

**PROJECT INFORMATION DOCUMENT
APPRAISAL STAGE**

Report No.: AB7055

Project Name	Export Finance Intermediation Loan Additional Financing
Region	EUROPE AND CENTRAL ASIA
Country	Croatia
Sector	General industry and trade sector (40%), General finance sector (30%), Other industry (25%), Agro-industry, marketing, and trade (5%)
Project ID	P129220
Parent Project ID	P116080
Borrower(s)	CROATIAN BANK FOR RECONSTRUCTION & DEV.
Implementing Agency	CROATIAN BANK FOR RECONSTRUCTION & DEV.
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Environment Category	<input type="checkbox"/> A <input type="checkbox"/> B <input type="checkbox"/> C <input checked="" type="checkbox"/> FI <input type="checkbox"/> TBD (to be determined)
Date PID Prepared	May 28, 2012
Date of Appraisal Authorization	June 25, 2012
Date of Board Approval	August 30, 2012

I. Country and Sector Background

1. Following the sharp contraction of Croatia's output during the global economic and financial crisis in 2009/10, the output decline leveled off in 2011. The sovereign debt crisis in euro area countries and worries about the global recovery are slowing growth across Europe. Croatia's economic recovery is affected by the heightened uncertainty. The main channels of contagion between the euro area and Croatia are trade and financial flows. The banking sector is another channel of transmission, as there are banks that are indirectly exposed to euro area crisis through their ownership structure. Although these banks are well capitalized with good governance and management, the banking sector may face systemic risks arising from shifts in the strategies of parent banks, resulting in possible deleveraging. Risks to the banking sector health are also increasing as a result of a downturn of the economy, which will further heighten cautious lending and shift banking sector focus more on loans with short maturity and are not supportive for growth-enhancing investments.

2. The dependence of banks on external financing exposes them to the risk of contagion from the euro area (interest and roll-over risks), as almost 1/5 of total liabilities and capital comes from parent funding. Potential difficulties in obtaining refinancing at reasonable interest rates could also lead to excessive or disorderly deleveraging, constraining needed financing of the private sector. Creditors are holding back on lending under the impact of uncertainty in global

financial markets, pessimistic expectations about economic growth and stability in the euro area, as well as the increased risk perception regarding Croatia.

II. Objectives

3. The objective of this credit line is to enhance the access to finance to support the preservation and growth of exports by providing medium and long term finance to exporters and foreign exchange earning companies. Importantly, the additional financing will enable banks to continue extending credit to exporters and foreign exchange earning enterprises in an environment of constrained funding.

III. Rationale for Bank Involvement

4. In the context of growing uncertainty and risks, in both global and local terms, the key challenge is to create the conditions for economic growth and maintaining macroeconomic stability. The private sector strongly adjusted to the reduced market demand and risk-averse banking sector by reducing its investments and increasing its savings preference, hindering much needed recovery. The government is determined to provide the incentives by starting its own investment cycle, by supporting private investment through reduced taxes for entrepreneurs and investors, and by ensuring financial stability. However, cost of capital and access to finance remain a serious obstacle for the Croatian exporters in increasing their exports, competitiveness and employment.

5. The current CPS sees fostering productivity and improving competitiveness as key factors for growth. The CPS aims to address one of the main constraints to private sector led growth -- access to long-term financing -- using HBOR and PFIs to on-lend to creditworthy private enterprises for viable projects throughout the economy. The progress report specifically mentions continued cooperation with HBOR.

6. The project has achieved impressive results to date with a broad spectrum of exporting companies that benefited from competitive cost of capital. The funding helped them strengthen their long-term business opportunities, and more importantly ride out the 2010 crisis. As of end-March 2012, €70.2 million was provided to companies for working capital purposes, with most of the financing provided to the agri-business and pharmaceuticals. The rest was distributed to the agricultural production, IT and tourism related activities. Exports of the supported companies, which account for 5 percent of overall exports of Croatia, grew by 19 percent. The portfolio under the project remains robust and to date there are no NPLs.

7. Against this backdrop, long term funding from the World Bank intermediated through eligible participating financial institutions (PFIs) is an optimal instrument to help private sector to confront and mitigate the economic downturn, which is again expected in 2012. The additional finance will enable further expansion of private sector by enhancing the impact of improved access to finance and ensuring the competitiveness of Croatian exporters as Croatia is moving towards EU integration. Additional finance allows for a faster and cost-efficient delivery of improved access to finance than would a new project in part by using a streamlined approval procedure in the Bank and in part by leveraging the experience and institutional capacity that has been built within the PIUs to execute the project.

IV. Description

8. The Croatia EFIL Project is a Financial Intermediation Loan (FIL) and is implemented by Croatian Bank for Reconstruction and Development (HBOR). The original project was supported by a loan of EUR100 million (US\$141.2 million equivalent) with a 29 year maturity and a 7 year grace period.

9. There are no changes to the original project objectives, design or scope. The proposed additional loan would help finance the scaling up of the Project, which is being successfully implemented. Given the success of the initial Project, additional funds are requested to scale up the project and enhance the development impact. Under the additional finance, the proposed amount is EUR 50 million.

V. Financing

Source:	(\$m.)
Borrower	0
International Bank for Reconstruction and Development	67
Total	67

VI. Implementation

10. The implementation arrangements will remain the same as the PIUs under the original project have performed satisfactory and developed the needed capacity. The PIU is within the Croatian Bank for Reconstruction and Development (HBOR).

VII. Lessons Learned from Past Operations in the Country/Sector

11. From the original project, some of the lessons learnt are that access to medium and longer-term finance is important for private sector growth, especially in the environment of a global financial crisis. Healthy competition among participating financial institutions PFIs is essential, and hence there is a need to ensure sufficiently broad participation from PFIs. As they bear the credit risk, the credit decision is also best left in the hands of the PFIs.

12. As with the original project, the project will strengthen the banking sector's balance sheets by providing long term funding. The original project had also improved the level of financial intermediation within the financial system and led HBOR to operate under market principles. Through close monitoring, the project aims to continue strengthening the compliance of the PFIs with prudential ratios and credit appraisal systems.

VIII. Safeguard Policies (including public consultation)

13. Environmental Assessment Policies (OP/BP 4.01), Pest Management (OP 4.09) and Physical Cultural Resources (OP/BP 4.11) will apply to the proposed project. PFIs and sub-borrowers will have to comply with these policies. No other policy is expected to be triggered by the project. The possibility of other policies being triggered by specific sub-loans made to eligible companies will be assessed when conducting the loans' environmental assessments.

IX. Contact point

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