



HNB



YEARS OF  
THE CROATIAN  
NATIONAL  
BANK



HNB

# Why Croatia Wants to Introduce the Euro?

Boris Vujčić, Governor

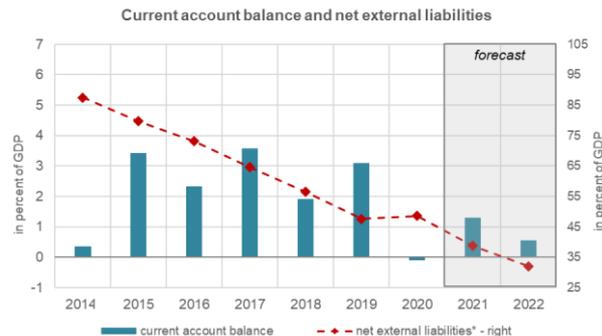
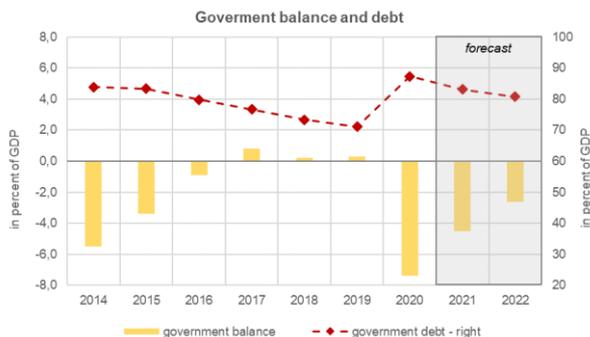
19 November 2021

# Introduction

- Croatia was a **latecomer** into the EU (1 July 2013)
  - ... but the first country to enter under the new negotiating framework
  - ... entering at the same time when the EU was going through a major overhaul of its economic and financial architecture
- Euro introduction, since then, has been the **next natural step** for Croatia
- The process of euro introduction, however, has become **more complex** since the global financial/Eurozone debt crisis
  - prior to ERM II entry, a country is expected to improve macroeconomic fundamentals (EDP and excessive macroeconomic imbalances) ...
  - ... and establish the close cooperation with the ECB ...
  - ... but also special attention is devoted to structural measures (pre-entry commitments), which are country specific (with one exception – the AML area)

## Introduction (cont.)

- Euro introduction is a multi-year project, which Croatia started in 2017 ...
  - with the publication of the Eurostrategy document ...
  - ... which included economic analysis of the pros and cons of the euro introduction for Croatia
  - in parallel, economic policy was firmly oriented towards the reduction of internal and external macroeconomic imbalances



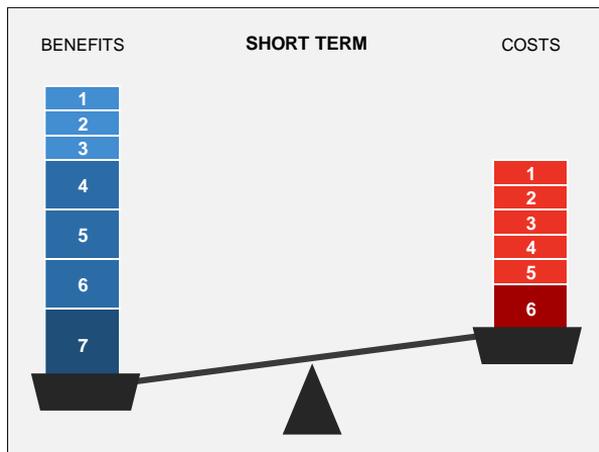
Note: Net external liabilities are equal to the net international investment position with the opposite sign  
Sources: HNB, DZS

## Introduction (cont.)

- ... with an aim to enter the ERM II
  - in July 2019 Croatia sent the Intention Letter signalling its dedication to enter ERM II in 12 months ...
  - ... which came with sufficiently improved macroeconomic fundamentals and an agreement on structural pre-entry policy measures
  - in July 2020 Croatia joined the ERM II, during the fully fledged pandemic crisis...(swap)
  - ... and at the same time the close cooperation between the HNB and the ECB was established
  
- that meant the intention to introduce the euro sooner rather than later
  - target date – 1 January 2023

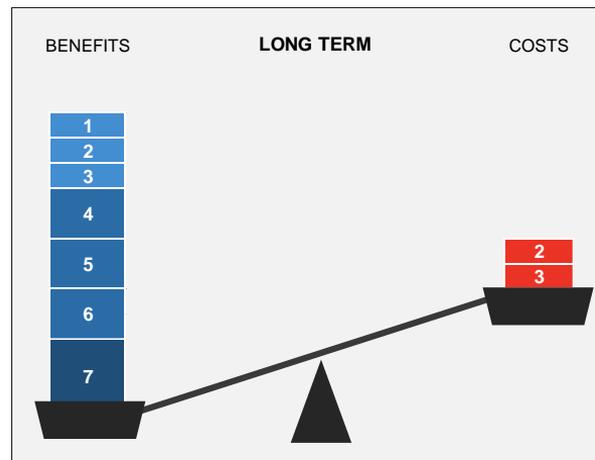
# Why?

## Benefits of adopting the euro will by far outweigh the costs ...



### Benefits of adopting the euro:

1	Lower transaction costs
2	Participation in the allocation of the Eurosystem's monetary income
3	Access to euro area financial assistance mechanisms
4	Reduction of borrowing costs
5	Stimulus to international trade and investment
6	Higher resilience to financial crises
7	Elimination of currency risk

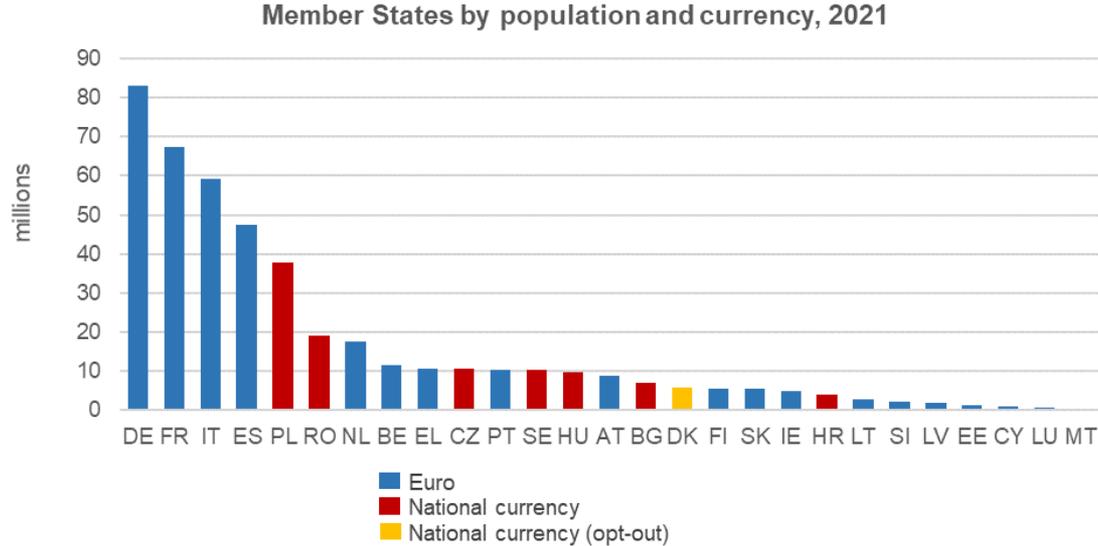


### Costs of adopting the euro:

1	Risk of a one-off price increase due to conversion
2	Loss of independent monetary policy
3	Risk of excessive capital inflows and accumulation of macroeconomic imbalances
4	One-off changeover costs
5	Transfer of funds to the European Central Bank
6	Transfer of funds to the European Stability Mechanism

... in particular due to three specific characteristics of the Croatian economy: (1) its size

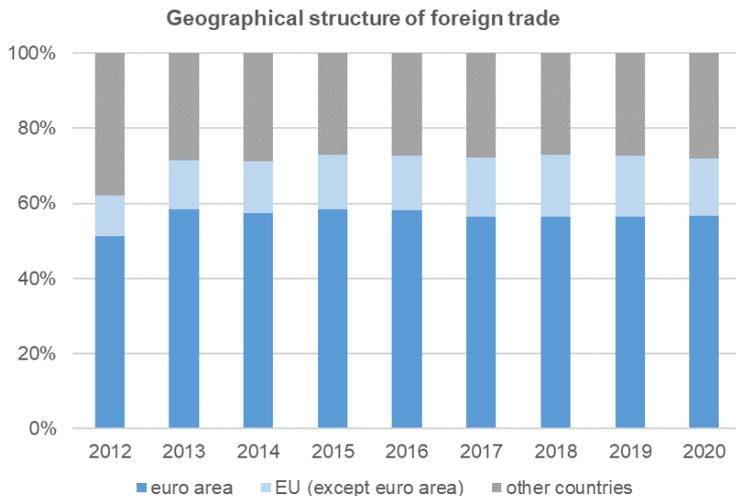
- Croatia is the smallest EU Member State that continues to use its own currency



Source: Eurostat

## ... (2) its trade and financial integration with the euro area

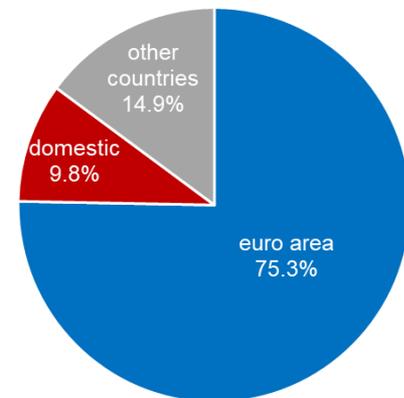
- Croatia is closely integrated with the euro area in terms of trade



Source: Eurostat

- Banks owned by institutions from the euro area dominate the Croatian banking system

Ownership structure of the banking system, in percentage of total banking system assets

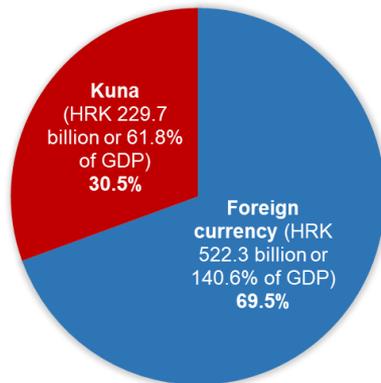


Source: HNB

## ... (3) and its level of euroization

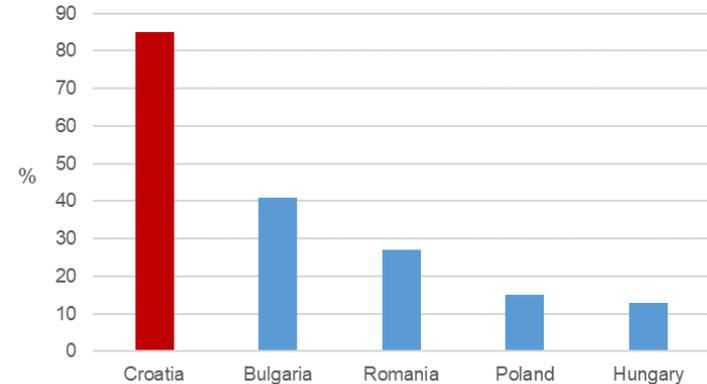
- Croatia is highly euroised which increases the benefits of eliminating currency risk
  - even a mild depreciation of the kuna would considerably increase the burden of debt repayments for households, companies and the government

Currency structure of domestic sectors' total debt



Source: HNB

Share of FC deposits in total time and savings deposits, 2020



Sources: national central banks, IMF

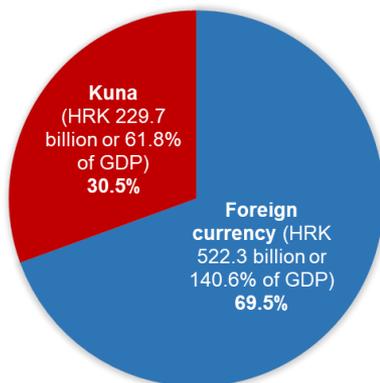
# Given these specifics, the loss of independent monetary policy is more theoretical than practical

- The loss of independent monetary policy may be reflected in:

## 1) Real exchange rate channel

- the maneuvering space of monetary policy is already limited due to high exposure to currency risk
- the exchange rate is kept stable and cannot be used as a tool for boosting competitiveness

Currency structure of domestic sectors' total debt

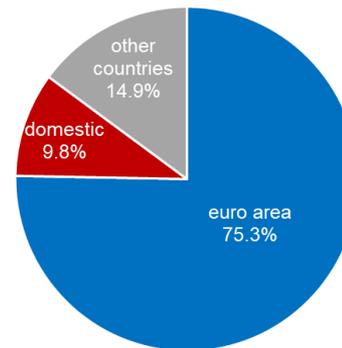


Source: HNB

## 2) Real interest rate channel

- Croatia is financially closely integrated into the euro area, with a high share of foreign ownership in its banking system, which makes it unable to conduct a fully independent monetary policy

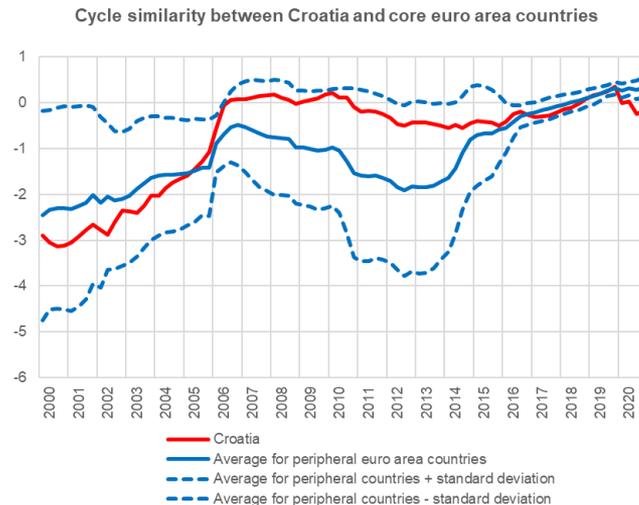
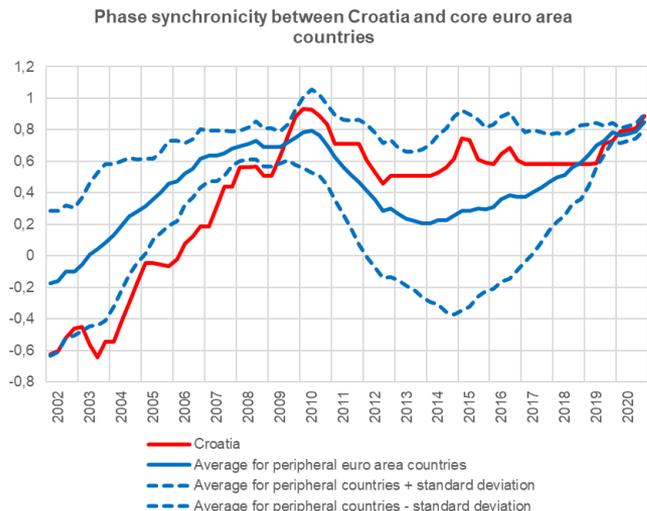
Ownership structure of the banking system, in percentage of total banking system assets



Source: HNB

# The ECB's monetary policy will most likely meet the needs of the Croatian economy, given the high level of correlation of business cycles...

*Croatia's business cycle is highly synchronized*

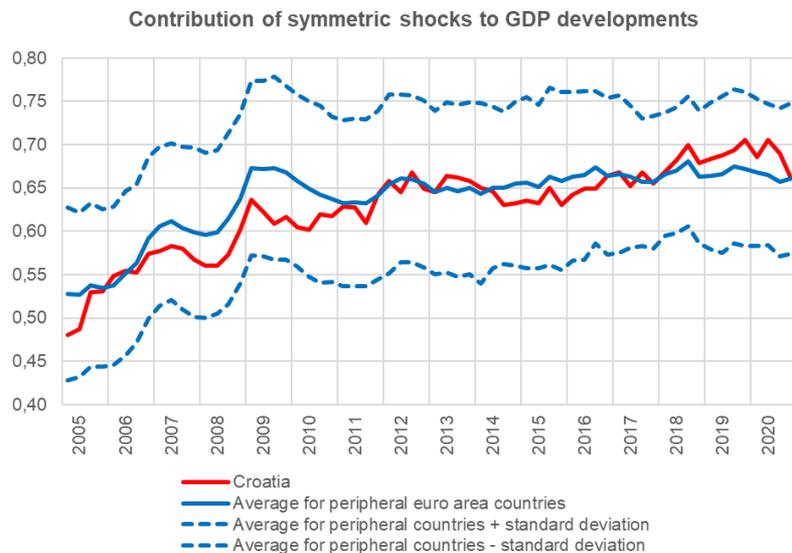


Note: Core euro area countries are Germany, France, Spain, Italy, the Netherlands, Belgium and Austria. Peripheral countries are all other euro area member states.

Source: HNB

## ... as well as the exposure to symmetric shocks

*Croatia and euro area Member States are exposed to similar shocks, with approximately symmetrical reactions of their economies*

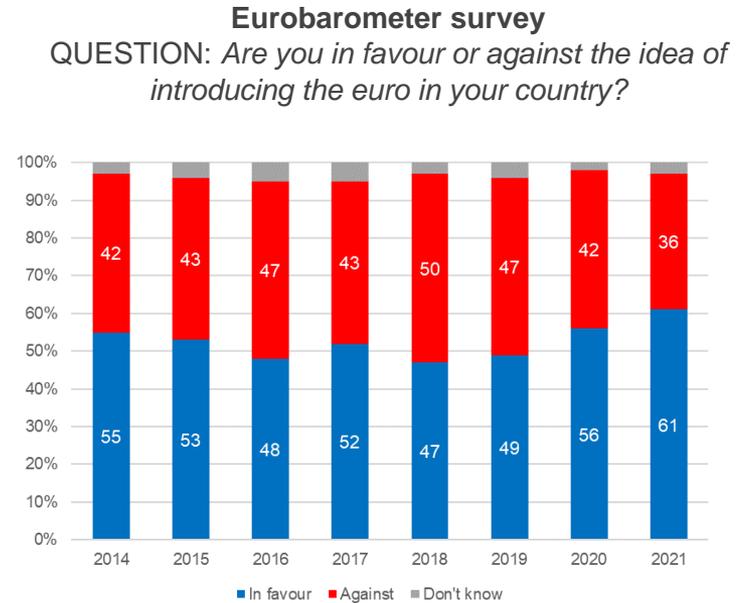


Note: Core euro area countries are Germany, France, Spain, Italy, the Netherlands, Belgium and Austria. Peripheral countries are all other euro area member states.

Source: HNB

## For euro introduction, besides economic rationale, public opinion also matters

- Support for the euro has been firm and is increasing in Croatia
  - tourism and euroization of the financial system are part of the explanation
  - a significant part of the population is concerned with the potential impact of euro introduction on prices, i.e. on their standard of living
  - continuous communication about the pros and cons of euro introduction



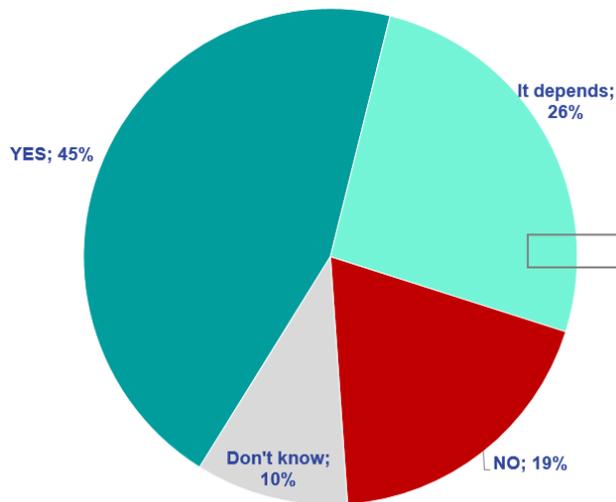
Sources: Flash Eurobarometer 400; 440; 465; 487; 492

Thank you for your attention!

## Surveys suggest that Croatian citizens, for the most part, support the introduction of the euro

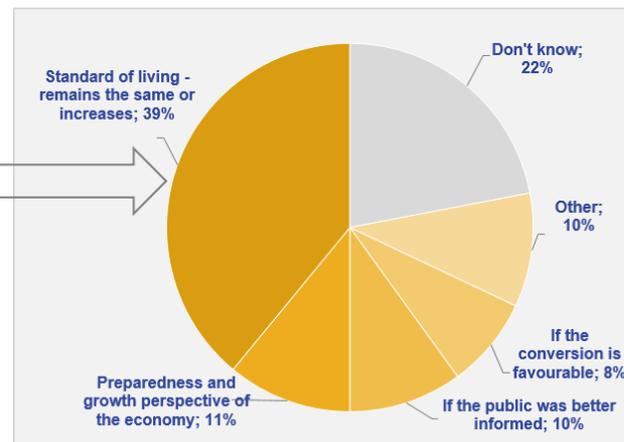
### IPSOS survey

QUESTION: *Do you support the introduction of the euro?*



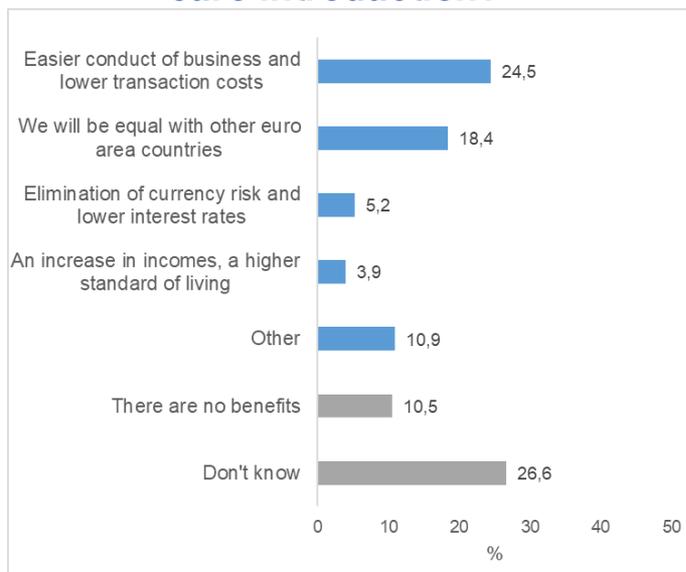
Source: Ipsos, March 2021

QUESTION: *In which circumstances would you support the introduction of the euro?*



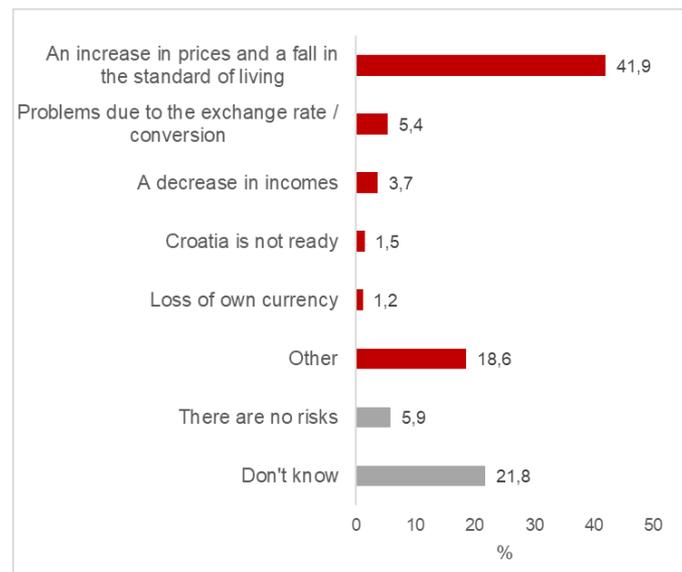
# The opinion of respondents on the greatest advantages and risks of the euro introduction

## What is the greatest advantage of euro introduction?

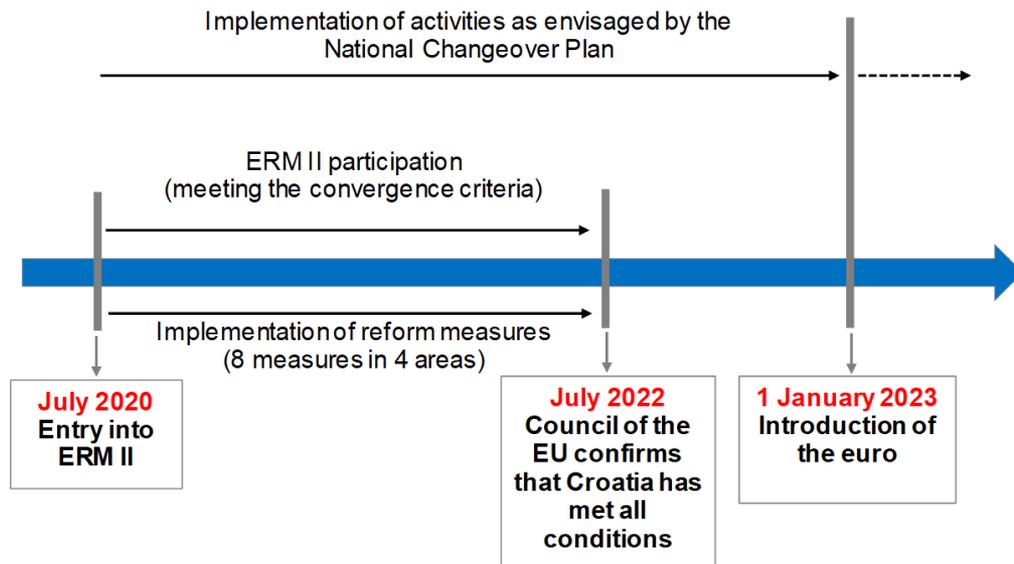


Source: Ipsos, March 2021

## What is the greatest risk of euro introduction?



# What remains to be done?



## Next steps (1): Implementing reform measures and meeting the nominal convergence criteria

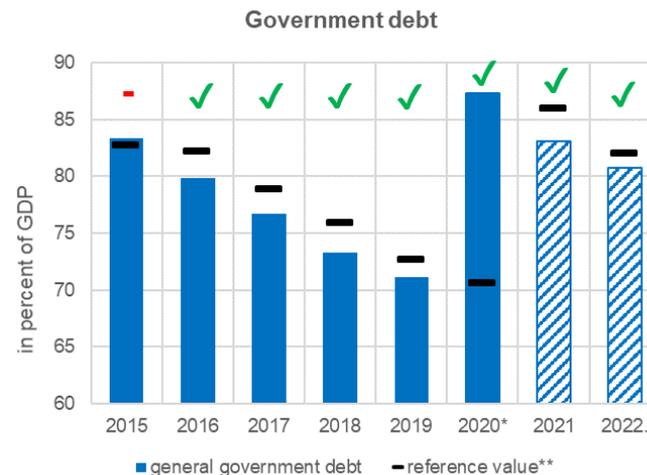
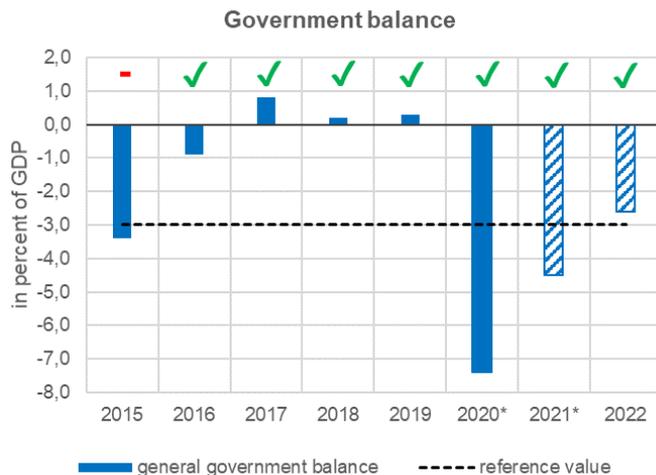
- There are 8 measures in 4 areas (post-entry commitments) to be implemented by the spring of 2022
  - the anti-money laundering framework
  - the administrative and financial burden for the economy
  - the corporate governance of SOE's
  - the insolvency framework
  
- Based on the current economic forecast, we expect to meet all the nominal convergence criteria

	2013	2014	2015	2016	2017	2018	2019	2020	2021 (forecast)	2022 (forecast)
Price stability	-	+	+	+	+	+	+	+	+	+
Exchange rate stability* (participation in ERM II)	(+)	(+)	(+)	(+)	(+)	(+)	(+)	+	+	+
Government balance	-	-	-	+	+	+	+	+	+	+
Government debt	-	-	-	+	+	+	+	+	+	+
Long term interest rates	+	+	+	+	+	+	+	+	+	+

Note: By 2019, the exchange rate stability criterion was marked with "(+)", which means that the criterion was met de facto, but not de jure given that the Croatian kuna entered ERM II only in July 2020.

Sources: Eurostat; HNB; MoF

# The adverse impact of the pandemic on fiscal indicators and the temporary suspension of fiscal rules



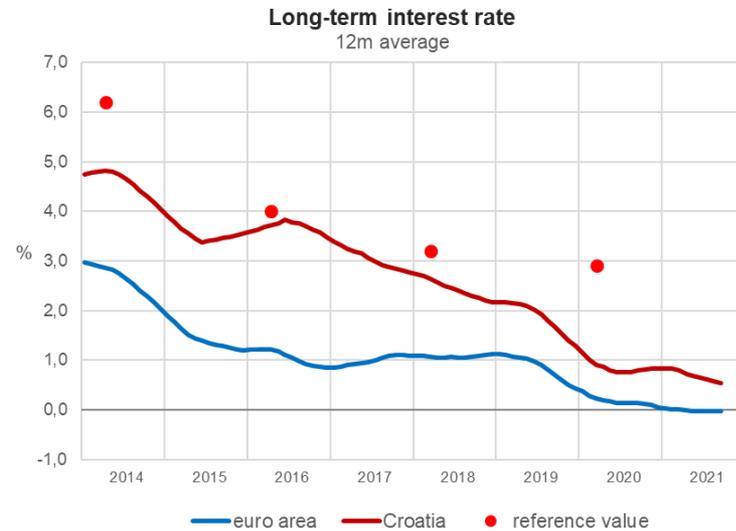
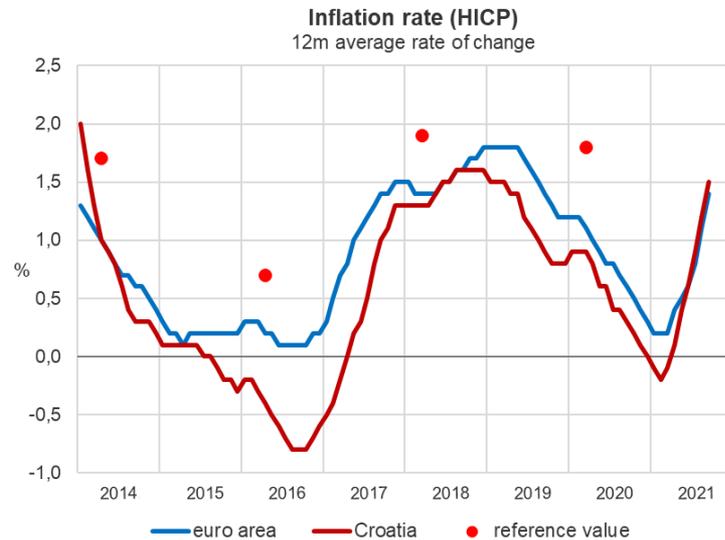
## Notes:

\* The budget balance and government debt in 2020, as well as the budget balance in 2021, are marked with „✓” because the European Commission decided in March 2020 to suspend the fiscal rules (the "general escape clause" was activated), allowing Member States to temporarily exceed the reference values for fiscal indicators without being subject to the corrective mechanism (the Excessive Deficit Procedure, EDP).

\*\* The reference value for the government debt criterion for the current year is equal to the value of the government debt-to-GDP ratio at the end of the previous year minus 1/20th of the difference between the government debt-to-GDP ratio at the end of the previous year and 60% of GDP.

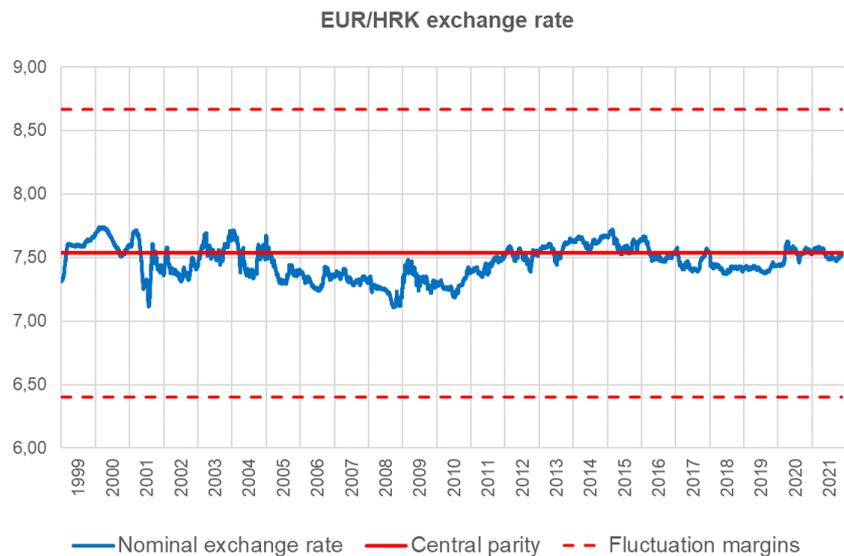
Sources: HNB, Ministry of Finance

# The pandemic will not affect compliance with price stability and long-term interest rates criteria



Source: Eurostat

The exchange rate will remain close to the central parity until the introduction of the euro



Source: HNB

## Next steps (2): **The National Changeover Plan**

- The Changeover Plan was adopted by the Government in December 2020
  - it was prepared jointly by the Croatian Government and the Croatian National Bank
- The Changeover Plan sets out practical steps for the introduction of the euro:
  - how the procurement and distribution of euro cash will be organized, including the selection of the national sides of coins and the minting of the necessary volumes of euro and cent coins
  - when and where the public will be able to exchange kuna banknotes and coins for euros
  - how kuna deposits and loans, as well as other financial instruments will be converted
  - how interest rates will be adjusted
  - the rules for recalculating prices
  - the measures to be taken to protect consumers against unjustified price increases
  - how the national legal framework will be amended to provide for the new official currency