

# Press release

1 June 2022

## ECB reports on EU countries' progress towards euro adoption

- Biennial report assesses progress of seven non-euro area EU Member States
- Positive assessment of Croatia in view of possible euro adoption on 1 January 2023
- Progress has been limited overall owing to challenging economic conditions

Limited progress has been made by non-euro area EU countries on economic convergence with the euro area since 2020, the [June 2022 Convergence Report of the European Central Bank \(ECB\)](#) concludes. This is mainly due to challenging economic conditions.

The report, which is issued every two years, assesses progress towards euro adoption by seven EU countries that have not yet adopted the euro: Bulgaria, the Czech Republic, Croatia, Hungary, Poland, Romania and Sweden.

The report includes a more in-depth assessment of Croatia, which has announced its intention to adopt the euro on 1 January 2023. Bulgaria and Croatia both joined the exchange rate mechanism (ERM II) and the banking union on 10 July 2020.

The coronavirus (COVID-19) crisis led to a significant drop in economic activity in 2020, from which all countries under review rebounded strongly. The Russian invasion of Ukraine in February 2022 has weighed on growth, and inflation has increased in all the countries assessed. However, it is too early to draw any firm conclusions about how the convergence paths will be affected. The forward-looking convergence assessment is surrounded by high uncertainty, and the full impact can only be evaluated *ex post*.

### European Central Bank

Directorate General Communications, Global Media Relations Division  
Sonnemannstrasse 20, 60314 Frankfurt am Main, Germany  
Tel.: +49 69 1344 7455, email: [media@ecb.europa.eu](mailto:media@ecb.europa.eu), website: [www.ecb.europa.eu](http://www.ecb.europa.eu)

As regards **the price stability criterion**, only Croatia and Sweden recorded inflation rates below or well below the reference value of 4.9%. This reference rate is based on the average inflation figures recorded in the three best-performing countries over the last 12 months – Finland, France and Greece (after exclusion of the outliers: Malta and Portugal). In the five other countries assessed – Bulgaria, the Czech Republic, Hungary, Poland and Romania – inflation rates were well above the reference value over the last 12 months, as was also the case in the 2020 Convergence Report.

**On the fiscal criteria**, at the time of the publication of the report, only Romania is subject to an excessive deficit procedure (launched in April 2020). Although three further countries under review – Bulgaria, the Czech Republic and Hungary – exceeded the 3% of GDP deficit reference value in 2021, no new excessive deficit procedures were opened.

After a sharp increase in 2020 in the wake of the COVID-19 crisis, budget deficits remained elevated in all countries in 2021 except Sweden. Compared with 2020, budget balances improved in all the countries under review in 2021 except Bulgaria and the Czech Republic. According to the European Commission's Spring 2022 Economic Forecast, the **deficit-to-GDP ratio** is expected to decline in most of the countries in 2022 and 2023. Nonetheless, it is expected to exceed the reference value in 2023 in the Czech Republic, Hungary, Poland and Romania.

**The government debt-to-GDP ratio** was between 20% and 40% in Bulgaria and Sweden in 2021 and reached between 40% and 60% in the Czech Republic, Poland and Romania, while the debt ratios in Croatia and Hungary were above the 60% reference value.

In 2022 and 2023 government debt ratios are expected to decline in four of the countries as a result of both the improvement in economic activity and the phasing-out of fiscal measures taken in response to the COVID-19 pandemic, while budget balances are expected to be burdened by new measures taken in response to high energy prices and the Russia-Ukraine war.

As regards the **exchange rate criterion**, the Bulgarian lev and the Croatian kuna participated in ERM II for most of the two-year reference period from 26 May 2020 to 25 May 2022, at central rates of 1.95583 levs per euro and 7.53450 kuna per euro respectively. The exchange rate of the Croatian kuna displayed a low degree of volatility and traded close to its central rate. The Bulgarian lev did not deviate from its central rate. Except for the Romanian leu, the exchange rates of the currencies not participating in ERM II showed a relatively high degree of volatility.

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When considering **the convergence of long-term interest rates**, the lowest 12-month average long-term interest rates were recorded in Bulgaria, Croatia and Sweden. At 2.5%, the Czech Republic was just below the reference value of 2.6%. Two of the countries under review – Hungary and Poland – recorded 12-month average long-term interest rates above the reference value, while in Romania the 12-month average long-term interest rate was well above the reference value.

**The strength of the institutional environment** is an important factor in the sustainability of convergence over time. Except in Sweden, the quality of institutions and governance in the countries under review is relatively weak. When it comes to **legal convergence**, Croatia is the only country examined where the legal framework is fully compatible with the requirements for adoption of the euro under the Treaty on the Functioning of the European Union and the Statute of the European System of Central Banks and of the European Central Bank (Statute of the ESCB).

## Croatia

The ECB's assessment concludes that Croatia is within the reference values of the convergence criteria.

### Price stability

In April 2022 the 12-month average rate of HICP inflation in Croatia was 4.7%, i.e. below the reference value of 4.9%. This rate is expected to increase gradually over the coming months, driven mainly by the higher commodity prices, broadening price pressures and further aggravation of supply bottlenecks as a result of the Russia-Ukraine war.

Looking ahead, there are concerns about whether inflation convergence is sustainable over the longer term in Croatia. In order to prevent the build-up of excessive price pressures and macroeconomic imbalances, the convergence process must be supported by appropriate policies.

### General government deficit and debt ratios

Croatia's general government budget balance was just below the 3% of GDP deficit reference value in 2021, while its debt ratio was above the 60% of GDP reference value, but declined from the previous year. The deficit ratio amounted to 2.9% of GDP in 2021, which fulfills the deficit criterion. The debt

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ratio was 79.8% of GDP in 2021, a decline from the peak of 87.3% of GDP in 2020. This strong decline in the debt ratio ensured fulfillment of the debt criterion.

The European Commission's Spring 2022 Economic Forecast indicates that Croatia is on track to continue to be compliant with the requirements of the Stability and Growth Pact. Moreover, the European Commission found in its 2022 European Semester Spring Package that Croatia faces medium debt sustainability risks over the medium term. To safeguard sound public finances and put the debt ratio onto a long-lasting downward path, it is essential that Croatia implements the envisaged fiscal reforms under its recovery and resilience plan.

## Exchange rate

The Croatian kuna was included in ERM II on 10 July 2020 at a central rate of 7.53450 kuna per euro with a standard fluctuation band of  $\pm 15\%$ . Over the two-year reference period from 26 May 2020 to 25 May 2022, the exchange rate displayed a low degree of volatility and the kuna traded close to its central rate.

## Long-term interest rates

Over the reference period from May 2021 to April 2022, long-term interest rates in Croatia stood at 0.8% on average, which was below the 2.6% reference value for the interest rate convergence criterion. Long-term interest rates in Croatia have decreased since 2012, with 12-month average rates declining from slightly below 7% to below 1%.

## Sustainable convergence

Croatia would benefit from stability-oriented economic policies and wide-ranging structural reforms. In 2022 the European Commission concluded that the macroeconomic imbalances that the country was experiencing continued to subside in 2021, returning to their favourable pre-pandemic trends. Structural reforms would help Croatia improve its institutional and business environment, boost competition and make its public administration and its judicial system more efficient. In October 2020 the ECB became responsible for directly supervising eight significant institutions and overseeing 15 less significant institutions in Croatia.

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## Legal criteria

Croatian law is compatible with the Treaties and the Statute of the ESCB as required under Article 131 of the Treaty.

For media queries, please contact [Alexandrine Bouilhet](#), tel.: +49 172 174 93 66.

## Notes

- [Introductory statement by Mr Panetta at the Euro Accession Countries Working Group of the Committee on Economic and Monetary Affairs of the European Parliament](#)
- [European Commission's Convergence Report 2022](#)
- The Convergence Report of the ECB reviews the economic and legal convergence of non-euro area EU Member States with a derogation every second year or at the request of a specific country. It assesses the degree of sustainable economic convergence with the euro area, whether the national legislation is compatible with the EU legal framework, and whether the statutory requirements are fulfilled for the respective national central banks. Given its "opt-out" clause, Denmark is not covered by the assessment unless this is requested by the country.
- The cut-off date for the statistics included in this Convergence Report was 25 May 2022. The reference period for the price stability and long-term interest rate criteria is from May 2021 to April 2022. For exchange rates, the reference period is from 26 May 2020 to 25 May 2022. Historical data on fiscal positions cover the period up to 2021. Forecasts are based on the European Commission's Spring 2022 Economic Forecast and the most recent convergence programmes of the countries concerned, as well as other information relevant to a forward-looking examination of the sustainability of convergence.
- Since November 2014 any country joining the euro area has also joined the Single Supervisory Mechanism (SSM) and the other components of the banking union. The banking system of the country in question is subject to a comprehensive assessment conducted by the ECB. On 10 July 2020 the ECB decided to establish close cooperation with Българска народна банка (Bulgarian National Bank) and Hrvatska narodna banka following the fulfilment of the necessary supervisory and legislative prerequisites. On 1 October 2020 the ECB became the supervisor in charge of common procedures for all supervised entities and assumed responsibility for the oversight of less significant institutions in the two countries.

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