



**REPUBLIC OF CROATIA**  
**MINISTRY OF FINANCE**

**CLASS: 011-01/22-01/1**  
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**Zagreb, 25 January 2022**

**Mr Francesco Mazzaferro**  
**Head of the ERB Secretariat**  
**European Systemic Risk Board**  
**60640 Frankfurt am Main**

**SUBJECT: Warning of the European Systemic Risk Board on medium-term vulnerabilities in the residential real estate sector of Croatia (ESRB/2021/13)**

Dear Mr Mazzaferro,

Thank you for your letter of 9 December 2021 notifying the Ministry of Finance that, on 2 December 2021, the General Board of the ESRB has adopted the set of country-specific Recommendations and Warnings on medium-term vulnerabilities in the residential real estate sector in seven countries, including Warning ESRB/82021/13 (hereinafter: Warning) on medium-term vulnerabilities in the residential real estate sector in Croatia.

Ministry of Finance welcomes the extensive work of the ESRB in connection with analyses and assessment of vulnerabilities and will continue to support ESRB's work on monitoring and mitigating systemic risks to financial stability.

As regards the ESRB findings, the Warning states main vulnerabilities concerning Croatian residential real estate sector namely signs of house price overvaluation, elevated house price growth, and high mortgage credit growth with indication of relatively loose lending standards.

Residential real estate market in Croatia has proven resilient to the pandemic as real estate prices continue to gain momentum. Number of factors on the demand and supply side, such as unavailability of buildings in the areas affected by earthquakes, low interest rate environment, and strong foreign demand have been driving house price increase over the last couple of years. As house price increases exceed growth of disposable income and rental costs, already weak housing affordability has further worsened, while real estate prices are diverging from their

long-term trend to an increasing extent, potentially increasing the medium-term risks for financial stability.

The Government has recognized the need to address housing market shortcomings, encourage demographic renewal, urban regeneration of settlements as well as to reduce the emigration of young families. Therefore, in 2017 Croatian Parliament adopted Act on Subsidising Mortgages (Official Gazzette, No. 65/17, 61/18, 66/19, 146/20). Regarding the above mentioned factors implementation of the measures prescribed by this Act, especially Government subsidies additionally stimulated the demand side. According to this Act, if eligible, 1/3 to 1/2 of the monthly instalments for mortgage are being paid from State Budget. Although around 30% of all real estate transactions in 2020 were in direct connection with the measure, one should note that it is intended to be a temporary measure so currently, subsidies on this basis can be requested only until 31st December 2023.

As pointed out in the ESRB Warning, there are several macroprudential measures in place in Croatia that mitigate at least part of current residential real estate vulnerabilities, including current capital-based measures (stricter definition of the residential real estate for the use of preferential risk weights, and systemic risk buffer). In addition, Croatian National Bank informed Ministry of Finance that Croatian National Bank is considering introducing a positive countercyclical capital buffer rate, on the grounds of increasing cyclical risks, particularly due to strong real estate market developments and mortgage lending. Apart from capital-based measures, implicit debt service to income ratio is applied to housing and long-term consumer lending, imposing a strict limit to debt service burden for low-income borrowers. As also acknowledged by the ESRB, this provides a cushion against the potential materialisation of residential real estate related risks.

Further, Croatian National Bank has a legal ground to implement explicit borrower based measures and stands ready to use this type of measures after consultations with all relevant stakeholders (other macroprudential bodies, government, general public) and in alignment with other economic policies aimed to address risks and vulnerabilities arising from the real estate market. Namely, potential borrower based measures are to be carefully designed, by taking into account general macroeconomic and financial environment, current monetary policy stance in Eurozone, cyclical position in Croatia, taxation, subsidies and other housing policies. Currently, Croatian National Bank has prioritized quality assurance of the granular data on consumer lending and discusses with individual banks their lending policies.

However, the available data showed that household indebtedness in Croatia is relatively low, compared to other Member States in European Union. Moreover, we would like to point out that only half of the value of real estate purchase and sale transactions in the observed period were financed by housing loans from domestic banks. In other words, a significant part of the demand for real estate is financed from other sources (through foreign banks, cash payments, etc.). In this regard, the potential application of borrower-based explicit measures, proposed within the Warning, will be carefully analysed by taking into account general macroeconomic and financial environment, current monetary policy stance in Eurozone, cyclical position in Croatia, taxation, subsidies and other housing policies. In addition to that, with abundant liquidity across Europe, if any regulatory intervention is needed it should be treaded carefully in order not to squeeze first time homebuyers out of the market in favour of investors.

Finally, Ministry of Finance in close cooperation with the Croatian National Bank and Croatian Financial Services Supervisory Agency, as members of Financial Stability Council, remains committed to closely monitor developments in the residential real estate sector, and if needed will not hesitate to take timely and effective action to address medium-term vulnerabilities in the residential real estate sector.

Yours sincerely,

**DEPUTY PRIME MINISTER AND  
MINISTER OF FINANCE**  
*Zdravko Marić*  
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