



MACROPRUDENTIAL RISK SCANNER

2025 - Second Quarter

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1 INTRODUCTION

Together with the Croatian National Bank and the Ministry of Finance, the Croatian Financial Services Supervisory Agency (hereinafter: Hanfa) is responsible for the stability of the financial system in the Republic of Croatia, therefore promoting and preserving financial stability, in accordance with the Act on the Croatian Financial Services Supervisory Agency, is one of the basic goals of its work. A **stable financial system** implies the smooth functioning of all its segments (financial institutions, markets, services and infrastructure) in the process of resource allocation, risk assessment and management, and carrying out payments, as well as its resistance to sudden shocks.

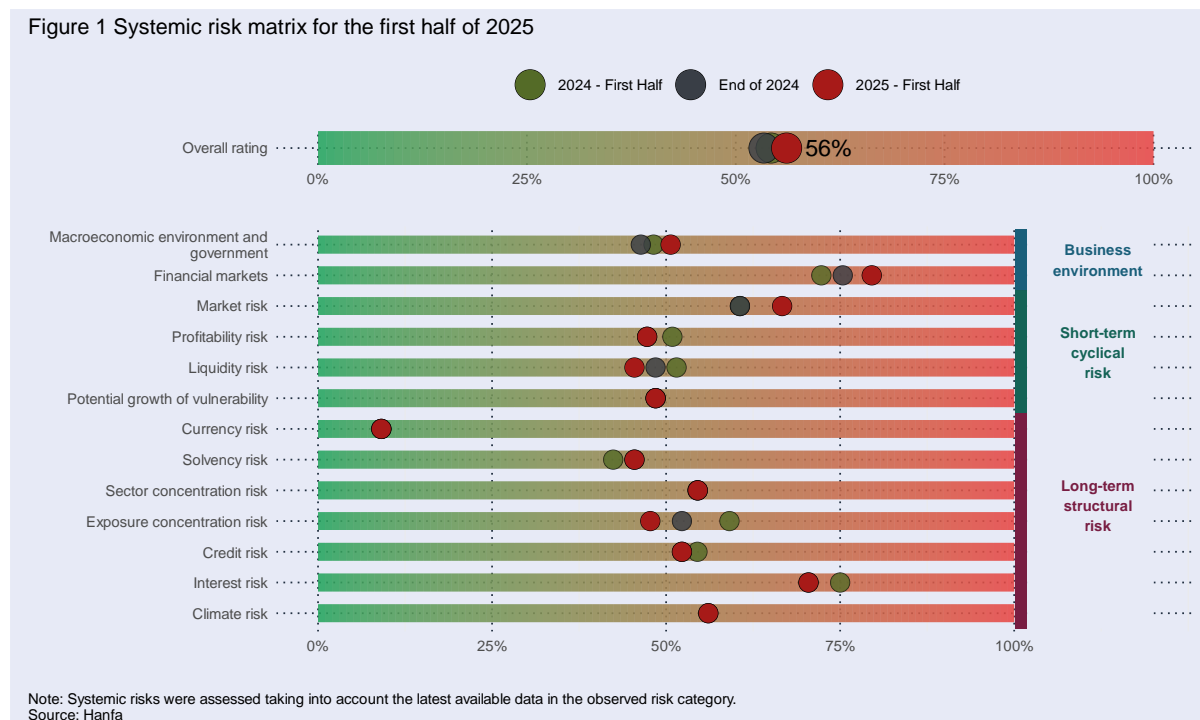
Financial stability can be disrupted by the processes that arise and develop within the system, creating vulnerabilities that may materialize in the event of certain shocks in the form of disturbed liquidity and capital positions of financial institutions, disabling the smooth functioning of a part or the entire financial system. Such shocks can be external, i.e., transferred from the international environment, or idiosyncratic, i.e., generated by domestic macroeconomic and financial developments, economic policy or changes in the institutional environment. Therefore, any risk to which the system is exposed and which can have adverse effects on the functioning of the entire financial system or its part, thus causing a serious negative impact on the real economy, represents a **systemic risk**.

At the global level, progress has been made as regards the understanding and consequently identification, evaluation and monitoring of systemic risks of the financial sector. However, in order to prevent the identified risks in time, and to mitigate the effect of their materialisation, it is necessary to develop an appropriate set of instruments and tools, i.e., policies aimed at preservation of the stability of the system as a whole, called **macroprudential policies**. Therefore, in the European Union (EU), bodies with macroprudential powers and mandates have been established at the national and international level after the global financial crisis, and frameworks for international cooperation have been developed along with macroprudential tools. Although the initial phase of macroprudential capacity development was primarily focused on the banking sector, the growing share and importance of the non-banking part of the financial system create structural changes and require further development of the macroprudential framework, as well as the expansion to the financial services sector in order to adequately address systemic risk and prevent regulatory arbitrage. In addition, financial integration is constantly deepening, creating the need for a holistic approach, which the system

views as an inseparable whole, the key part of which consists of monitoring and addressing vulnerabilities in a cross-sectoral, but also cross-border context.

The publication ***Macroprudential Risk Scanner*** therefore seeks to provide insight into the process of identifying, assessing and monitoring the evolution of systemic risks in the financial services sector under Hanfa's supervision, in order to timely take appropriate measures to prevent their materialisation and the impairment of the financial system stability. This contributes to better understanding of systemic risks, particularly as regards the identification of vulnerabilities and risk transmission channels, encourages action planning and measures that provide adequate protection against the effects of the materialisation of such risks and contributes to greater confidence in the financial system and to the strengthening of the system's resistance to shocks.

Figure 1 Systemic risk matrix for the first half of 2025



In the first half of 2025, the level of systemic risks in the financial services sector remained elevated. Although the domestic economy has achieved above-average growth and fiscal prospects are stable, elevated inflationary pressures and the continued expansion of real estate prices represent significant sources of risk for the domestic macroeconomic environment. Financial markets were marked by a short-lived but sharp rise in volatility driven by the U.S. protectionist decisions, whose effects temporarily heightened uncertainty in global markets. The course and outcome of the trade negotiations contributed to the gradual easing of volatility and the sentiment recovery. Therefore, despite the high level of global uncertainty, most classes of financial assets recorded growth, which had a positive impact on the profitability of the financial services sector and contributed to a slight reduction in cyclical risks.

On the other hand, the sector's long-term systemic risks remain elevated, and the sector is still sensitive to market and interest rate shocks. Structural characteristics of the domestic financial services sector, such as the concentration of institutional investors' exposure, have slightly improved but can still act as a catalyst for potential sector losses in the event of a rise in the globally suppressed risk premium. Exposure to climate risks is assessed as moderate, but its importance in assessing overall systemic vulnerabilities is gradually increasing, in line with global regulatory and market trends.

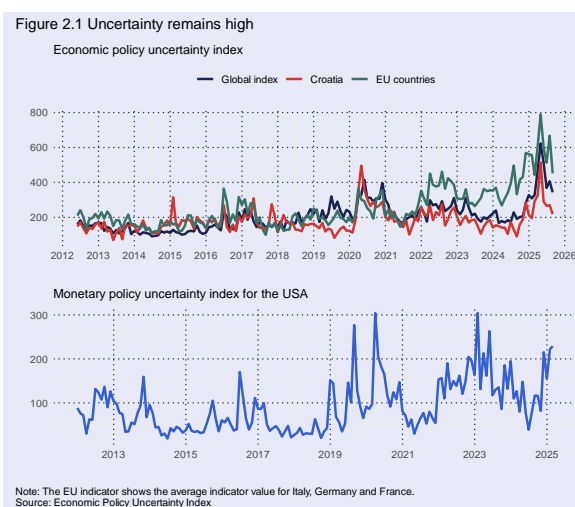
2 MACROECONOMIC AND FINANCIAL ENVIRONMENT RISKS

2.1 Macroeconomic environment

Despite the continuation of strong economic growth in the second quarter and stable fiscal outlook, pronounced international uncertainties and domestic vulnerabilities (notably the accelerated rise in real estate and consumer prices) keep macroeconomic risks at an elevated level. Their potential materialisation in the coming period could slow down economic activity and worsen the state of public finances, which would negatively affect the operations of the financial services sector.

Uncertainties in the international environment continue to be a significant source of risk (Figure 2.1). At the beginning of April, the introduction of U.S. tariffs on a wide range of imported products was announced, which increased trade tensions (Figure 2.1) and provoked strong reactions from key trading partners, including the introduction of reciprocal measures. Although the tariffs were eventually mitigated and entered into force at the beginning of August, the assessment of their overall effects will only be possible with time. From an economic perspective, tariffs increase production costs and inflationary pressures, while from a geopolitical standpoint they heighten uncertainties in

global trade relations, which can negatively affect the dynamics of international trade and global growth. The main risk therefore does not stem from the level of tariffs, but from their broader impact on the global macroeconomic environment. Given the relatively small share of trade ties with the U.S.¹, the introduced American tariffs have a limited direct impact on the Croatian economy. However, indirect channels, such as price changes in global trade or a potential reduction in demand from key trading partners, can have a more significant and far-reaching impact.

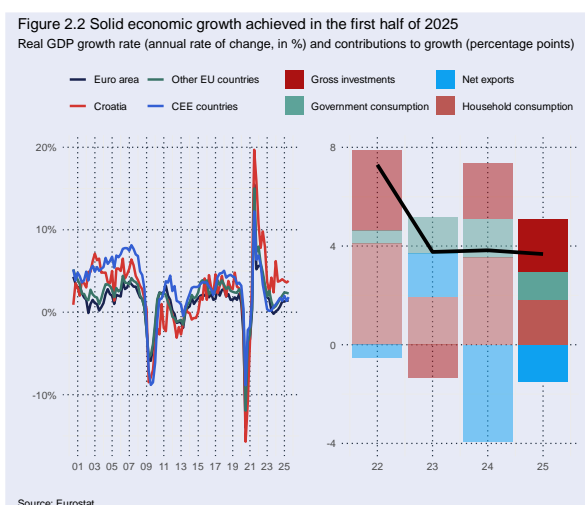


Despite global instabilities, the Croatian economy continued to grow faster than most European countries in the second quarter of 2025 (Figure 2.2.). At the end of June, GDP recorded annual growth of 3.6%, driven primarily by growth in personal consumption (up 4.1%) and investment activity (up 4.9%),

and mechanical devices, audiovisual equipment, weapons and ammunition, and certain mineral products.

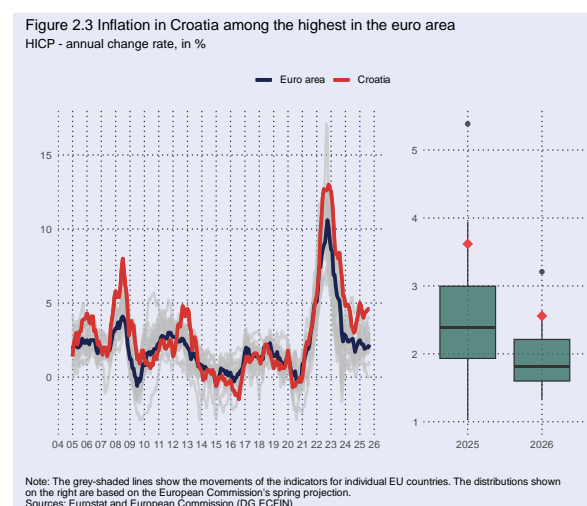
¹ Croatian exports to the U.S. account for less than 1% of GDP and mainly consist of pharmaceutical products, electrical machinery

while the contribution from net exports remained modest, reflecting weaker foreign trade activity. At the same time, the economic growth of the European Union was half as slow, amounting to 1.4% in the same period. Although economic indicators have been positive for two years, growth largely relies on domestic and foreign household consumption, which is sensitive to inflationary pressures, and on investments partly financed by European funds, the inflow of which is declining. Such structure of growth could limit its sustainability and increase the vulnerability of the domestic economy. Therefore, the main cyclical systemic risks stem from a potential slowdown or temporary halt in the investment cycle, which, combined with a decline in domestic demand, would increase the vulnerability of the domestic economy. Additional pressures arise from global trends, in particular the possible spillover of geopolitical tensions and uncertainties in international trade (more information in [Box 1 Geopolitical shocks and resilience of the Croatian financial system](#)).



Inflation remained high in the first half of the year and continues to be

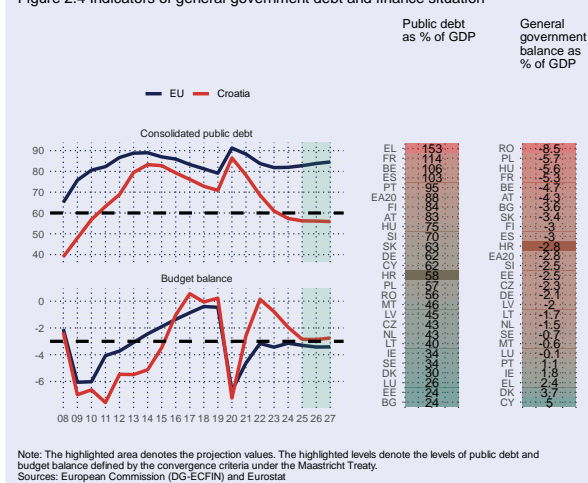
one of the key risks to the domestic macroeconomic environment. At the end of September, the inflation rate stood at 4.6%, which was about 2.5 percentage points higher than in the euro area (Figure 2.3). Rising inflation in Croatia is largely driven by persistent pressures on the prices of food and services, reflecting strong domestic demand and "strained" labour market conditions. According to the European Commission's projections, inflation could drop down to 3.4% at the end of 2025, however, global uncertainties are increasing the negative risks of such a projection. A potential further escalation of geopolitical tensions and a worsening of trade relations could disrupt the supply of energy and other raw materials (more information in [Box 1 Geopolitical shocks and resilience of the Croatian financial system](#)), which would strengthen inflationary pressures. Domestic factors such as labour shortage, strong wage growth and economic growth driven by personal consumption make it even more difficult to calm inflation.



Despite the balanced fiscal position and the fulfilment of the Maastricht criteria, fiscal pressures in 2025 remain pronounced, primarily due to growing medium-term demands on

the expenditure side of the budget. At the end of June 2025, public debt amounted to 57.6%, while the deficit in the same period deepened to -3.0% (Figure 2.4). Relatively favourable debt indicators over the past period² are the result of a strong nominal GDP growth, with Croatia remaining below the euro area average (Figure 2.4); however, global uncertainties could affect the dynamics of public finances in the coming period. Projected defence spending in 2025 will reach approximately 2% of GDP, with an expected increase to 5% of GDP by 2035, as predicted at the last NATO meeting. The planned growth in expenditures, combined with revenues that predominantly rely on consumption tax, makes the budget sensitive to extraordinary events and limits the scope for fiscal policy adjustment. Preserving fiscal stability, along with the existing fiscal discipline, largely depends on the resilience of the economy to macroeconomic shocks and the maintenance of the risk premium at low levels, which keeps the risks in this segment at an elevated level.

Figure 2.4 Indicators of general government debt and finance situation

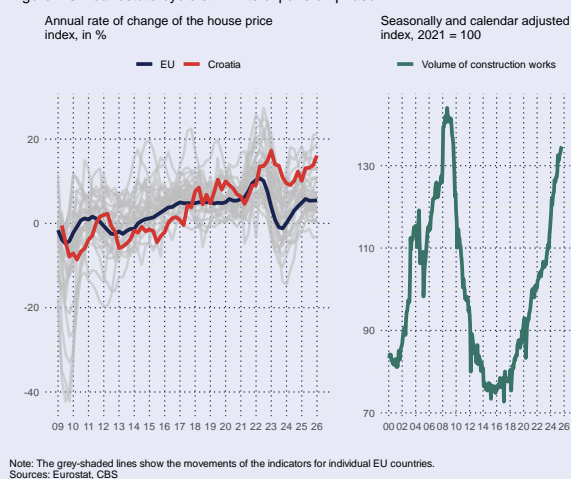


Note: The highlighted area denotes the projection values. The highlighted levels denote the levels of public debt and budget balance defined by the convergence criteria under the Maastricht Treaty.
Sources: European Commission (DG-ECFIN) and Eurostat

² At the end of June, public debt was 3.7% higher in absolute terms on an annual basis.

³ According to the calendar-adjusted index.

Figure 2.5 Real estate cycle still in its expansion phase



Note: The grey-shaded lines show the movements of the indicators for individual EU countries.
Sources: Eurostat, CBS

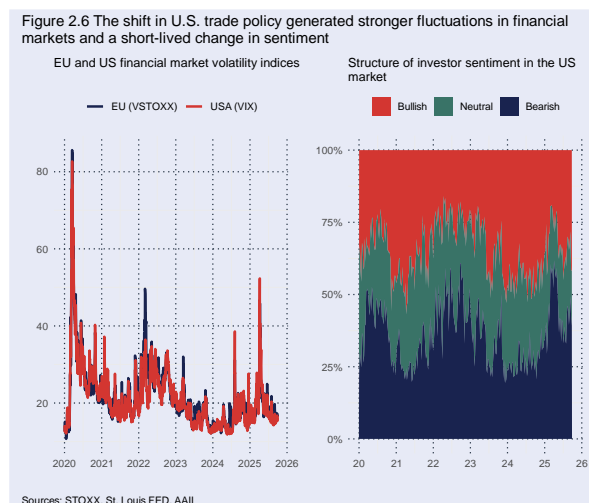
The real estate market is one of the important factors of macroeconomic stability, and its current dynamics are increasing the systemic risks of the economy. In the second quarter, real estate prices increased by 13.2% on an annual basis, continuing the multi-year expansion (Figure 2.5). Strong growth is also confirmed by data on the volume of construction works, which in the first half of this year recorded a significant growth³ of 7% on an annual basis. Since real estate prices have been rising faster than macroeconomic fundamentals for quite a long time, the possibility of their decline is increasing, especially in conditions of significant deterioration of economic trends and stricter lending conditions. In order to address systemic risks in this market, new macroprudential measures of the central bank came into force at the beginning of July, which, among other things, tightened the conditions for granting housing loans. However, given the large share of transactions taking place without bank intermediation⁴, the effects of these

⁴ According to the CNB data, the share of purchase transactions financed by housing loans averaged around 30% between 2021 and 2024.

measures on demand and price growth remain uncertain.

2.2 Financial environment

Geopolitical tensions and economic uncertainty are predominantly affecting recent developments in financial markets. At the beginning of April, volatility rose sharply due to the U.S. protectionist decisions, while their easing spurred a recovery. The recovery of investor optimism reduced the risk premium, but also maintained high valuations of stock markets, which in turn emphasises the risk of market corrections. The growing concentration and reduced liquidity of trading amplify the oscillations in the domestic market, which, in the scenario of a stronger external shock, could jeopardise the recent positive trends in the domestic market and adversely affect the institutional investors' profitability.



The first half of the year was marked by short-lived but strong volatility in global financial markets, triggered by the protectionist policy of the new

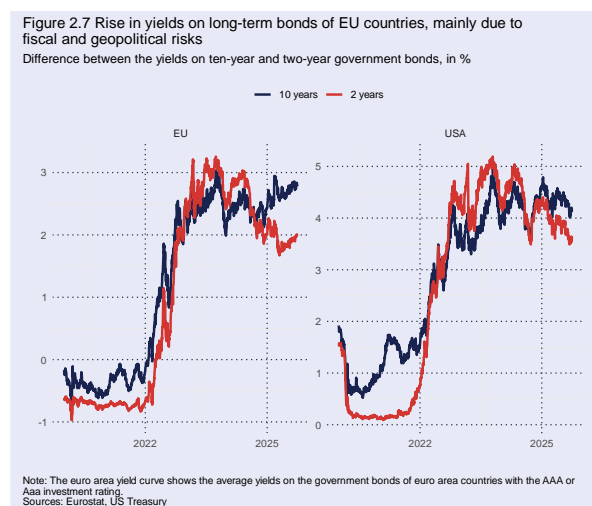
U.S. administration, introducing a new dose of uncertainty into the macroeconomic environment. The positive sentiment from the beginning of the year soon vanished after announcements of a change in the U.S. trade policy, and the peak of tensions was recorded on April 2 with the announcement of the American strategy of “reciprocal tariffs”, aimed at countries that have the largest trade surpluses with the U.S. Increased risks of a trade war escalation and the fragmentation of international trade have pushed financial market volatility to its highest level since the COVID-19 crisis (Figure 2.6.). The temporary suspension of measures and the start of bilateral negotiations calmed movements in the financial markets, while the indications of successful negotiations⁵ prompted a recovery in market valuations in the summer months.

Trends in bond markets during the year were predominantly shaped by geopolitical risks and monetary expectations. The initial investor optimism reduced fears of a recession at the beginning of the year, causing the yield curve in the EU and the USA to steepen (Figure 2.7). The peak of volatility in the European market was recorded in March, when returns on long-term bonds jumped by 51 p.p., reaching nearly 3%, driven by announcements of larger fiscal expenditures for defence and infrastructure, which raised concerns about the sustainability of public debt in certain EU Member States and the inflationary impact of fiscal expansion. On the other side of the Atlantic, investors reacted to the news of the introduction of

⁵ At the end of July, the EU and the U.S. concluded a framework trade agreement under

which the U.S. imposes a 15% tariff on most goods from the EU.

tariffs in April by selling the U.S. bonds, putting pressure on yields and seeking a “safe haven” in European bonds. Despite the dynamic trends in international markets, returns on bonds of the Republic of Croatia remained relatively stable, holding at 3.0% at the end of August. Returns on domestic bonds fully converged towards the average returns of euro-area countries during the first eight months of 2025, confirming a 60-basis-point reduction in the spread between Croatian and German yields since the beginning of the year.



Financing conditions eased in the months that followed, primarily due to the expected reduction in interest rates by the Fed⁶, although the U.S. protectionist trade policy is fuelling inflation, which could lead to yields rising again. Rising political risks⁷ in certain EU Member States are further tightening financing

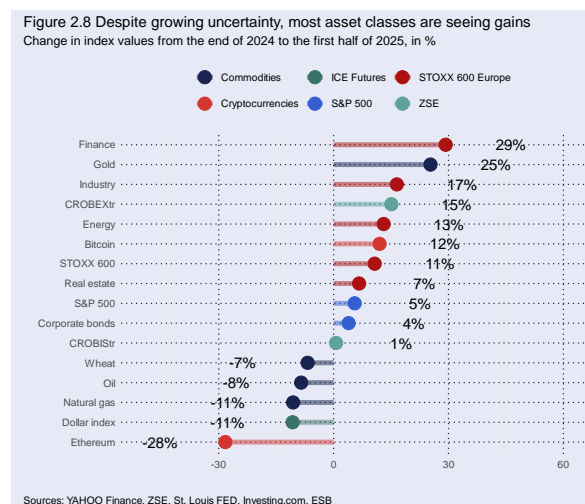
⁶ The Fed cut its benchmark interest rates by 25 b.p. in mid-September, after which the range stood between 4.00% and 4.25%.

⁷ In early September, a vote of no confidence was passed against the French government, resulting in a 16-basis-point jump in the yield on the ten-year bond.

⁸ The Dollar Index is a nominal measure of the dollar's value relative to the six currencies of the

conditions within the EU in the coming period.

Despite the high level of global uncertainty, most classes of financial assets recorded strong growth, implying an underestimation of the global risk premium (Figure 2.8). Uncertainties surrounding the U.S. trade policy and the ECB's lower interest rates prompted a shift in capital flows towards the European market, so in the first half of the year the EU STOXX 600 delivered a better performance (+11%) compared with the S&P 500 (+5%). The weakening of the dollar as a “safe haven” (an 11% fall in the Dollar Index⁸) boosted the demand for gold (+25%). Among the sectors, financial institutions (+29%) dominate, owing to stable net interest margins, and industry (+17%) due to growth in the defence sector's revenues and anticipated infrastructure projects in the construction sector.

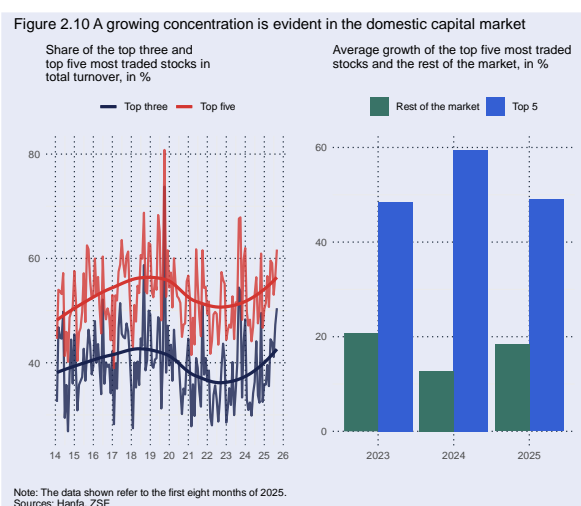
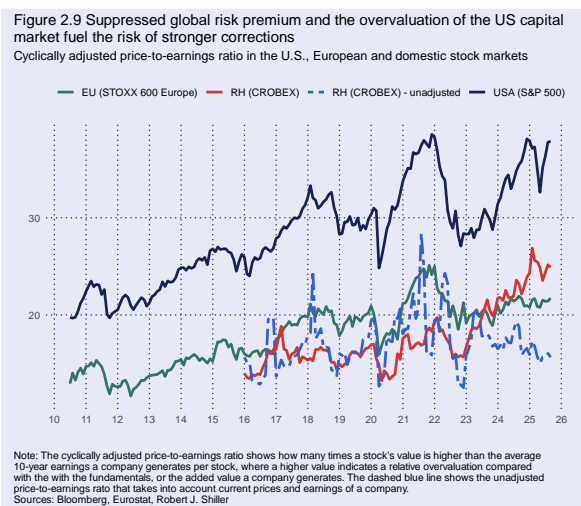


United States' most important trading partners, with each currency's weight adjusted daily according to its share of trade with the U.S. An increase in the index represents an appreciation of the dollar, while a decrease represents a depreciation of the dollar against a basket of currencies.

The surge in valuation maintains the global equity market's overvaluation given the uncertainties and continues to pose the risk of sudden corrections that could spill over to high-level institutional investors. The risk of sudden and strong price corrections is particularly pronounced in the U.S. stock market, especially if one considers the high representation of several technology companies in market capitalisation. Thus, idiosyncratic risks in the technology sector amplify volatility in the broader market⁹, spilling over into other countries as well.

Despite a 6.6% rise in the earnings of Crobex components over the six-month period, the domestic market also shows signs of being overvalued relative to its long-term earnings average and compared with the EU stock market (Figure 2.9). This is the result of the spillover of positive trends from international markets and the concentration on the domestic stock exchange, which is why Crobex continues to record relatively high values.

The domestic capital market continues to record strong results, however, it is still characterised by high concentration of trading and suppressed liquidity because the investors keep their focus on a few of the most liquid issues. Despite short-term oscillations in March and April, the main stock index CROBEX recorded a solid growth of 16% in the first eight months of 2025, continuing the positive trends of the previous two years. Increased investor activity was also reflected in the growth of total turnover, which in the first eight months exceeded the total turnover from 2024 and increased by 80% on an annual basis. However, the investors' focus on only a few of the most liquid issues narrows the space for the expansion of the aforementioned positive trends and liquidity to the entire market and supports the growth of trading concentration. The top three stocks account for half, and the top five almost two-thirds of total trade in 2025, which is above the long-term average (Figure 2.10). This is also reflected in price movements, with several of the most

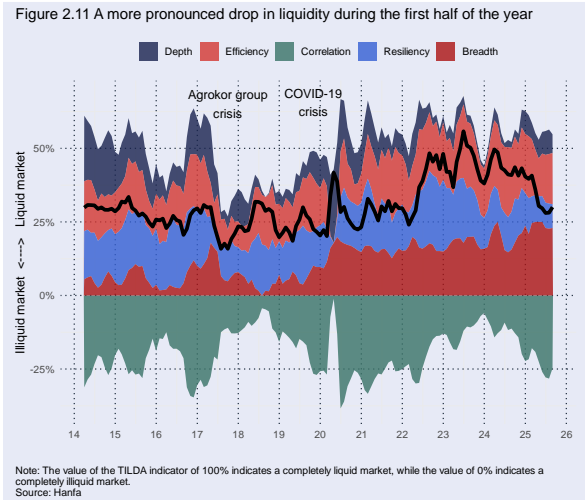


⁹ The market's sensitivity to developments in the technology sector was best reflected in the S&P 500's 1.5% daily correction at the end of

January, caused by the launch of the Chinese DeepSeek R1 language model, which is more cost-effective than its American competitors.

heavily traded stocks recording above-average price growth, while the rest of the market is also rising at a significantly slower pace. Average market liquidity has deteriorated since the start of the year (Figure 2.11), primarily due to weakening resilience and efficiency dimensions. This implies higher transaction costs and a reduced ability for price recovery after a possible initial price shock. The combination of these factors exposes the domestic market to the risk of a sharp price correction, which could indirectly spill over into the rest of the financial

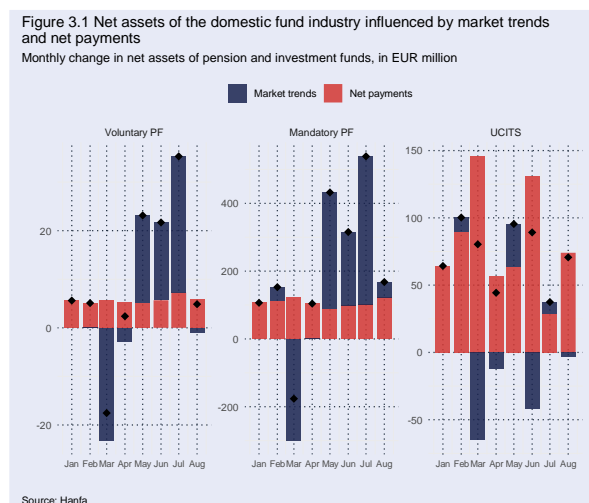
services sector.



3 RISKS IN THE FINANCIAL SERVICES SECTOR

3.1 Short-term risks

Cyclical risks in the financial services sector decreased in the first half of 2025. Positive market trends stimulated asset growth, as well as the preservation of fund returns and high profitability for institutional investors. Despite the increased macroeconomic uncertainties, no stronger liquidity pressures were recorded, and high levels of liquidity are a key support for the stability of the sector in the event of new systemic shocks.



Positive market trends and the inflow of new funds stimulated strong growth in the assets of pension and investment funds in 2025. At the end of August, pension funds’ net assets reached EUR 26.9bn, 9.1% more

compared to the end of the previous year¹⁰ (Figure 3.1). In addition to positive market trends reflecting investor optimism, growth was significantly driven by the influx of new members¹¹, resulting in higher net contributions, which at the end of August reached EUR 838.0m for mandatory pension funds and EUR 42.0m for voluntary pension funds.

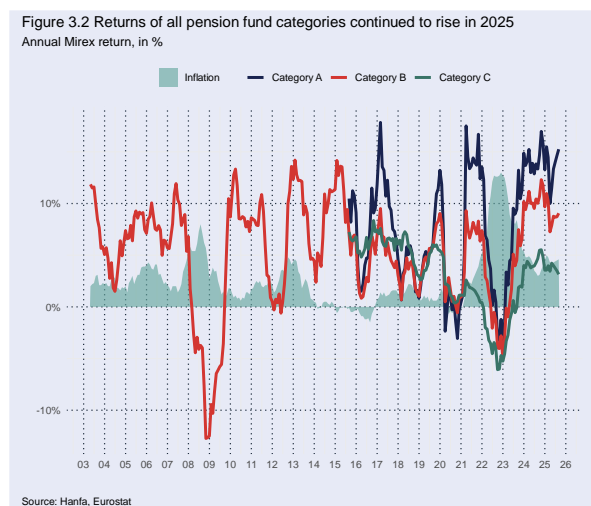
UCITS also recorded strong growth of 33.1% on an annual basis, with their net assets amounting to EUR 3.9 billion at the end of August. This growth is largely the result of a strong inflow of funds into money market funds¹², which at the end of August managed assets of EUR 1.3bn, representing a third of the sector's total assets. This led to significant changes in the investment structure of UCITS, which place an increasing part of their assets¹³ in deposits of domestic banks (20.2%) and money market instruments (18.6%), with the retained dominance of government bonds (36.3%). The investor structure remained relatively unchanged, with retail investors slightly increasing their share to 79.5%, while institutional investors accounted for 14.2%.

¹⁰ During the period in question, the assets of mandatory pension funds increased by 9.2% to €25.3 billion, while voluntary pension funds reached €1.6 billion, up by 7.6%.

¹¹ In the first eight months of 2025, the number of beneficiaries of mandatory and voluntary pension insurance rose by 2.0% and 3.5% respectively.

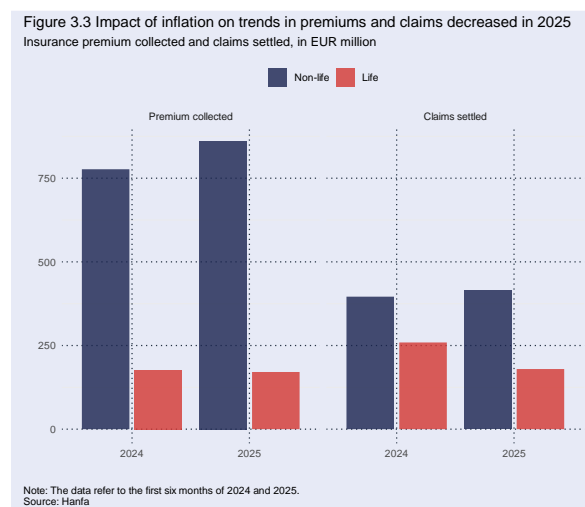
¹² Of the total net inflows, which amounted to EUR 653.7m in the first eight months, as much as 90.2% was accounted for by money market funds.

¹³ At the end of August 2025, investments in money market instruments had increased by 70.9%, and investments in deposits by 53.6% compared with the end of 2024.



Positive market trends, driven by favourable macroeconomic indicators, kept fund returns at high levels. Despite short-lived episodes of volatility, market trends in the first half of 2025 were positive and enabled pension and investment funds to achieve good results. In the first eight months of 2025, category A mandatory pension funds recorded annual returns of 7.3%, category B funds recorded returns of 3.6% and category C returns of 1.2% (Figure 3.2.). At the same time, equity funds generated a return of 13.9%, followed by bond funds and balanced funds, which reported returns of 1.2% and 1.1%, respectively. Thus, the profitability risks in the financial services sector remained at low levels, continuing the very good results of the previous two years. Although trends have been very favourable so far this year, the current environment of heightened geopolitical and macroeconomic uncertainty (more in Chapter **2.2 Financial environment**) emphasises the sector's short-term systemic risks, with sudden market

changes potentially having an adverse effect on the sector's operations and testing the sustainability of recent developments.



The effects of elevated inflation remain present in the operations of insurance companies, but with clear signs of weakening. Total premium collected at the end of June amounted to EUR 1.0bn (an 8.3% year-on-year increase), with the non-life insurance segment growing by 10.9%, while premium in the life insurance segment fell by 3.2%, despite a 1.0% rise in the number of policies (Figure 3.3.). Given that the growth in collected premiums in the non-life insurance segment outstrips the increase in the number of policies (significantly in some lines of insurance¹⁴), the impact of inflation remains, albeit weaker than in 2024. The decline in life insurance premium collected stems from reduced demand for traditional life insurance products (-11.4%), which are losing their appeal amid higher interest rates and increased competition from other forms of savings.

¹⁴ Growth in collected motor insurance premium at the end of June 2025 amounted to 14.8% year-on-year (a 3.4% increase in the number of policies), while the growth in collected premium

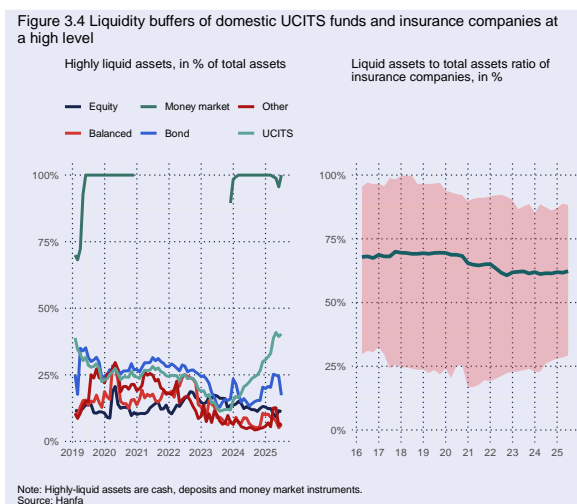
for other property insurance amounted to 16.0%, with a 4.5% increase in the number of policies.

Total claims settled decreased by 9.3% on an annual basis, primarily due to a large drop in the life insurance segment (-30%), while the growth in claims settled in the non-life insurance segment slowed significantly¹⁵. Excellent net results from insurance contracts (a 20.5% increase) and positive investment returns boosted the profitability of non-life insurance segment to a high 6.3%, while the profitability of life insurance decreased to 0.9%, primarily due to a 32.9% decline in investment results on an annual level.

The number and value of newly concluded leasing contracts continued to grow, but more slowly than in 2024. The value of new finance lease contracts rose by 6.4%, while operating lease saw a year-on-year fall of 7.7%¹⁶. As at the end of June 2025, finance lease contracts accounted for 86.9% of the value of all active contracts, which rose by 14.3% on an annual level. At the end of June, the profitability of leasing companies was slightly reduced, primarily due to increased borrowing, namely a 23.6% rise in short-term credit and loan liabilities compared with the previous quarter.

The liquidity of the financial services sector improved during the first half of this year. Strong growth of money market funds strengthened the liquidity of UCITS. Their investment structure, i.e., exclusively in highly liquid instruments, increased the share of liquid assets to 40.3% of the sector's total assets, 18.0 p.p. higher than a year earlier

(Figure 3.4). Maintaining a sufficient level of liquidity is a key prerequisite for the system's resilience, given the dominant share of retail investors, who may be prone to rapid and intense reactions to negative market trends.



In the insurance sector, the growth of interest rates on financial assets resulted in the highest level of liquidity in the last two years (62.3% at the end of June). The rise in interest rates and yields in financial markets prompted companies that had invested a significant portion of their assets in less liquid forms, such as property or loans, to reallocate part of them towards more liquid forms. While increased liquidity buffers keep liquidity risk at low levels, the still present inflationary pressures in the form of higher claims expenditures, signs of overvaluation in real estate investments and rising geopolitical risks could lead to sharp corrections in asset prices. Therefore, it is of paramount importance to manage liquidity risk responsibly in order to avoid unwanted

¹⁵ Although claims settled in the non-life insurance segment rose by 4.6% year-on-year at the end of June, this was significantly lower than the growth in the same period of the previous year, which stood at 22.8%.

¹⁶ The number of new contracts increased by 5.4% in the finance lease segment, while in the operating lease it decreased by 1.1%.

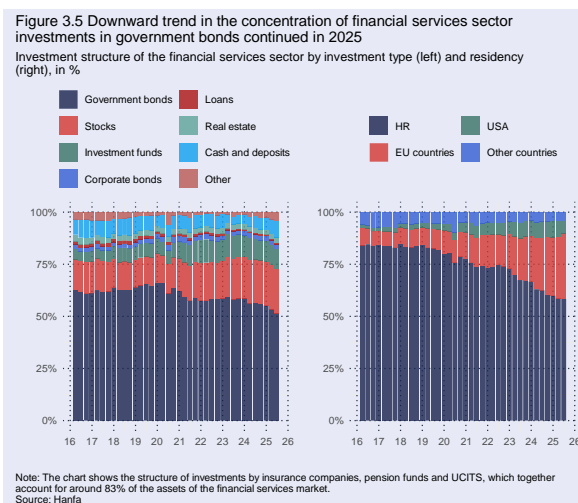
forms of (forced) asset sales and negative impacts on companies' profitability and capitalisation.

3.2 Long-term risks

High valuations and a low-risk premium, combined with heightened geopolitical and macroeconomic uncertainties, maintain elevated long-term systemic risks for the sector in the first half of 2025, making it vulnerable to market and interest rate shocks. The capitalisation of insurance and leasing companies remains stable, ensuring the sector's resilience. The sector's exposure to climate risks remains at moderate levels, however, global trends and regulatory expectations indicate a gradual increase in their intensity and growing importance in the assessment of systemic vulnerabilities.

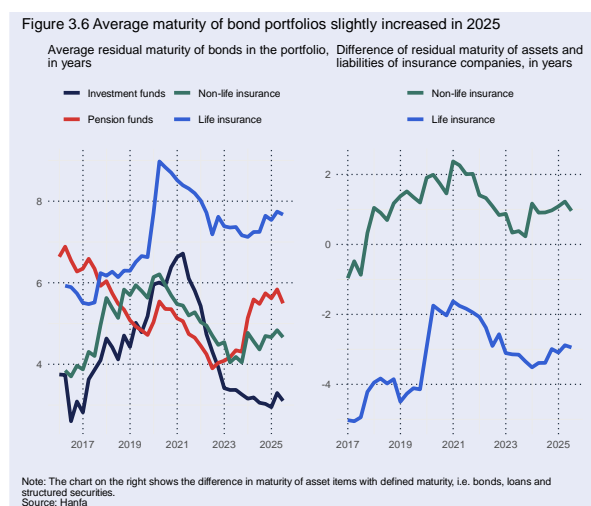
The process of reducing the investment concentration of the financial services sector continued into 2025 (Figure 3.5). At the end of the second quarter of 2025, the sector's overall exposure to government bonds decreased by 3.9 p.p. compared to the end of 2024 (to 51.4%), which was largely due to a fall in the share of domestic government bonds (-3.7 p.p.), as well as U.S. government bonds (-1.4 p.p.). At the same time, exposure to EU countries continued to grow, equally through an increase in the share of government bonds (+1.2 p.p.) and equity investments (+1.1 p.p.). Although diversification supports the sector's profitability and resilience, greater geographical dispersion of investments

increases exposure to market risks from the international environment, while higher exposure to more profitable but also riskier asset classes increases the sector's sensitivity to sudden price corrections. The high degree of international market interconnection was confirmed by the short-lived fluctuations in the U.S. and European markets in April 2025, which highlighted the sector's vulnerability to negative information. The continuation of geopolitical tensions, high asset valuations and low risk premium (more information in Chapter [2.2 Financial Environment](#)) further increase the likelihood of market risks materialising through sharp price corrections in the event of an economic slowdown or other systemic shocks.



The high proportion of bonds in institutional investors' portfolios and the heightened volatility of bond markets emphasise the importance of interest rate risk as one of the key challenges for the financial services sector. Fluctuations in the European bond markets recorded in March this year highlighted the uncertainty regarding the direction of monetary policy and the fiscal sustainability of certain European countries. In the context of an expected

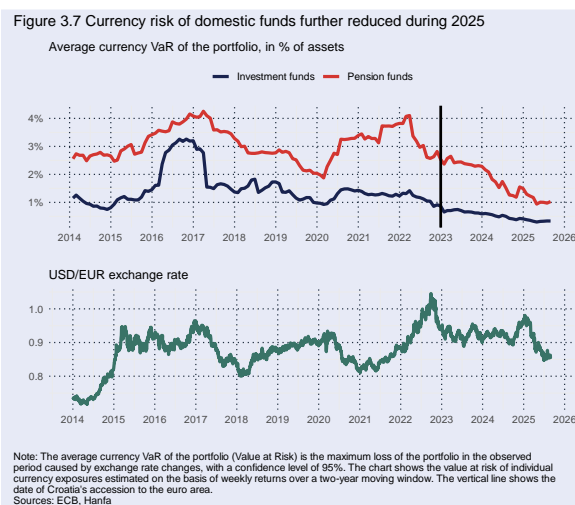
easing of monetary policy, domestic institutional investors shifted towards investments with longer maturities to capitalise on better yields at the longer end of the curve, which resulted in a slight increase in the average maturity of bond investments in 2025 (Figure 3.6) and increased the sector's vulnerability to future changes in yields. Investor expectations regarding monetary policy are focused on a further reduction in interest rates, particularly in the event of a more pronounced economic slowdown. At the same time, fiscal expansion in defence and infrastructure projects and trade tensions are working in the opposite direction, fuelling the pressure on the risk premium growth, and thus driving up returns on government bonds, which would, in the short term, burden the profitability of the financial services sector through a fall in the value of existing investments.



Insurance companies, particularly those engaged in life insurance, continue to face a pronounced problem of maturity mismatch between assets and liabilities (Figure 3.6.). Under conditions of potential interest rate fluctuations, the value of their liabilities may vary significantly relative to the value of their

assets and potentially result in a reduction in own funds and pressure on their capital position.

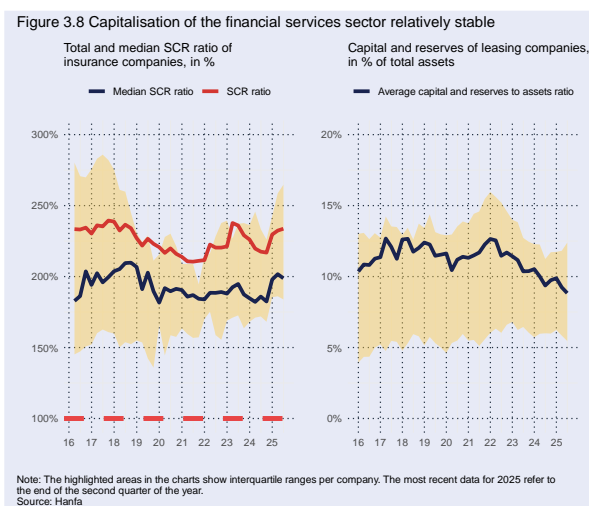
Institutional investors' exposure to credit risk remained stable in the first half of 2025. Positive economic trends (more information in Chapter [2.1. Macroeconomic environment](#)), good business results of non-financial companies and keeping the Republic of Croatia's credit rating at the A- level with a stable outlook contributed to the resilience of the domestic bond and equity markets to changes in the global risk premium. Credit risk exposure of leasing companies remained very low, with a share of non-performing receivables of 1.3%, and a relatively high coverage of non-performing placements of 62.7% at the end of June 2025.



Given the portfolio's dominant orientation towards the issuers from EU countries, the sector's exposure to currency risk remained low. The share of USD-denominated investments fell to 8.6% of total investments at the end of June 2025, 2.2 p.p. lower than at

the end of 2024¹⁷. Moderate fluctuations in the exchange rate of the euro against the dollar did not significantly increase portfolio volatility (Figure 3.7), however, the further development of U.S. monetary policy and the fiscal decisions of the new administration could represent a source of future pressures.

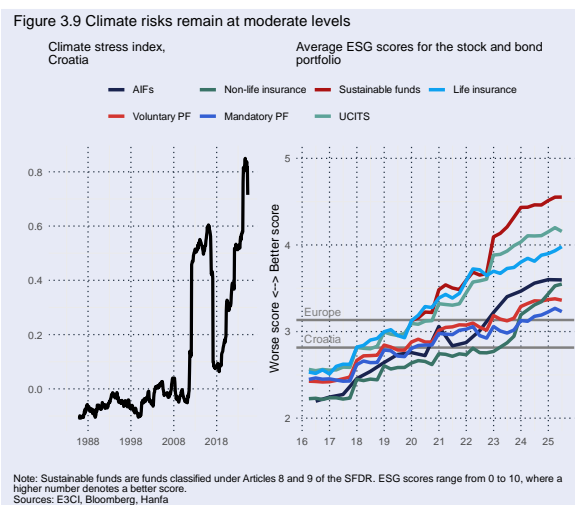
The capitalisation of the financial services sector remained at relatively high levels (Figure 3.8). Insurance companies' capital buffers are still well above the regulatory minimum, with the aggregate SCR ratio standing at 233.7% at the end of June 2025 (up 4.1 p.p. from the end of 2024)¹⁸. Positions of companies in the lower part of the distribution remained stable, while those of companies in the upper part further strengthened, thereby increasing the resilience of the insurance sector over the past period.



At the same time, the capitalisation of leasing companies decreased, with the aggregate ratio of capital and reserves to total assets standing at 8.8% at the end of the second quarter of 2025 (down by

¹⁷ Investments by insurance companies and pension funds and UCITS, which together account for around 83% of financial services market assets, were taken into account.

1.0 p.p. from the end of 2024)¹⁸. This is the result of increased business volume and a significant (11.9%) rise in assets.



The sector's exposure to climate risks is moderate, with physical risks posing a greater short-term threat. In the first four months of 2025, climate stress for Croatia slightly declined compared to the same period in 2024, primarily due to better weather conditions and a lower intensity of heatwaves. However, these are temporary fluctuations, while long-term trends indicate a continuous rise in climate stress. Physical risks remain at elevated levels above the EU average, which could adversely affect macroeconomic developments through their impact on the tourist season and the rising costs of damage from natural disasters. The materialisation of physical risk, combined with low levels of insurance cover for natural disasters, exposes the household sector to potentially significant expenditure. The potential transfer of the costs of damage from natural disasters from the private to the public sector could

¹⁸ Median SCR ratio stood at 198.8% (up by 0.9 p.p. from the end of 2024).

result in an increase in public debt and a deterioration of the fiscal position. Exposure to transition risks remained relatively unchanged. ESG ratings of

domestic institutional investors continued to improve slightly as a result of investment allocations towards more socially responsible issuers.¹⁹

¹⁹ More details on the impact of climate risks on the domestic financial services sector and the methodological framework for their

measurement can be found in **Box 1 Risk matrix: monitoring climate risks** in Financial Stability No 4.

BOX 1 GEOPOLITICAL SHOCKS AND RESILIENCE OF THE CROATIAN FINANCIAL SYSTEM

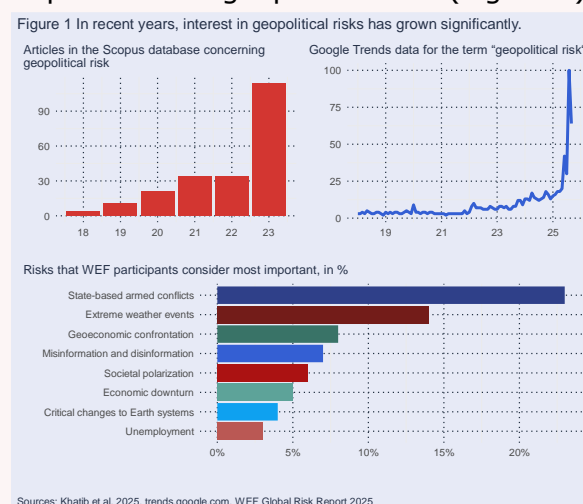
Geopolitical risks such as trade wars, armed conflicts and cyber-attacks are becoming some of the key challenges to preserving financial stability. Their effects could lead to the fragmentation of global trade and the destabilisation of financial markets, increasing uncertainty and systemic vulnerabilities. Recent geopolitical shocks have also been reflected in domestic market trends, but to a relatively limited and short-lived extent. However, the intensification of geopolitical risks following the outbreak of the war in Ukraine emphasises the importance of timely identifying and monitoring the transmission channels through which they can be transferred to liquidity and asset prices. Systematic monitoring of geopolitical risks is therefore important for timely macroprudential action aimed at strengthening the resilience of the financial system.

Introduction

Rising geopolitical tensions are creating an environment of heightened uncertainty, which is negatively affecting economic and financial developments. An extended period of political and trade turmoil is increasingly jeopardising economic prospects, while geopolitical fragmentation is heightening market volatility and the risk premium. Due to their increasingly pronounced and frequent impact on economic and financial systems, geopolitical risks in

2025 stand out as one of the most significant sources of short-term systemic vulnerabilities, as evidenced by the growing

public interest and the increasing number of studies devoted to the negative implications of geopolitical risk (Figure 1).



Empirical research consistently suggests that geopolitical risks negatively affect economic and financial flows. Caldara and Iacoviello (2022) show that geopolitical shocks reduce private investment and economic activity per capita, and negatively affect share prices in developed countries. At the same time, the effects on raw material prices and bond yields are mixed, with increased volatility in the short term, and stabilisation in the long term. Similar findings are confirmed by the IMF’s analyses (2024), which highlight that significant geopolitical events, such as the war in Ukraine or the trade war between the U.S. and China, can trigger a sharp fall in stock markets, while the impact on bonds is more pronounced in developing

and heavily indebted countries. Huu and Orsal (2023), Yilmazkuday (2024) and Agoraki (2022) confirm that geopolitical risks have a stronger negative impact on shares in developed countries, while Smiles (2021) warns that the effect is not always statistically significant when natural market volatility is taken into account.

The negative effects of geopolitical risks are also reflected in the performance of investment funds. The IMF (2024) warns of the increased exposure of equity funds to countries affected by geopolitical risks, while bond funds are more resilient, with funds investing in government bonds even recording net inflows. Similar findings are confirmed by an analysis by the Czech National Bank (2024), which shows that fund inflows are negatively correlated with financial and political uncertainty, with hedge funds being the most sensitive, but bond funds as well. The ECB (2024) shows that rising geopolitical risk causes outflows in almost all equity fund categories, while bond funds, particularly those holding government bonds, record net inflows.

Impact of geopolitical risk on financial stability

The term **geopolitical risks** encompasses threats arising from changes in international political relations that can lead to an economic slowdown and increased market instability. The importance of their systematic monitoring is also highlighted in the World Economic Forum's [Global Risks Report 2025](#) (Figure 1), in which world leaders ranked armed and economic conflicts among the

most relevant global risks. Investors and economic policymakers, such as central banks²⁰ and financial regulators, also recognise this importance, increasingly incorporating an assessment of the impact of geopolitical risks on the financial sector's operations into their analyses and decisions.

Geopolitical risks can threaten the stability of the financial system via two interconnected transmission channels (Figure 2).

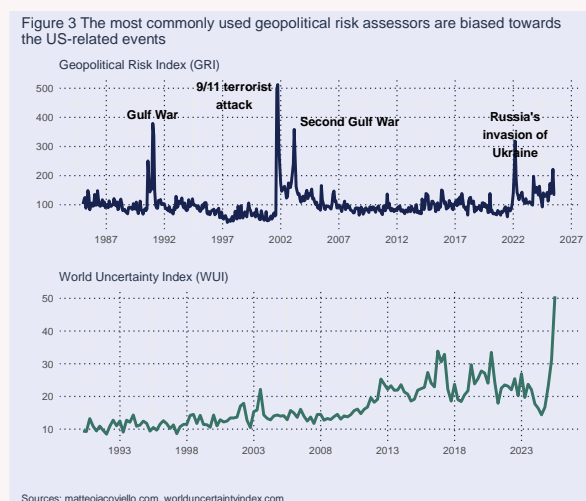
The **economic channel** is reflected in a slowdown in economic growth, rising inflationary pressures, a decline in international trade and interest in foreign direct investment, and a change in household consumption and savings patterns. In this context, trade restrictions and sanctions can disrupt the functioning of supply chains, undermine companies' profitability and worsen the outlook for economic growth, thereby increasing the likelihood of credit risk materialising.

The **market sentiment channel** is reflected in the increased volatility in financial markets. In a context of heightened geopolitical tensions, a decline in investor confidence and their shift into safer financial assets could disrupt global capital flows, trigger exchange rate fluctuations, and increase the risk premium in the bond market. Uncertainty regarding possible price corrections exposes the financial system to increased market risk, while the withdrawal of money from funds and sectors that are more susceptible to geopolitical risks increases liquidity risk.

²⁰ More information at [CNB](#) and [ECB](#) web pages.

Middle East, and since the beginning of 2025, it has been on a slight upward trend following the tightening of trade policy by the new U.S. administration (Figure 3).

Although GPR provides long-term and informative quantification of geopolitical risks, it is limited by the media bias of sources that are largely based in the U.S., which does not necessarily reflect a European perspective. For a comprehensive assessment of geopolitical risks, additional indicators are therefore often used, such as the **Economic Policy Uncertainty Index** (EPU), the **Global Militarization Index** (GMI) and the **Global Conflict Risk Index** (GCRI).



The effects of geopolitical shocks on the Croatian economy

Although Croatia has not been directly involved in any significant geopolitical conflicts or tensions over the past 20

years, its economy and financial system operate within a highly integrated European and global environment. Under such conditions, shocks caused by rising geopolitical risks can be transferred indirectly, through trade and financial channels, to the domestic financial services sector. Given Croatia's strong link to the euro area's economic cycles, changes in global risk may affect domestic economic activity, inflationary pressures, interest rates and movements in financial markets.

An empirical assessment of these effects is therefore important for understanding the domestic economy's potential exposure to external shocks and for assessing the resilience of the financial system to this increasingly prevalent source of systemic risk. For this purpose, a VAR analysis²³ was conducted, quantifying the relationship between geopolitical risks and key macroeconomic and financial variables in Croatia. Also shown are the impulse response functions²⁴ of macroeconomic and financial indicators to a one-standard-deviation shock in the Geopolitical Acts Indicator, thereby assessing the short-term reaction of key variables to changes in the level of geopolitical tensions. The analysis enables an assessment of the intensity and temporal dynamics of the effects of geopolitical shocks and

²³ The analysis was conducted using a standard VAR model with two or three time lags, depending on the Akaike Information Criterion (AIC). Before model estimation, all relevant diagnostic tests were carried out, including tests of variable stationarity, model stability, serial autocorrelation and heteroskedasticity of the residuals. Particular attention was paid to multicollinearity, with highly correlated variables included in separate model specifications. The assessments were carried for the period from January 2010 to June 2025. Monthly data were

used to analyse the effects on macroeconomic variables, while weekly data were used to assess the effects on financial variables, in line with the availability and dynamics of the indicators observed. Data sources include Hanfa, Eurostat, ZSE, St. Louis FED and Caldara and Iacoviello (2022).

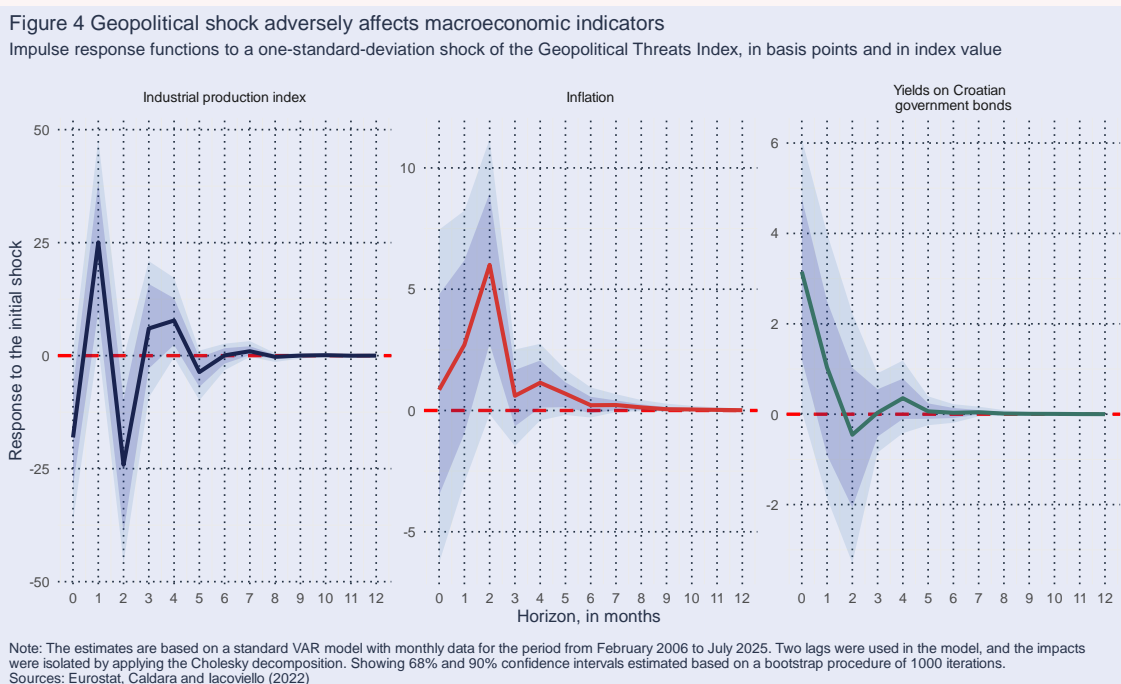
²⁴ Confidence intervals were estimated using the bootstrapping method with 1,000 repetitions, thereby ensuring the robustness of the obtained estimates.

identifies the channels through which they are transmitted to the real and financial sectors.

The estimated results indicate that the domestic economy exhibits short-term vulnerability to geopolitical shocks, with the estimated effects consistent with the findings of previous empirical research. The inflation response to an increase in geopolitical tensions is positive and statistically significant, with a lag of approximately two months after the shock. This suggests that, in the short term, geopolitical uncertainty has a pro-inflationary effect, primarily through higher energy and raw material prices and increased procurement and transport costs. Yields on government bonds rise by 3.6 basis points in the same month the shock occurs, confirming the assumption that investors rapidly revise their expectations of future risks and demand a higher risk premium in the context of heightened geopolitical uncertainty. On

the other hand, the impact on real economic activity, as approximated by the industrial production index, is neither unambiguous nor statistically significant. This result highlights the complexity of the relationship between geopolitical risks and the real sector, with the effects potentially mediated through trade and investment channels and mitigated by fiscal and monetary policies.

These results suggest that an increase in geopolitical tension could temporarily increase inflationary pressures and financing costs, which in turn could tighten refinancing conditions for both the government and businesses. Although the short-term effects on real activity are not pronounced, a sustained elevated level of geopolitical risk could be reflected in a gradual deterioration of financing conditions and a reduction in investment activity, thereby increasing the financial system's vulnerability to external shocks.



The estimated effects of geopolitical shocks on the financial indicators of the

financial services sector point to an obvious sensitivity of capital markets to

rising geopolitical uncertainty. The stock market's reaction to the occurrence of a shock is negative and statistically significant – the value of the CROBEX index decreases by about 0.1 percentage point in the week the shock occurs, which is consistent with the assumption that geopolitical events increase risk perception and prompt investors to withdraw from riskier asset classes. At the same time, a slightly negative impact on the European bond market was also recorded, indicating a temporary rise in risk aversion and a shift of investment into safer assets such as high-quality government bonds and money market instruments.

Investor behaviour in the domestic investment fund sector further confirms this pattern. Although total net sector-level outflows are not statistically significant, the analysis by class shows that equity and balanced funds experience short-term, significant outflows, while bond and money market funds remain relatively stable. Such results suggest that domestic investors temporarily abandon higher market-risk funds during periods of heightened uncertainty, but at the same time retain their confidence in lower-risk funds, and since 2022 they have even channelled funds into these lower-risk funds during stressful periods, which confirms the relative resilience of a system in which bond and money market UCITS funds account for 54% of net assets as of the end of June 2025.

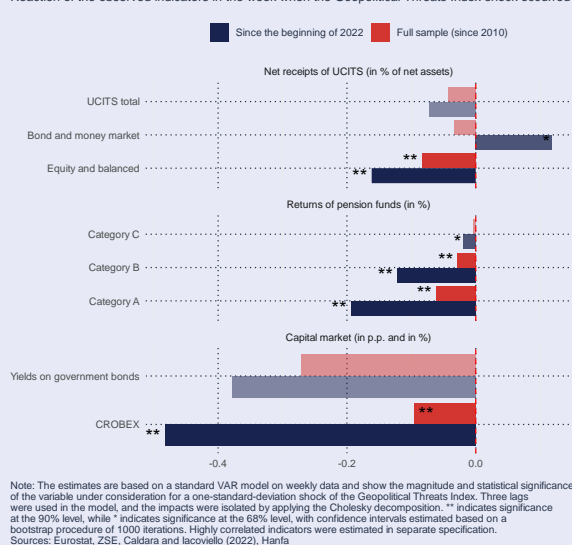
A negative but limited impact was also observed in the pension fund market, with the yields of category A and B funds falling in the short term, while category C funds remain relatively stable and do not

react to geopolitical shocks. Such dynamics reflect differences in the investment structure and the length of the investment horizon of the various fund categories, with more conservative funds being more resilient to external shocks.

Conclusion

Although the impact of geopolitical shocks on the domestic financial services sector is short-lived and has been relatively limited in historical context, its intensity increased significantly after the start of the war in Ukraine in 2022, which further emphasises the importance of addressing risks in a timely manner in the current circumstances. Their prolonged impact may lead to increased pressures on liquidity and asset prices, particularly in funds that are relatively more exposed to market risks. Therefore, the timely identification and monitoring of the transmission channels through which these risks materialise is crucial for well-timed action aimed at preserving the resilience of the financial system.

Figure 5 The impact of geopolitical shock on the financial services sector
Reaction of the observed indicators in the week when the Geopolitical Threats Index shock occurred



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LIST OF ABBREVIATIONS

AIF – alternative investment fund
GDP – gross domestic product
CBS – Croatian Bureau of Statistics
ECB – European Central Bank
ESG – environmental, social and governance
EPU – Economic Policy Uncertainty Index
EU – European Union
EUR – euro
Fed – Federal Reserve System
GCRI – Global Conflict Risk Index
GMI – Global Militarization Index
GPA – Geopolitical Acts Index
GPR – Geopolitical Risk Index
GPT – Geopolitical Threats Index
Hanfa – Croatian Financial Services Supervisory Agency
HICP – Harmonised Index of Consumer Prices
CNB – Croatian National Bank
CES – Croatian Employment Service
PF – pension funds
m – million
bn – billion
IMF – International Monetary Fund
NATO – North Atlantic Treaty Organisation
p.p. – percentage point
VAT – value-added tax
ROAA – return on average assets
USA – United States of America
SCR – Solvency Capital Requirement
CEE – Central and Eastern Europe
TILDA – Stock Liquidity Market Index

UCITS – undertakings for collective investment in transferable securities

USD – US dollar

VIX – Volatility Index

ZSE – Zagreb Stock Exchange

WEF – World Economic Forum

WUI – World Uncertainty Index

Country codes: AT – Austria; BE – Belgium; BG – Bulgaria; CY – Cyprus; CZ – Czech Republic; DE – Germany; EE – Estonia; EL – Greece; ES – Spain; FI – Finland; FR – France; HR – Croatia; HU – Hungary; IE – Ireland; IT – Italy; LT – Lithuania; LV – Latvia; MT – Malta; NL – Netherlands; PT – Portugal; PL – Poland; RO – Romania; USA – United States of America; SE – Sweden; SI – Slovenia; SK – Slovakia

The logo for HANFA features the word "HANFA" in a bold, white, sans-serif font. Above the text is a thin, red, curved line that arches over the letters, resembling a stylized wave or a protective shield.

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