



CROATIAN NATIONAL BANK

EUROSYSTEM

Croatia's recent experience with the adoption of the euro

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Governor

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Overview

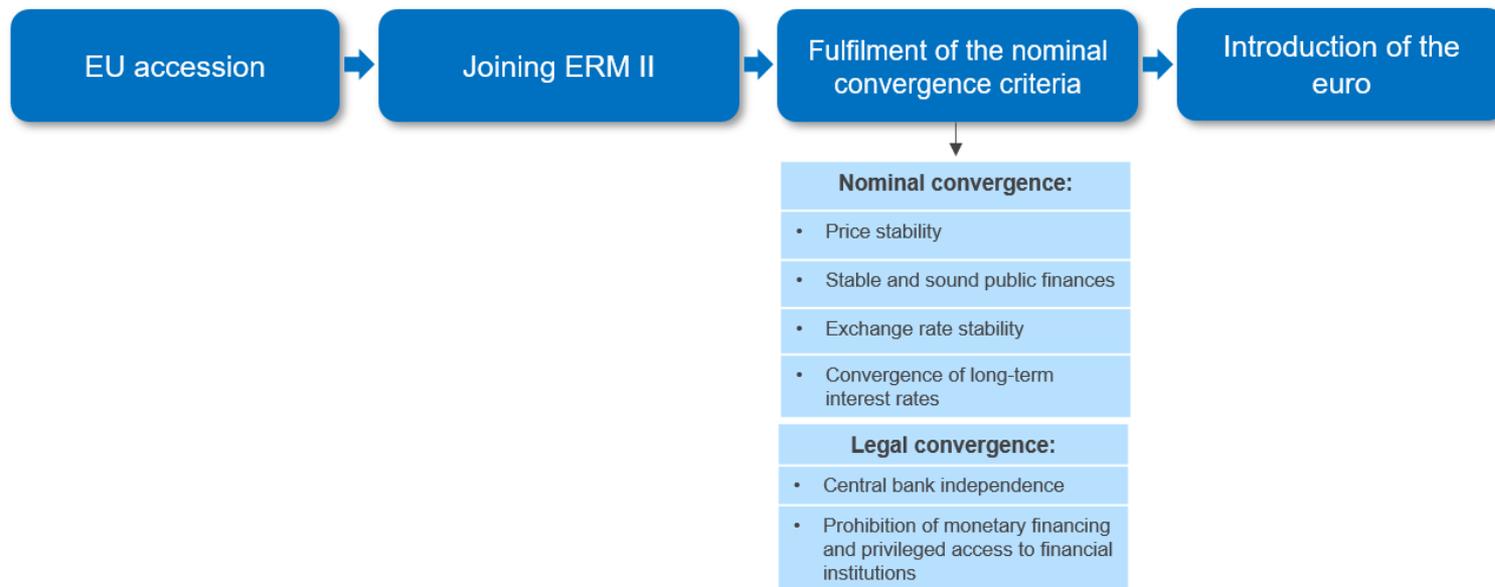
- Croatia's road to the euro
- Economic benefits of euro adoption
- Recent economic developments
- Lessons from Croatia's experience

- Croatia's road to the euro

Until 2008, the road to the euro was fairly simple

- EU Member States interested in joining the euro area only had to fulfil the nominal convergence criteria (the Maastricht criteria) ...
 - price stability
 - stable and sound public finances
 - exchange rate stability (during the two-year participation in ERM II)
 - convergence of long-term interest rates
- ... and achieve the required degree of legal convergence
 - central bank independence
 - prohibition of monetary financing and privileged access of the public sector to financial institutions
- There were no preconditions for joining ERM II
 - new EU Member States that were willing to launch the euro adoption process were allowed to start participating in ERM II soon after they joined the EU in May 2004

The euro adoption process - then



The euro adoption process - now

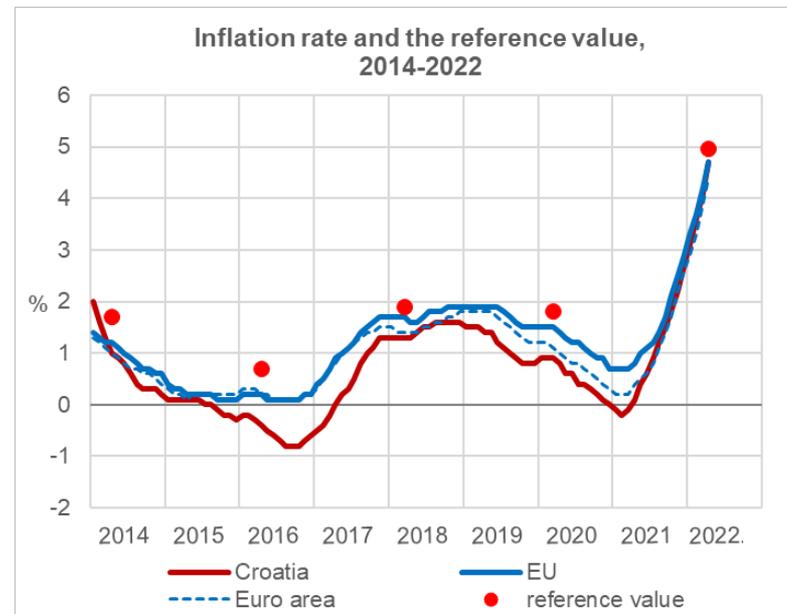


Our road to the euro involved numerous steps

June 2017	May 2018	February 2019	May 2019	June 2019	June 2020	July 2020
Excessive Deficit Procedure (EDP) closed – decision by the Council of the EU	Government adopted the Euro adoption strategy	Excessive macro imbalances eliminated – confirmation by the Commission	Request for close cooperation with the ECB	Letter of intent for ERM II and commitments were taken (19 measures in 6 areas)	Commission and the ECB confirmed that all measures had been completed	Kuna included in ERM II and additional commitments were taken (8 measures in 4 areas)
October 2020	December 2020	March 2022	May 2022	June 2022	July 2022	1 January 2023
Close cooperation with the ECB started	Government adopted the National Euro Changeover Plan	Additional commitments fully implemented	Law on the introduction of the euro	Commission and the ECB published convergence reports (all criteria had been met)	EU Council decision on the introduction of the euro in Croatia	Introduction of the euro

In the high-inflation environment, the price stability criterion was the greatest challenge among the convergence criteria

- Since its EU accession, Croatia was continuously compliant with the price stability criterion
- However, global inflationary pressures that emerged in 2021-22 called into question Croatia's ability to meet the criterion
- The price criterion was met by a small margin
 - in April 2022, Croatia's 12m average inflation rate was **4.7%**, 0.2 pp below the reference value of **4.9%**
 - Malta and Portugal were excluded from the calculation because their inflation rates (2.1% and 2.6%) were significantly lower than the EU average (4.7%)



Source: Eurostat

Practical preparations for the changeover

- **National Euro Changeover Plan** adopted in December 2020 set out practical preparations in 6 areas:

Legal adjustments

**Conversion of
loans and deposits
and other
adjustments in the
financial sector**

**Adjustments in the
government sector**

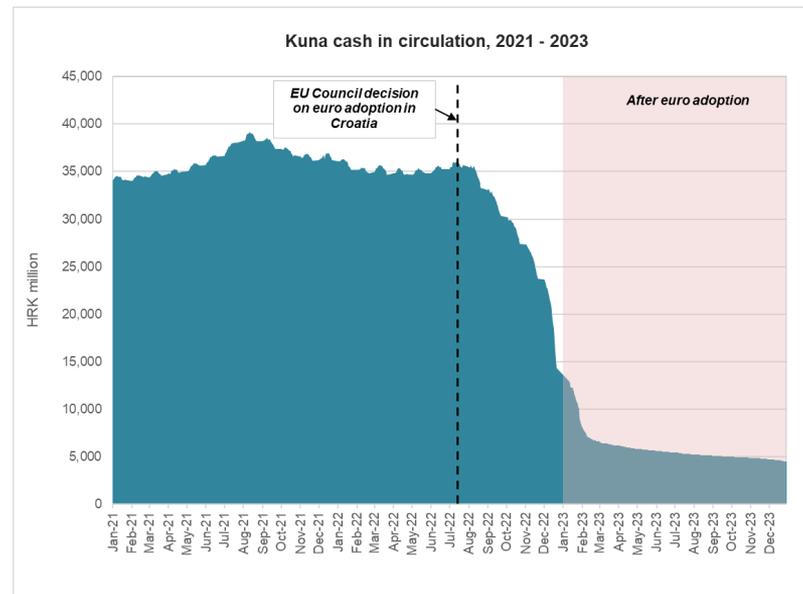
Cash changeover

**Adjustments in the
business sector
and consumer
protection**

**Information
campaign**

The changeover to the euro was smooth and successful

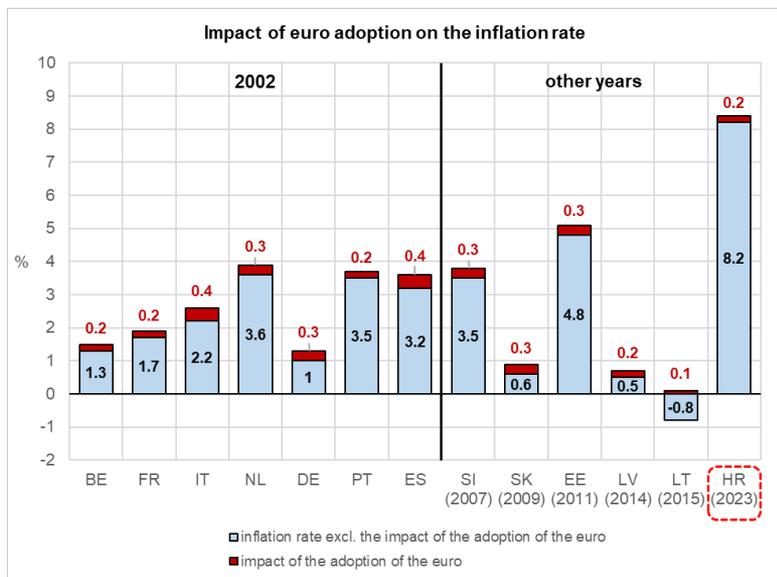
- Despite significant logistical challenges, the cash changeover was carried out successfully
 - kuna cash in circulation fell **by 60%** already by end 2022
- The conversion of loans, deposits and other instruments completed on 1 January without any incidents
- Payment systems, payment cards and ATMs were operational shortly after midnight on 1 January
- Following extensive preparations, retailers played a significant role in facilitating the currency changeover over 2-weeks dual circulation period



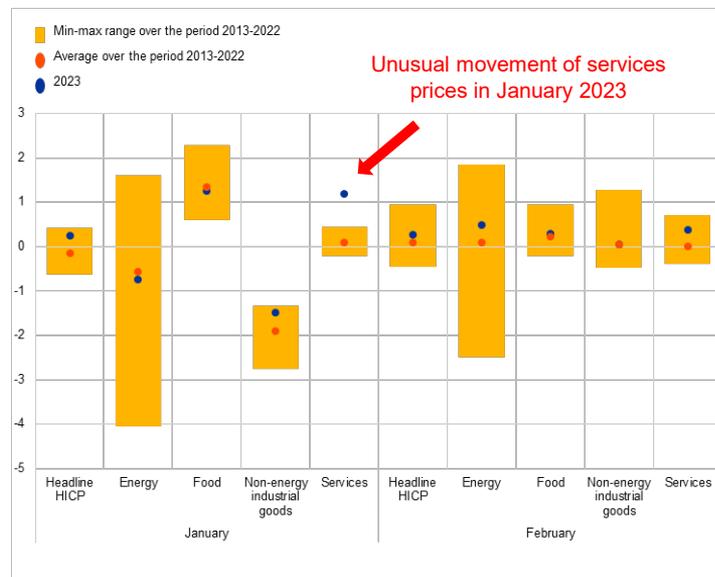
Source: HNB

The impact on consumer prices was low as expected

As in other countries in the past, the inflationary impact of the euro was very small on aggregate, although the prices of services did increase somewhat due to rounding up



Sources: Eurostat, Pufnik (2017)



Source: Eurostat

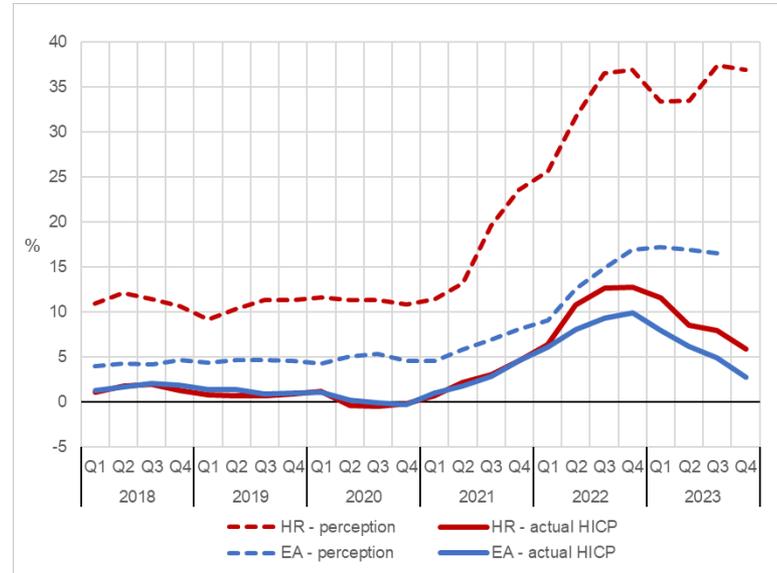
Public perception was a bit different, which is not surprising given the persistent gap between perceived and actual inflation

Eurobarometer (November 2023): Do you think that the euro introduction had any impact on prices?



Source: Flash Eurobarometer 538

Perceived inflation over the last 12 months and actual inflation

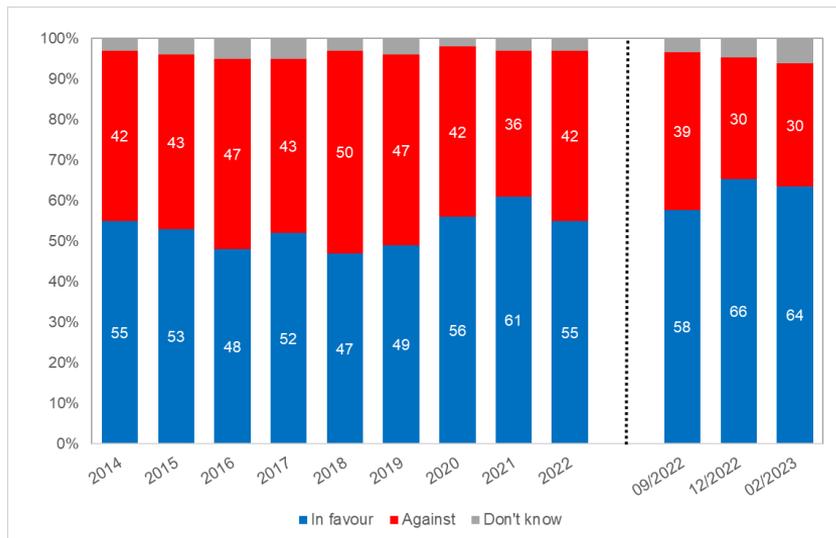


Sources: Eurostat; EC Business and Consumer Survey; HNB

Although most people believe that all prices have increased, public support for euro adoption remained relatively high

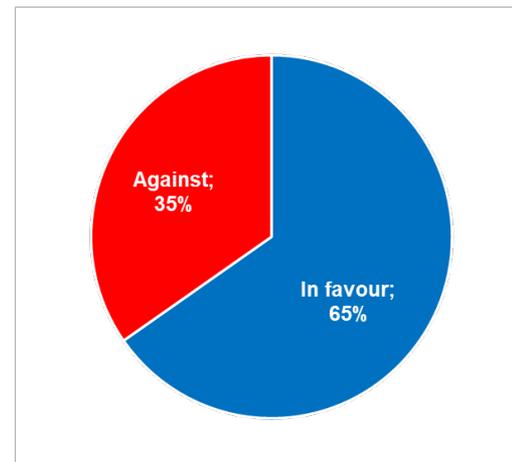
Survey question: *Are you personally more in favor or against the idea of introducing the euro in your country?*

**Eurobarometer (2014-2022) and Ipsos surveys
(09/2022, 12/2022 and 02/2023)**



Source: Flash Eurobarometer; Ipsos

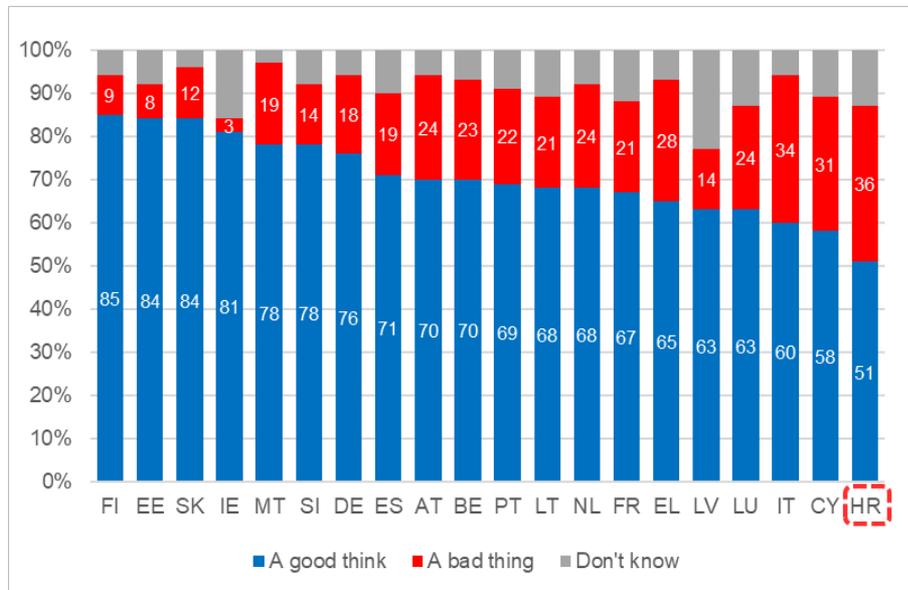
**Average result of Ipsos surveys (09/2022,
12/2022 and 02/2023)**



* The responses categorized as „Don't know” are allocated proportionally to the „Against” and „In favour” responses.
Source: Ipsos

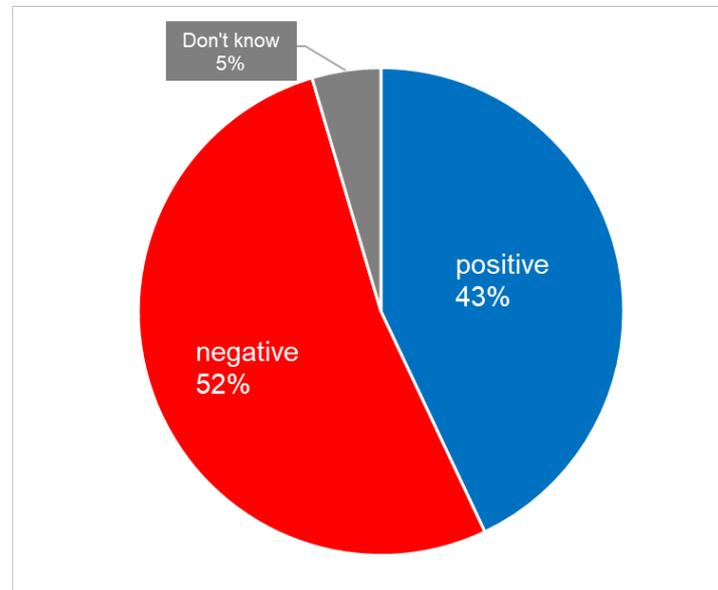
The share of respondents who believe that having the euro is a good thing for Croatia has increased after the €-day

Eurobarometer (2023): *Is having the euro a good or bad thing for your country?*



Source: Flash Eurobarometer 538

Ipsos (2021): *What will be the effects of the adoption of the euro on Croatia?*



Source: Ipsos, March 2021

- Economic benefits of euro adoption

Economic benefits of adopting the euro

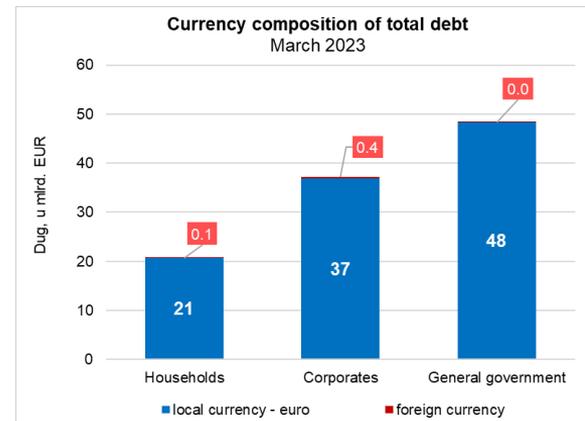
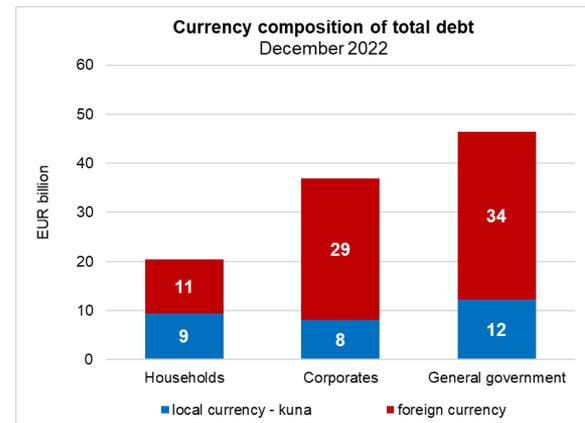
1. Elimination of foreign exchange risk
2. Reduction of borrowing costs
3. Lower transaction costs
4. Greater resilience to financial crises

Benefits (1): Elimination of FX risk

- As a previously highly euroized country, Croatia has benefited significantly from the adoption of the euro as foreign exchange risk has disappeared completely

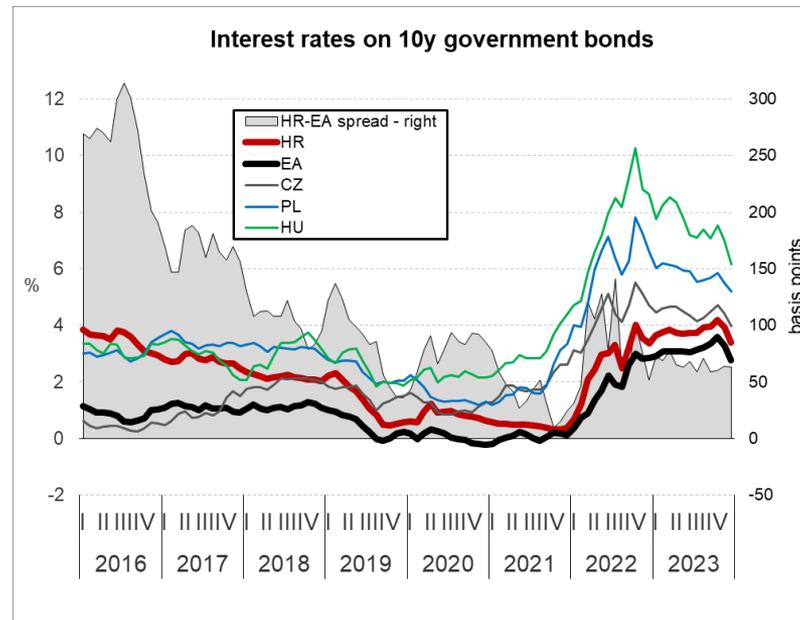
❖ in December 2022, foreign currency debt amounted to EUR 77 bln (**115% of GDP**)

❖ in March 2023, foreign currency debt amounted to only EUR 0.5 bln (**0.7% of GDP**)



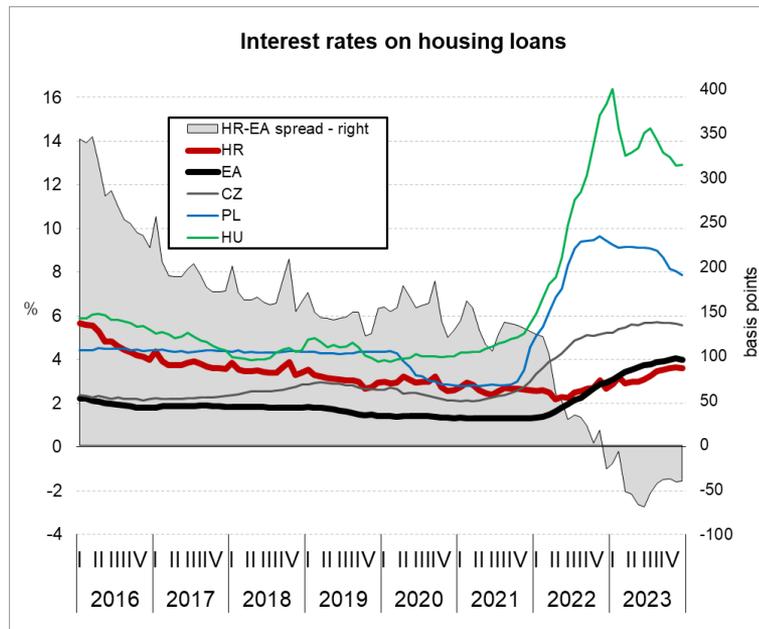
Benefits (2): Reduction of borrowing costs

- Euro adoption leads to a reduction in borrowing costs through **2 channels**:
 - 1) lower country risk premium
 - greater resilience to shocks implies higher credibility in financial markets and therefore lower sovereign yields
 - 2) lower regulatory costs for the banking system
 - in Croatia, the reserve requirement rate stood at 9% one year before the introduction of the euro
 - in the EA, the reserve requirement rate is only 1%

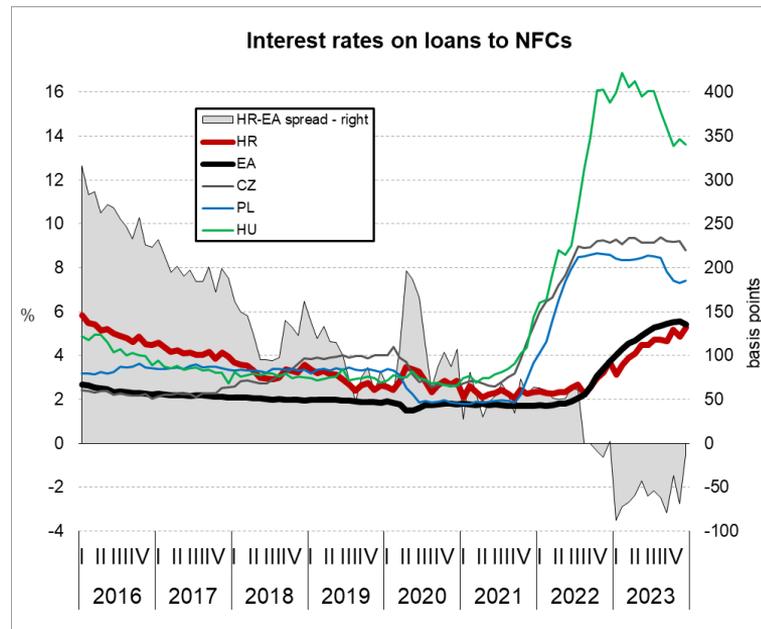


Source: Eurostat

Benefits (2): Reduction of borrowing costs (cont.)



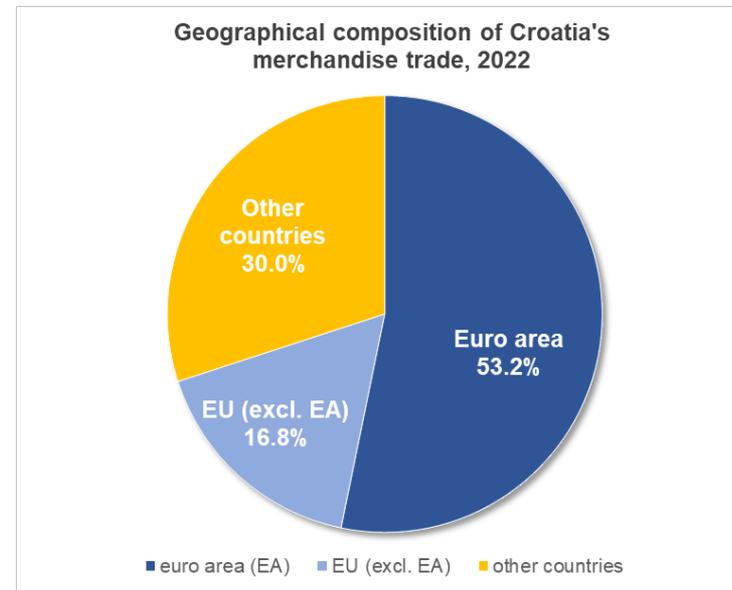
Source: ECB



Source: ECB

Benefits (3): Lower transaction costs

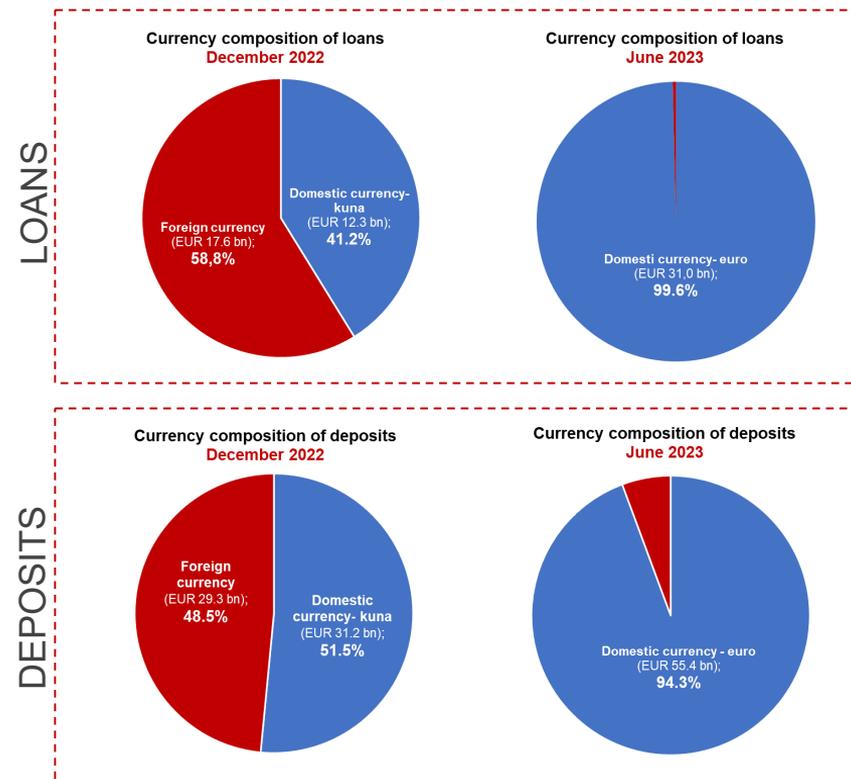
- Merchandise trade with euro area countries is facilitated as there is no longer a need for currency conversion
- The competitiveness of tradable sectors, including tourism, has been further increased by the **entry into the Schengen area**
- Total annual savings for the non-financial sector due to the disappearance of currency conversion costs are estimated at **EUR 160 million** (HRK 1.2 billion)



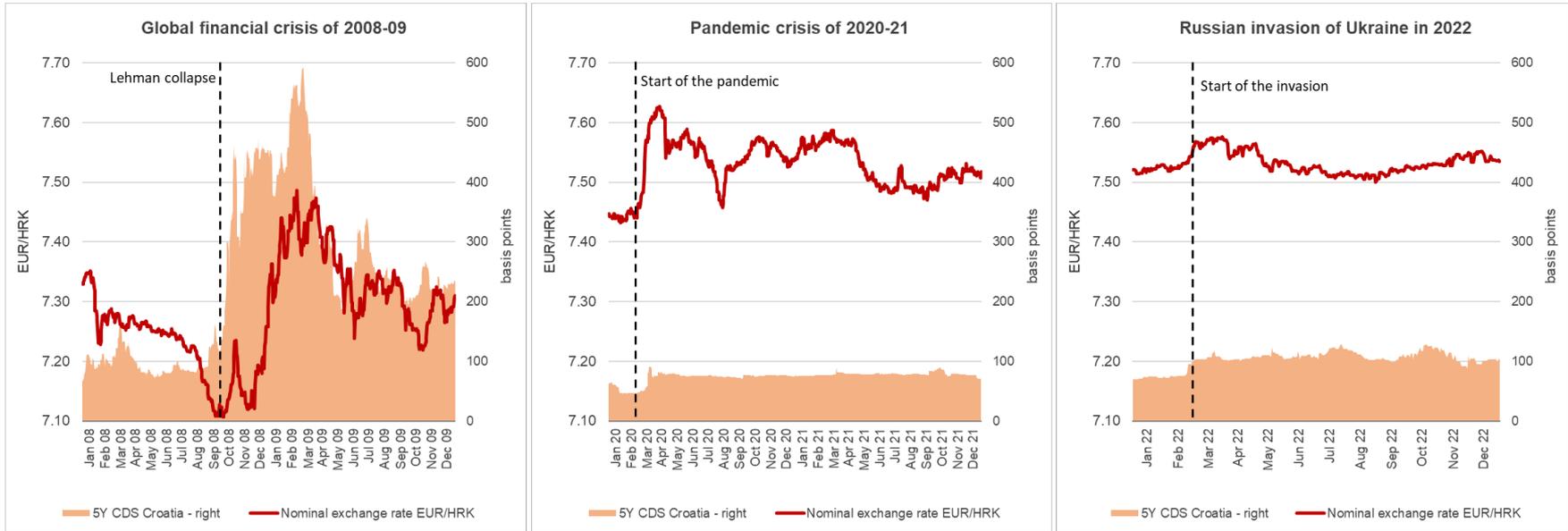
Source: Eurostat

Benefits (4): Greater resilience to financial crises

- Financial stability risks are significantly lower after the adoption of the euro:
 - the elimination of FX risk for borrowers led to increased resilience of the overall economy
 - FX-induced credit risk is eliminated as virtually all loans are now in domestic currency (**99,6%**)
 - almost all deposits (**94%**) are in domestic currency, which simplifies liquidity risk management in banks
 - as part of the Eurosystem, HNB can react more forcefully in case of turmoil – LOLR in full capacity
 - a harmful currency depreciation no longer possible
 - the government can borrow from the ESM in case of financial difficulties

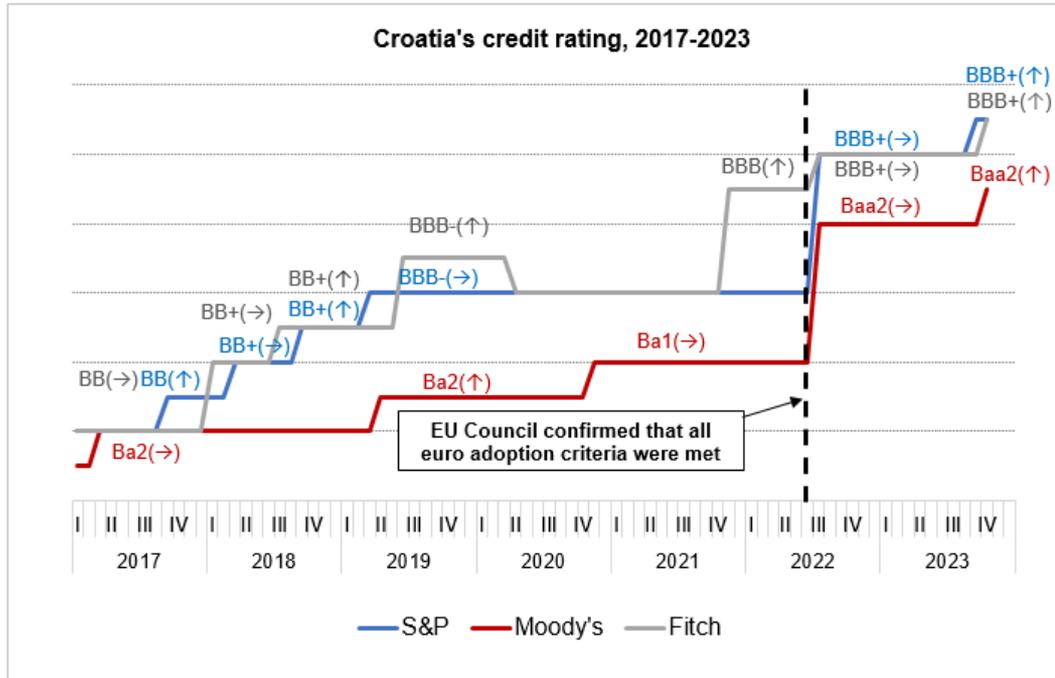


Benefits (4): Greater resilience to financial crises (cont.)



Sources: CNB; Bloomberg

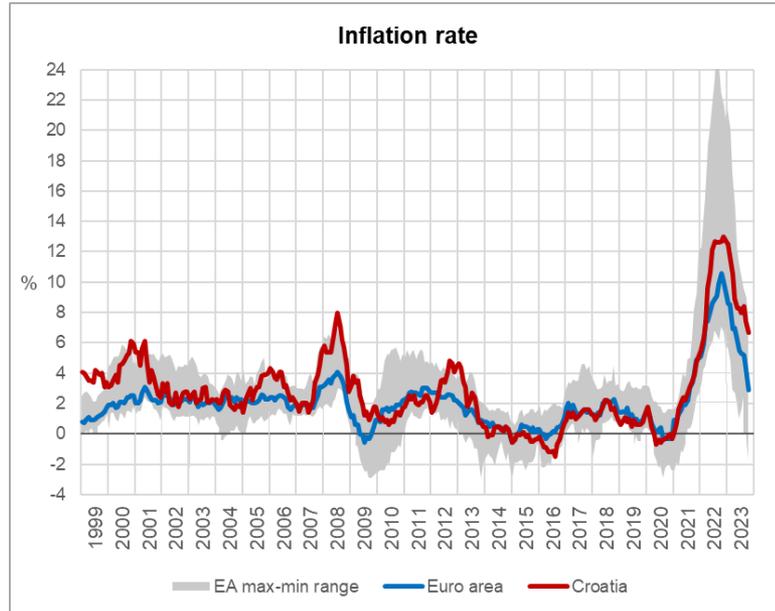
Euro adoption has reflected positively on the credit rating



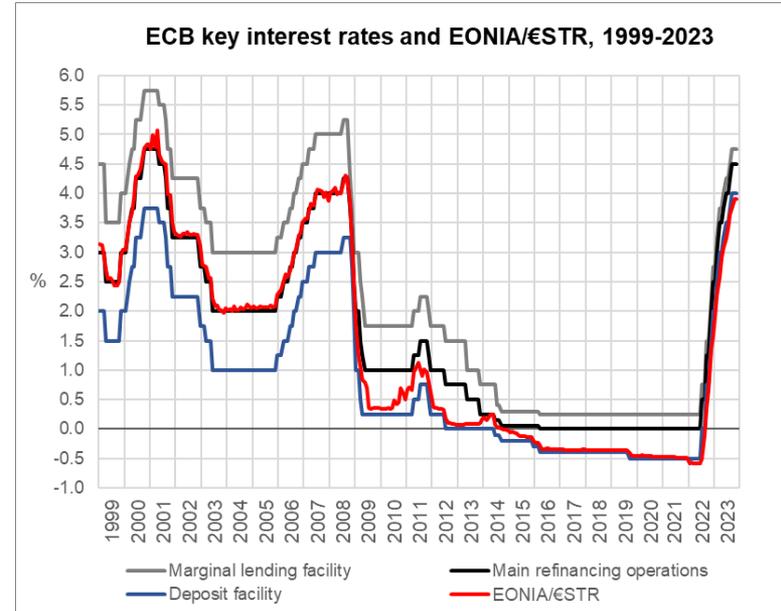
Source: HNB

- Recent economic developments

Croatia adopted the euro in a period of unusually high inflation and an increasingly tight monetary policy

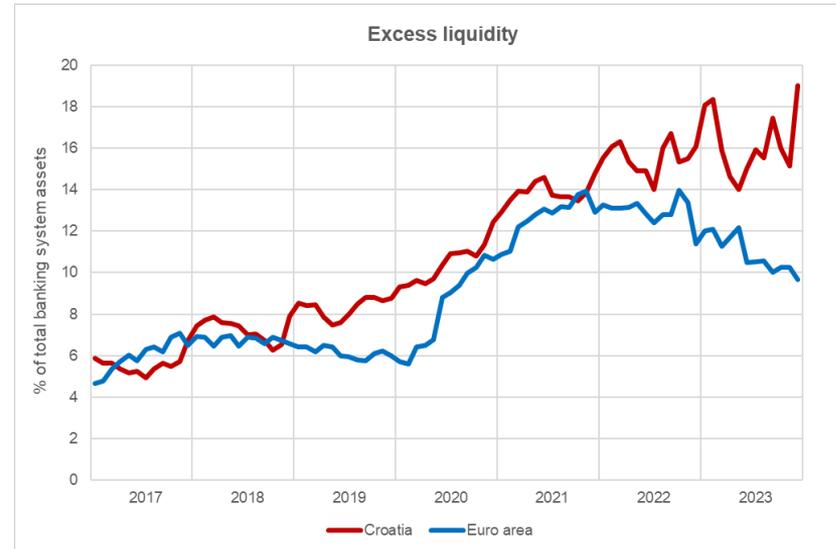
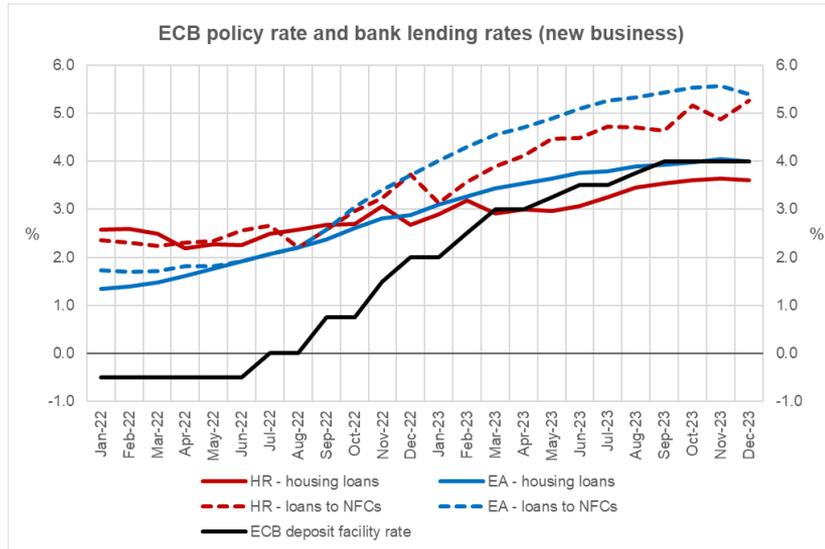


Source: ECB

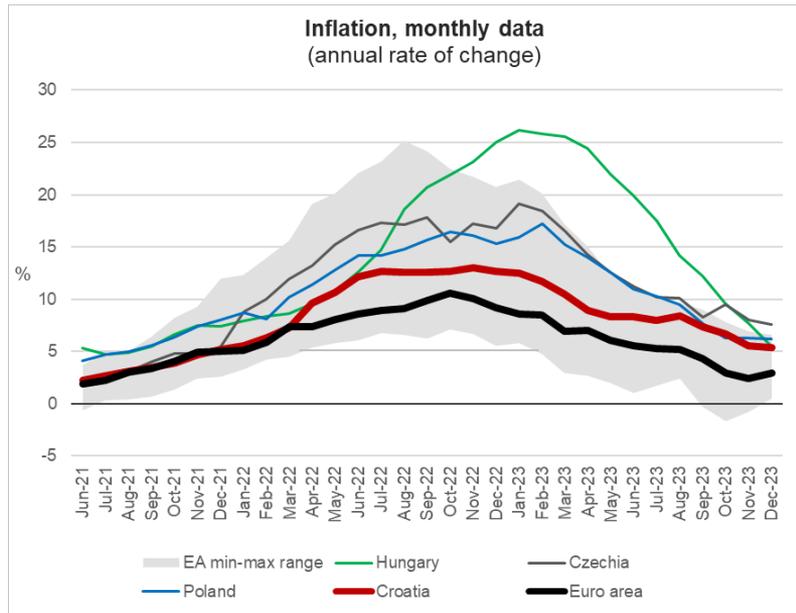


Source: ECB

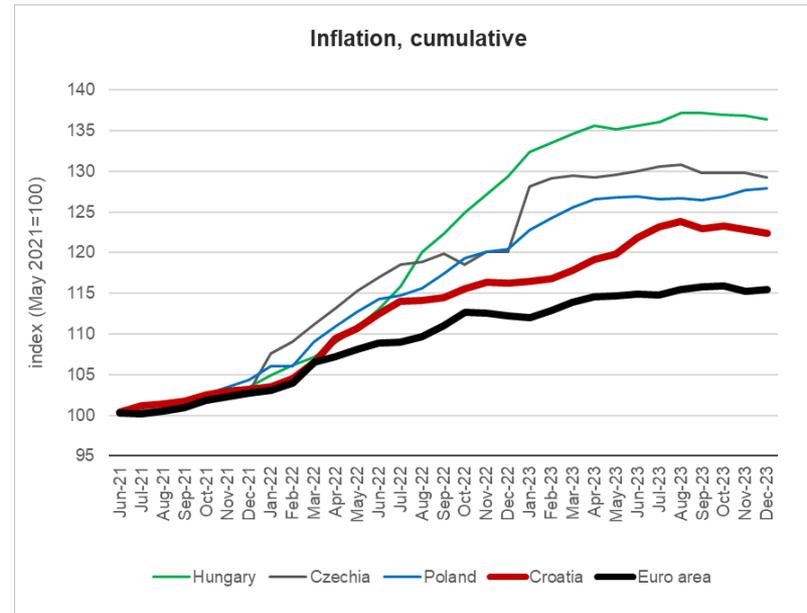
The pass-through of ECB policy rate hikes to bank lending rates has been weaker than in other EA countries



Inflation rate is higher than the euro area average, but lower than in CEE non-EA peer countries

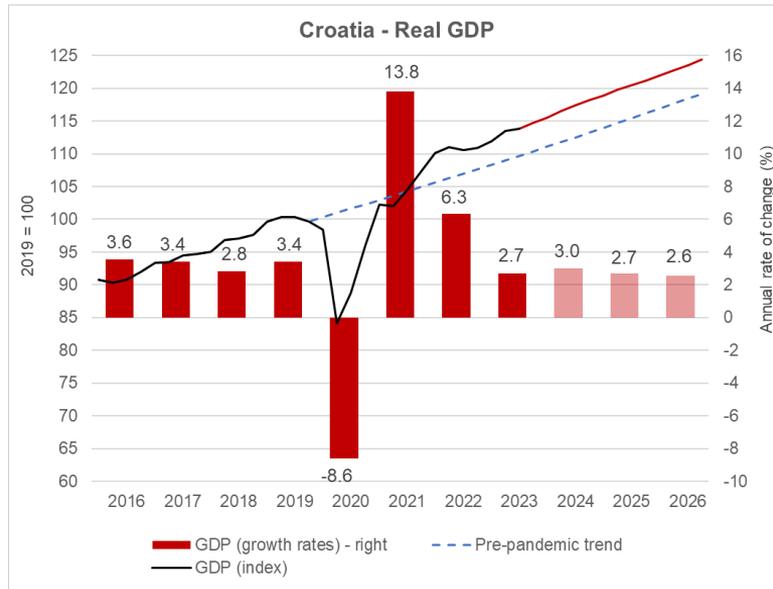


Source: Eurostat

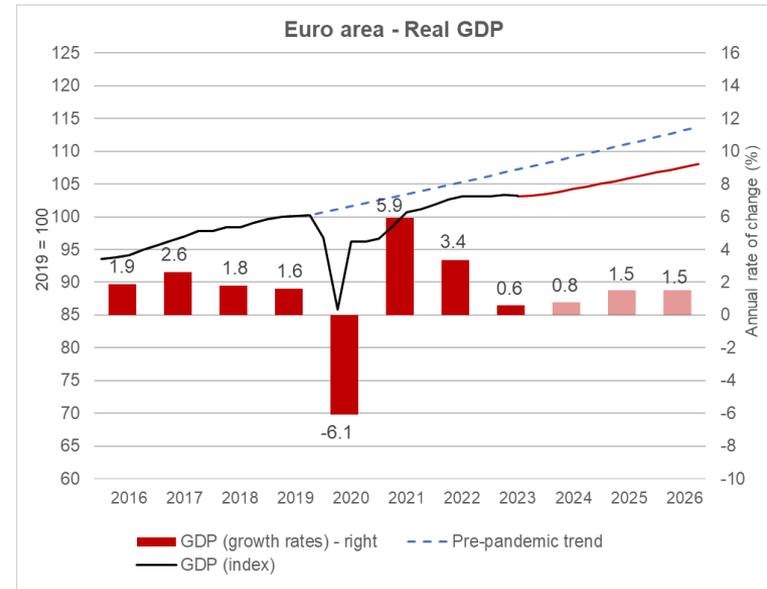


Source: Eurostat

Croatia continues to report solid GDP growth despite the recent slowdown in the euro area

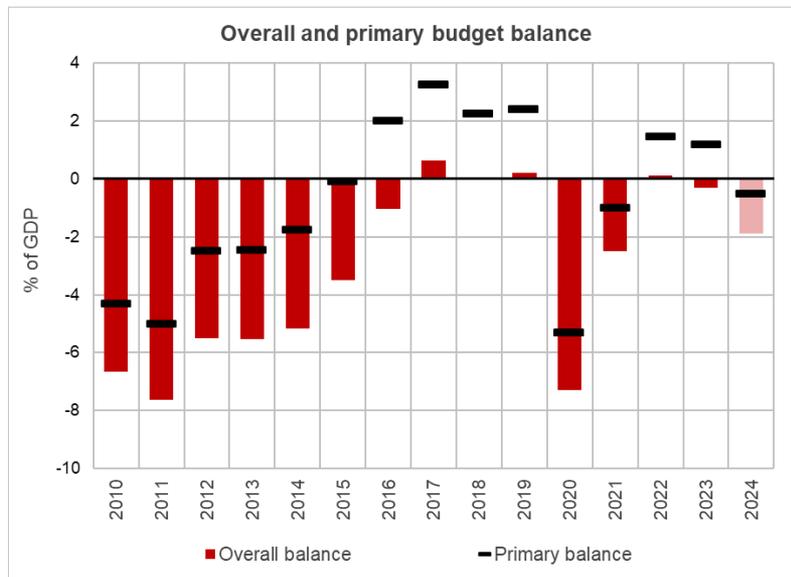


Source: CBS, HNB

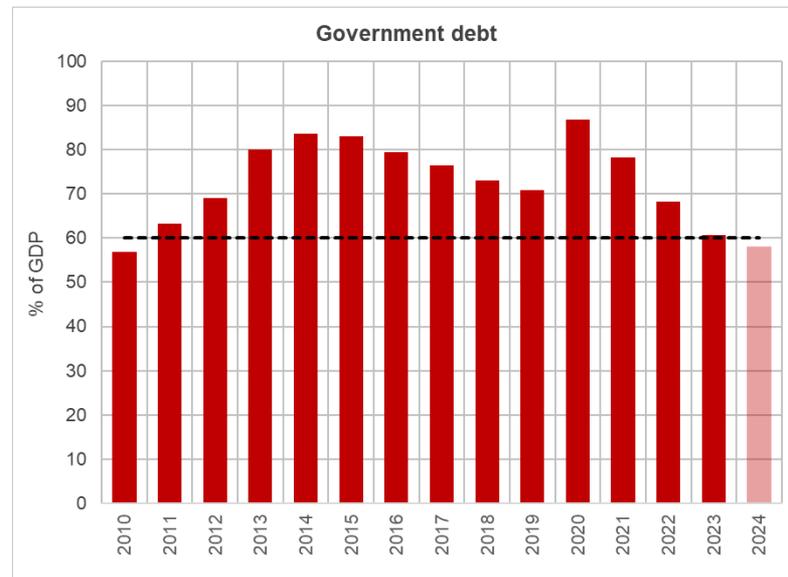


Source: ECB

Fiscal imbalances have narrowed substantially in recent years supported by solid GDP growth and elevated inflation



Sources: CBS, Ministry of Finance



Sources: CBS, Ministry of Finance

Lessons from Croatia's experience

- **Strong ownership of the process**, based on a clear institutional setup, is key
 - detailed planning and close coordination with all major stakeholders required to ensure smooth transition to the euro
- **Practical preparations for the changeover** should be defined and executed in a timely manner
 - Croatia's experience is 2 years, but doable in 18 months before the €-day
- **Consumer protection measures are crucial** for the success of the project
 - dual display of prices (in force for 16 months in Croatia)
 - detailed price monitoring
 - a „Fair euro introduction campaign” or an „Ethical code”, inviting companies to act responsibly when recalculating prices; the campaign should be well publicized to have a better impact
- **Extensive communication campaign** to reach all parts of the society
 - communicate clearly to the public about the significant benefits of euro adoption
 - invite citizens to deposit excess cash into their bank accounts before €-day to facilitate the cash changeover (in Croatia, cash in circulation fell by 60% before € day)

Thank you
for your attention!

