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PRESS RELEASE

Default Risk of Government Guarantees in Croatia

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The Annex to the semi-annual report on the execution of the 2011 state budget, submitted by the Government for parliamentary debate and adoption contains a Report on Issued Guarantees[1]. This Report shows that Croatia is still exposed to default risk in respect of issued guarantees, which might easily be converted into the general government debt. Particularly disturbing is the increase in outstanding guarantees from 0.7 % of GDP in 1996 to a high of 16.6 % in 2011.

Government guarantees - Croatia's direct or contingent debt

Guarantees are generally approved by the government, but partly also by Parliament for loans received from international financial institutions (EBRD, World Bank, etc.). From 1996 to June 2011, the Government and Parliament jointly issued 1,257 government guarantees worth HRK 148.2bn. Out of this, 1,022 were financial guarantees totalling HRK 113.2bn and 235 performance guarantees in the amount of HRK 35bn. In the 1996-2011 period, 74% of issued financial guarantees on average were euro-denominated in euros, 15% in kunas and 11% in US dollars. About 53% of guarantees were given for external borrowing (from commercial banks and international financial institutions) and 47% for borrowing in Croatia.

Outstanding guarantees grew from 0.7% of GDP in 1996 to 16.6% of GDP in the current year. Until 2008, outstanding guarantees averaged about 8% of GDP, but their share increased twofold between 2008 and June 2011, i.e. by 8.6 percentage points.

In 2011, after a four-year recess, the government resumed providing performance guarantees to shipyards[2]. However, there is no information on this type of guarantees in the Report on Issued Guarantees for the first half of 2011, although the Report was published early in June this year.

There is great likelihood that the government will break through the limit of HRK 4.9bn on financial guarantee issue in 2011. Only in the first half of the year, approved guarantees reached HRK 3.8bn, 80% of the total limit for 2011. Given the long-standing government practice of disregarding the imposed limits, it is hard to believe that there would be much sense in imposing additional legal or constitutional fiscal constraints (rules) on issuing guarantees and public debt.

The guarantee reserves for the entire 2011 amount to HRK 1bn, but only in the first half of the year, the government already spent HRK 667m out of these funds on called guarantees. The called guarantees had been given to shipyards (Brodosplit, Brodotrogir, Uljanik, Kraljevica and 3. maj), hotel companies

[1] http://www.sabor.hr/Default.aspx?art=40889
[2] http://www.vlada.hr/hr/naslovnica/sjednice_i_odluke_vlade_rh/2011/146_sjednica_vlade_republike_hrvatske

(Plat, Šolta, Medena, Vis, Živogošće, Podgora, Hum, Omišalj and Lipik), a farming enterprise (IPK Osijek), as well as to Vjesnik, Croatia Airlines and two local government units (Vukovar and Imotski). The government has settled the due liabilities of these entities in the amount of HRK 646m from the guarantee reserves and the remaining HRK 21m have been paid from receipts from the recourse-based recovery of guarantees from the debtors. It is worth noting that in the first half of 2011, the state-owned Croatian Postal Bank (HPB) called in guarantees worth HRK 54m. From 2006 to June 2011, shipyards and Croatian Railways (HŽ) took on government-guaranteed loans from the HPB in the amount of HRK 1.3bn. Let us mention that in 2010, the government again recapitalized the HPB with HRK 450m from the state budget.

From 1998 to 2011, called-in government guarantees reached HRK 9.8bn, and only in the past two-and-a-half years, they amounted to about HRK 2.9bn. Guarantees repaid to the government by original debtors in the period from 1998 to 2011 were as low as HRK 606m or 6.7% of total called guarantees.

Based on its relatively good estimate of potentially called guarantees, from 2008 the government allocates HRK 1bn per year to the guarantee reserves. However, the reserve funds for 2009 were still insufficient, as a result of calling in HRK 2bn in government guarantees, which is why the government had to draw on the budget funds and, in part, receipts from borrowing by bond issue.

In April 2011, the shipyards' debt totalling HRK 11.3bn was converted into the general government debt[3]. By a single administrative manoeuvre, the government increased the general government debt and reduced the need for issuing new guarantees in the second half of the pre-election year (2011). The shipyards' debt will be falling due until 2014, and after that, there will be potential maturity risks of guarantees provided to Croatian Motorways and Croatian Roads. However, the default risks posed by these guarantees are less serious, because these companies are able to cover their liabilities from collected tolls. On the other hand, the collected revenues are in kunas, whereas most credit liabilities of these companies are euro-denominated. Consequently, the government should take account of the currency structure of the liabilities of all companies to which guarantees are issued, in order to avoid the potential exchange rate risk of the kuna and further increase in liabilities.

Companies receiving government guarantees have undertaken credit liabilities until 2037. While the average maturity of guarantees issued in 2011 is about five years, most issued guarantees could potentially fall due in two to three years, which increases the pressures and creates a need for their refinancing. In the 2007-2011 period, the maturities of issued guarantees were reduced to about four years, returning to the levels of the 1996-1999 period when creditors approved guaranteed loans to companies with shorter maturities. In doing so, creditors approving government-guaranteed loans penalized not only original debtors but also the government for their poor creditworthiness. The government should establish the total amount and structure of original debtors' liabilities and strive to extend the maturities of guaranteed loans. This would prevent the accumulation of liabilities in a short period (two to three years) when not only the guarantees but also a considerable portion of the principal of and interest on issued government bonds fall due. The amount of due liabilities in respect of the principal of and interest on issued bonds will grow from HRK 11.1bn in 2012 to HRK 15.6bn in 2013 and to as much as HRK 16.6bn in 2014.

[3] Pursuant to the Act Governing the Rights and Obligations of Shipyards under Restructuring (OG, 61/11).