EUROPEAN CENTRAL BANK

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PRESS RELEASE

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ECB publishes its 2018 Convergence Report

- All seven EU Member States under review have made progress with regard to compliance with convergence criteria
- No country fulfils all obligations laid down in the Treaty, including legal convergence criteria
- Sustainable convergence is needed for successful adoption of the euro

The European Central Bank (ECB) is today publishing its 2018 Convergence Report, in line with the requirements of the Treaty on the Functioning of the European Union. The report covers Bulgaria, the Czech Republic, Croatia, Hungary, Poland, Romania and Sweden. It finds that the seven EU Member States have made progress towards fulfilling the criteria for adoption of the euro, although none of the countries fulfils all obligations. The report examines the degree of sustainable economic convergence achieved in these countries and assesses compliance with the statutory requirements to be met by national central banks to become an integral part of the Eurosystem. When assessing the sustainability of convergence, the report also takes into account the EU’s enhanced economic governance framework (e.g. the Stability and Growth Pact and the macroeconomic imbalance procedure) and other relevant factors, such as the strength of the institutional environment.

Economic convergence: As regards compliance with the nominal convergence criteria, some progress has been made since the publication of the ECB’s 2016 Convergence Report.

The cross-country differences in **inflation** have declined further, showing progress towards the achievement of a high degree of price stability. Over the 12-month reference period from April 2017 to March 2018, inflation increased in the EU, mainly owing to robust economic growth and rising energy and commodity prices. This was reflected in the reference value for the price stability criterion, which was met by five of the seven countries examined in the report. The Czech Republic and Hungary recorded inflation rates above the reference value, while inflation was at the reference value in Romania and Sweden, below it in Bulgaria and Poland, and well below it in Croatia. Looking ahead, inflation is expected to increase further in the countries under review in the coming years. There are concerns regarding the sustainability of inflation convergence over the longer term in most of the countries examined.

The report points to a visible improvement with regard to the **fiscal criteria,** with fiscal imbalances reduced in most of the countries examined. In 2017 all countries under review reported a fiscal balance within the 3% of GDP deficit ratio reference value, and no country is currently subject to an excessive deficit procedure. In 2016, Croatia was subject to such a procedure. Therefore, all the countries under review are in compliance with the deficit criterion. The debt ratio exceeds the threshold of 60% of GDP in Croatia and Hungary only, but is in both countries on a sufficiently diminishing trajectory and approaching 60% of GDP at a satisfactory pace, and can therefore be deemed compliant with the Stability and Growth Pact.

None of the countries under review participates in the **exchange rate mechanism (ERM II)**. In most countries the exchange rate exhibited a relatively high degree of volatility over the two-year reference period. The exceptions were Bulgaria (which has a currency board arrangement vis-à-vis the euro) and Croatia (which operates a tightly managed float).

With regard to the convergence of long-term interest rates, five of the seven countries under review recorded long-term interest rates below the reference value of 3.2%. Long-term interest rates were above the reference value in Poland and Romania. The lowest values were recorded in the Czech Republic and Sweden.

Sustainable convergence is essential: Countries adopting the euro should be able to demonstrate the sustainability of their convergence process. A prerequisite for sustainable convergence is macroeconomic stability and, in particular, a sound fiscal policy. Most of the countries under review have made progress in addressing macroeconomic imbalances in their economy. Sustainable convergence also requires **sound institutions**. Countries must have well-functioning product and labour markets, which is essential to cope with macroeconomic shocks. Moreover, appropriate macroprudential policies need to be in place to prevent the build-up of macroeconomic imbalances, such as excessive asset price increases and credit boom-bust cycles. Finally, an appropriate framework for the supervision and resolution of financial institutions needs to be in place, especially in view of the establishment of banking union and the Single Supervisory Mechanism.

Legal convergence: In none of the seven countries examined is the legal framework fully compatible with all the requirements for the adoption of the euro. Incompatibilities persist regarding central bank independence, in particular central banks' institutional and financial independence, as well as personal independence. In addition, in all countries under review, with the exception of Croatia, there are incompatibilities as regards the prohibition of monetary financing and the legal integration of the respective central banks into the Eurosystem.

For media queries, please contact Stefan Ruhkamp, tel.: +49 69 1344 5057.

Notes:

- A Convergence Report is published at least once every two years or at the request of an EU Member State that would like to join the euro area.

- Both the ECB and the European Commission issue these reports describing the progress made by non-euro area Member States towards achieving the criteria necessary for a country to adopt the euro.

European Central Bank Directorate General Communications, Global Media Relations Division
Sonnemannstrasse 20, 60314 Frankfurt am Main, Germany
Tel.: +49 69 1344 7455, E-mail: media@ecb.europa.eu, Website: www.ecb.europa.eu