) ⁽²⁾	4.1	3.7	4.0	6.4	8.2	7.0

Note: (1) According to local definition; (2) Over gross loans

Source: Croatian National Bank (CNB), Central Bureau of Statistics (CBS), Central Depository & Clearing Company (SKDD), Croatian Financial Services Supervisory Agency (HANFA), Zagreb Stock Exchange (ZSE), UniCredit Group CEE Strategic Analysis – Zagrebacka Banka Research

The global financial crisis has strongly affected the development of household financial assets and liabilities in Croatia. After years of very rapid growth with rates well in excess of 20 %, the global shock caused a dramatic reversal in household financial wealth during 2008, mainly through a deterioration in the capital market's performance. During that year the Croatian stock exchange index CROBEX fell by 67.1 % causing a drop of similar magnitude in all classes of financial wealth directly or indirectly linked to capital markets, i.e. listed shares held by individuals, assets under management of open and closed-end investment funds, and pension funds assets and insurance technical reserves as well. Those classes of household financial wealth accounted for approximately 40 % of the total before the crisis, while at the end of 2008 their joint share dropped to just 25.5 %. Additionally, the worldwide banking crisis and uncertainty caused a wave of withdrawals of banking deposits in October 2008, which was efficiently stopped

by the government's immediate response of increasing the level of guaranteed deposits from HRK 100,000 to HRK 400,000 (more than EUR 55,000). Thus, bank deposits grew in 2008 by almost 11 %. Currency holdings of households, an obvious "safe haven" in hard times, grew by 18 % (with FX currency holdings up by an estimated 28.9 %). Total household financial wealth as a result fell in 2008 by 8.4 %.

Households' consumption was not affected dramatically by the global financial crisis during most of 2008, partly due to the fact that retail loans still posted double-digit growth rates. Retail trade fell on a year-on-year basis just in the last two months. At the same time retail loans began decreasing. Demand for housing loans also gradually subsided and on the residential real estate market an excessive supply of new housing has appeared (especially in Zagreb).

As a result of the described dynamics in gross assets and liabilities, net household wealth dropped by 24 % in 2008. Accordingly, net wealth as a percentage of GDP fell to 34.9 % from 50 % recorded in 2007.

The labour market was not at all affected by the global financial crisis during 2008. Unemployment continued to fall until the end of the first quarter of 2009. Average gross wages in 2008 still grew by 7.0 % or 0.9 % in real terms. After the first quarter of 2009, however, there were signs of both increasing unemployment and a decreasing gross wages dynamic. Those trends inevitably implied lower household consumption. The decline was also additionally strengthened by the lowering of wages in the public sector, a mid-year VAT rate increase and the imposition of a new tax on all net incomes (including wages and pensions). Hence, while the sudden drop in households' consumption at the end of 2008 was mainly the result of the external shock which generated uncertainty and fear, the further decrease in consumption was largely the result of falling disposable income, along with the lower availability of retail loans and under tighter conditions.

In such circumstances financial liabilities of households in 2009 are projected to have dropped by 1.7 % in nominal terms (almost 5 % in real terms) driven especially by the decline in car loans, revolving credit card loans and other consumer loans. Sales of new cars in 2009 exactly halved in comparison with 2008, while retail trade as a whole is anticipated to have dropped by more than 14 % in real terms. Despite the slowdown in the residential real estate market, housing loans are still somewhat higher than in 2008.

The cooling in lending activity was accompanied by increasing signs of deterioration in households' solvency. The households non-performing loans ratio has largely deteriorated throughout 2009 to an anticipated 6.4 % with problems in terms of credit quality expected to peak in 2010. Much higher NPL rates have been recorded for riskier types of loans to households (especially car, revolving credit card and other consumer loans) than for housing loans, for which the NPL ratio was still below 3 %.

The financial wealth of households in 2009 was gradually recovering due to the positive change of mood in the capital market (the CROBEX index gained 20 % until the end of November 2009). The positive impact on the capital market linked to classes of financial wealth should have resulted in a 4 % growth of total households' financial wealth, as bank deposits (a major saving instrument) should have recorded only modest growth in 2009. As a result of these divergent trends in assets and liabilities, net households' financial wealth in 2009 is expected to have grown by 10 %.

Looking forward, we expect a gradual recovery in the accumulation of financial wealth on a total and net basis. The further recovery in the capital market's performance in 2010 and following years should push the growth rates of financial asset classes linked to the stock exchange above 10 % again. Unfavourable conditions in the labour market should begin to bottom out during the second half of 2010, which may also bring about a gradual recovery in demand for retail loans. Prospects of EU admission at the beginning of 2012 should further strengthen the positive macroeconomic trends in 2011 and later years. Nevertheless, we do not expect households' net financial wealth to reach the level recorded in 2007 by the end of 2011.

