



EUROPEAN CENTRAL BANK

EUROSYSTEM

Convergence Report

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1 Introduction

The euro has already been introduced in 20 of the 27 EU Member States. This report examines six of the seven Member States that have yet to adopt the single currency, namely Bulgaria, Czech Republic, Hungary, Poland, Romania and Sweden. These countries are committed under the Treaty on the Functioning of the European Union (hereinafter the “Treaty”) to adopt the euro, which implies that they must strive to fulfil all the convergence criteria.¹ The seventh Member State, Denmark, in 1992 notified the Council of the European Union (EU Council) of its intention not to participate in Stage Three of Economic and Monetary Union (EMU).² This means that Convergence Reports need only be provided for Denmark if it so requests. Given that no such request has been submitted, Denmark is not covered in this report.

In producing this report, the ECB fulfils its requirement under Article 140 of the Treaty. Article 140 states that at least once every two years, or at the request of an EU Member State with a derogation, the ECB and the European Commission must report to the EU Council “on the progress made by the Member States with a derogation in fulfilling their obligations regarding the achievement of economic and monetary union”. The six countries under review in this report have been examined as part of the regular two-year cycle. The European Commission has also prepared a report, and both reports are being submitted to the EU Council in parallel.

In this report, the ECB uses the framework applied in its previous Convergence Reports. It examines, for the six countries concerned, whether a high degree of sustainable economic convergence has been achieved, whether the national legislation is compatible with the Treaties and the Protocol on the Statute of the European System of Central Banks and of the European Central Bank (hereinafter the “Statute of the ESCB”), and whether the statutory requirements are fulfilled for the relevant national central bank (NCB) to become an integral part of the Eurosystem.

The examination of the economic convergence process is highly dependent on the quality and integrity of the underlying statistics. The compilation and reporting of statistics must not be subject to political considerations or interference. EU Member States have been invited to consider the quality and integrity of their statistics as a matter of high priority, to ensure that a proper system of checks and balances is in place when these statistics are compiled, and to apply minimum standards in the domain of statistics. These standards are of the utmost importance in reinforcing the independence, integrity and accountability of the national statistical institutes and in supporting confidence in the quality of government finance statistics (see Chapter 6).

¹ Unless otherwise stated, all references in this report to the “Treaty” refer to the Treaty on the Functioning of the European Union, and the references to article numbers reflect the numbering in effect since 1 December 2009. Unless otherwise stated, all references in this report to the “Treaties” refer to both the Treaty on European Union and the Treaty on the Functioning of the European Union. These terms are also explained in the [ECB’s glossary](#).

² When the Maastricht Treaty was concluded in 1992, Denmark was granted an exemption clause or “opt-out” under which it does not have to participate in the third stage of EMU and, therefore, introduce the euro.

From 4 November 2014 it became mandatory for any EU Member State whose derogation is abrogated to join the Single Supervisory Mechanism (SSM) at the latest on the date on which it adopts the euro.³ At that point, all SSM-related rights and obligations start to apply to that country. Therefore, it is of the utmost importance that the necessary preparations are made. In particular, the banking system of any Member State joining the euro area, and therefore the SSM, is subject to a comprehensive assessment.⁴ Bulgaria is currently the only Member State that participates in the SSM under the close cooperation established with the ECB as part of the country's commitment to joining the banking union and the exchange rate mechanism (ERM II) simultaneously.⁵ The close cooperation framework with Българска народна банка (Bulgarian National Bank) entered into force on 1 October 2020, following the fulfilment of the necessary supervisory and legislative prerequisites. On that date, the ECB assumed responsibility for (i) the direct supervision of the significant institutions in Bulgaria, (ii) the common procedures for all supervised entities, and (iii) the oversight of less significant institutions, which continue to be supervised by the national supervisor. ECB Banking Supervision and Българска народна банка (Bulgarian National Bank) collaborated very closely to ensure the smooth integration of the national competent authority into the SSM.⁶

This report is structured as follows. Chapter 2 describes the framework used for the examination of economic and legal convergence. Chapter 3 provides a horizontal overview of the key aspects of economic convergence. Chapter 4 contains the country summaries, which provide the main results of the examination of economic and legal convergence. Chapter 5 examines in more detail the state of economic convergence in each of the six EU Member States under review. Chapter 6 provides an overview of the convergence indicators and the statistical methodology used to compile them. Finally, Chapter 7 examines the compatibility of the national legislation of the Member States under review, including the statutes of their NCBs, with Articles 130 and 131 of the Treaty.

³ On 4 November 2014 the ECB assumed the tasks conferred on it by [Council Regulation \(EU\) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions](#) (OJ L 287, 29.10.2013, p.63). See Article 33(2) of that Regulation.

⁴ See recital 10 of [Regulation \(EU\) No 468/2014 of the European Central Bank of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities \(SSM Framework Regulation\)](#) (ECB/2014/17) (OJ L 141, 14.5.2014, p.1).

⁵ See [Decision \(EU\) 2020/1015 of the European Central Bank of 24 June 2020 on the establishment of close cooperation between the European Central Bank and Българска народна банка \(Bulgarian National Bank\)](#) (ECB/2020/30) (OJ L 224I, 13.7.2020, p. 1).

⁶ See the [ECB Annual Report on supervisory activities 2020](#), in particular Section 4.1 "Enlarging the SSM through close cooperation".

2 Framework for analysis

2.1 Economic convergence

To examine the state of economic convergence in EU Member States seeking to adopt the euro, the ECB makes use of a common framework for analysis. This common framework, which has been applied in a consistent manner in all European Monetary Institute (EMI) and ECB Convergence Reports, is based, first, on the Treaty provisions and their application by the ECB with regard to developments in prices, fiscal balances and debt ratios, exchange rates and long-term interest rates, as well as in other factors relevant to economic integration and convergence. Second, it is based on a range of additional backward and forward-looking economic indicators considered to be useful for examining the sustainability of convergence in greater detail. Some elements of this framework have been enhanced over time. The examination of the Member State concerned based on all these factors also provides important information which helps to ensure that its integration into the euro area will proceed without major difficulties. Boxes 1 to 5 below outline the legal provisions and provide methodological details on the application of these provisions by the ECB.

This report builds on principles set out in previous reports published by the ECB in order to ensure continuity and equal treatment. In particular, a number of guiding principles are used by the ECB (and prior to that by the EMI) in the application of the convergence criteria. First, the individual criteria are interpreted and applied in a strict manner. The rationale behind this principle is that the main purpose of the criteria is to ensure that only those Member States with economic conditions conducive to the maintenance of price stability and the coherence of the euro area can participate in it. Second, the convergence criteria constitute a coherent and integrated package, and they must all be satisfied. The Treaty lists the criteria on an equal footing and does not suggest a hierarchy. Third, the convergence criteria have to be met on the basis of actual data rather than forecasts. Fourth, the application of the convergence criteria should be consistent, transparent and simple. Moreover, when considering compliance with the convergence criteria, sustainability is an essential factor, as convergence must be achieved on a lasting basis and not just at a given point in time. For this reason, the country examinations elaborate on the sustainability of convergence.

In this respect, economic developments in the countries concerned are reviewed from a backward-looking perspective, covering, in principle, the past ten years. This helps to better determine the extent to which current achievements are the result of genuine structural adjustments, which in turn should lead to a better assessment of the sustainability of economic convergence.

In addition, and to the extent appropriate, a forward-looking perspective is adopted. In this context, particular attention is paid to the fact that the sustainability of favourable economic developments hinges critically on appropriate and lasting policy responses to existing and future challenges. Strong governance, sound institutions

and sustainable public finances are also essential for supporting price stability and sustainable output growth over the medium to long term. Overall, it is emphasised that ensuring the sustainability of economic convergence depends on the achievement of a strong starting position, the existence of sound institutions, resilience to shocks and the pursuit of appropriate policies after the adoption of the euro.

The common framework is applied individually to the six EU Member States under review. These examinations, which focus on each Member State's performance, should be considered separately, in line with the provisions of Article 140 of the Treaty.

The cut-off date for the statistics included in this Convergence Report was 19 June 2024. The statistical data used in the application of the convergence criteria are provided by the European Commission (see Chapter 6 as well as the tables and charts), in cooperation with the ECB in the case of exchange rates and long-term interest rates. In agreement with the Commission, the reference period for both the price stability criterion and the long-term interest rate criterion is from June 2023 to May 2024. For exchange rates, the reference period is from 20 June 2022 to 19 June 2024. Historical data on fiscal positions cover the period up to 2023. Account is also taken of forecasts from various sources and other information relevant to a forward-looking examination of the sustainability of convergence. The Commission's [Spring 2024 Economic Forecast](#) and its [Alert Mechanism Report 2024](#), which are also taken into account in this report, were released on 15 May 2024 and 21 November 2023 respectively. This report was adopted by the General Council of the ECB on 21 June 2024.

This Convergence Report also considers the impact of the Russian war of aggression against Ukraine on the convergence assessment. In 2021 energy prices, particularly for gas, had already started to rise very strongly, owing in part to Russia restricting gas supplies to Europe. Its invasion of Ukraine in late February 2022 then exacerbated the surge in energy and food prices, causing sizeable fiscal pressures, trade disruptions and increased uncertainty. These developments hit the EU as it was still recovering from the effects of the COVID-19 pandemic. Countries with higher energy dependence on and stronger previous trade links with Russia were affected more than others. Given the relatively short time span, it is difficult to draw firm conclusions about the impact on the medium to long-term convergence path, which also depends on the future evolution of Russia's war against Ukraine and further geopolitical developments. The forward-looking part of the convergence assessment is therefore subject to greater uncertainty than usual.

With regard to price developments, the legal provisions and their application by the ECB are outlined in Box 1.

Box 1

Price developments

1. Treaty provisions

Article 140(1), first indent, of the Treaty requires the Convergence Report to examine the achievement of a high degree of sustainable convergence by reference to the fulfilment by each Member State of the following criterion:

“the achievement of a high degree of price stability; this will be apparent from a rate of inflation which is close to that of, at most, the three best performing Member States in terms of price stability”.

Article 1 of Protocol (No 13) on the convergence criteria stipulates that:

“The criterion on price stability referred to in the first indent of Article 140(1) of the Treaty on the Functioning of the European Union shall mean that a Member State has a price performance that is sustainable and an average rate of inflation, observed over a period of one year before the examination, that does not exceed by more than 1½ percentage points that of, at most, the three best performing Member States in terms of price stability. Inflation shall be measured by means of the consumer price index on a comparable basis taking into account differences in national definitions”.

2. Application of Treaty provisions

In the context of this report, the ECB applies the Treaty provisions as outlined below.

First, with regard to “an average rate of inflation, observed over a period of one year before the examination”, the inflation rate has been calculated using the change in the 12-month average of the HICP in the reference period from June 2023 to May 2024 compared with the previous 12-month average. Inflation has been measured on the basis of the HICP, which was developed for the purpose of assessing convergence in terms of price stability on a comparable basis (see Section 6.2). Second, the notion of “at most, the three best performing Member States in terms of price stability”, which is used for the definition of the reference value, has been applied by taking the unweighted arithmetic average of the rates of inflation of the three Member States with the lowest average inflation rates (excluding outliers).

It should be noted that the concept of “outlier” has been referred to in previous ECB Convergence Reports as well as in the Convergence Reports of the EMI. In line with those reports, a Member State is considered to be an outlier if two conditions are fulfilled: first, its 12-month average inflation rate is significantly below the euro area average; and, second, its price developments have been strongly affected by exceptional factors. The identification of outliers does not follow a mechanical approach. The outlier concept was introduced to deal appropriately with potential significant distortions in the inflation developments of individual countries that reduce the representativeness of the inflation rates in those countries as a benchmark for convergence.

The ECB’s approach to identifying outliers in this report is in line with the approach followed in previous ECB Convergence Reports. In some cases, the identification of outliers may be a close call. The same methodology can lead to slightly different outcomes, depending, for example, on the way in which exceptional factors are interpreted.

The inflation rate of Finland was excluded from the calculation of the reference value. Price developments in this country over the reference period resulted in a 12-month average inflation rate of 1.9% in May 2024. Finland was treated as an outlier for the calculation of the reference value in this report because its inflation rate was significantly lower than the euro area average over the reference period and this was due to exceptional factors. In particular, the relatively subdued inflation developments in Finland reflect an [adjustment of the price index for electricity](#) implemented by Statistics Finland to correct an earlier double-counting error. The correction was introduced in August 2023, reducing the year-on-year HICP inflation rate by an estimated 0.7 percentage points.

On this basis, for the purposes of this report, the three best performing Member States in terms of price stability, excluding outliers, are therefore Belgium (1.9%), Denmark (1.1%) and the Netherlands (2.5%). Adding 1½ percentage points to the average of these three rates, the reference value for the price stability criterion is 3.3%.

It should be stressed that under the Treaty a country's inflation performance is examined in relative terms, i.e. against that of other Member States. The price stability criterion thus takes into account the fact that common shocks (stemming, for example, from global commodity prices) can temporarily drive inflation rates away from central banks' targets.

It should be acknowledged that it would also be possible to consider Belgium and Denmark as outliers given that the 12-month average inflation rates in these countries were significantly below the euro area average in May 2024 (by 1.5 and 2.3 percentage points respectively). The large difference in inflation dynamics vis-à-vis the euro area in these countries mainly resulted from stronger declines in the HICP energy component, owing to a faster pass-through from wholesale to retail energy prices, which mainly reflected specific characteristics of energy contracts.

In this report, the ECB does not treat Belgium and Denmark as outliers, because it does not consider country-specific differences in the pass-through of international energy prices to domestic energy prices as exceptional factors in so far as these reflect structural differences in the energy markets of Member States. The determination of best performing Member States for the June 2024 Convergence Report is without prejudice to the preparation of future Convergence Reports.

The average rate of HICP inflation over the 12-month reference period from June 2023 to May 2024 is reviewed in the light of the country's economic performance over the last ten years in terms of price stability. This allows a more detailed examination of the sustainability of price developments in the country under review. In this connection, attention is paid to the orientation of monetary policy, in particular to whether the focus of the monetary authorities has been primarily on achieving and maintaining price stability, as well as to the contribution of other areas of economic policy to this objective. Moreover, the implications of the macroeconomic environment for the achievement of price stability are taken into account. Price developments are examined in the light of supply and demand conditions, focusing on factors such as unit labour costs and import prices. Finally, trends in other relevant price indices are considered. From a forward-looking perspective, a view is provided of prospective inflationary developments in the coming years, including forecasts by major international organisations and market participants. Moreover, institutional and

structural aspects relevant to maintaining an environment conducive to price stability after adoption of the euro are discussed.

With regard to fiscal developments, the legal provisions and their application by the ECB, together with procedural issues, are outlined in Box 2.

Box 2

Fiscal developments

1. Treaty and other legal provisions

Article 140(1), second indent, of the Treaty requires the Convergence Report to examine the achievement of a high degree of sustainable convergence by reference to the fulfilment by each Member State of the following criterion:

“the sustainability of the government financial position; this will be apparent from having achieved a government budgetary position without a deficit that is excessive as determined in accordance with Article 126(6)”.

Article 2 of Protocol (No 13) on the convergence criteria stipulates that:

“The criterion on the government budgetary position referred to in the second indent of Article 140(1) of the said Treaty shall mean that at the time of the examination the Member State is not the subject of a Council decision under Article 126(6) of the said Treaty that an excessive deficit exists”.

Article 126 sets out the excessive deficit procedure (EDP). In accordance with Article 126(2) and (3), the European Commission prepares a report if a Member State does not fulfil the requirements for fiscal discipline, in particular if:

1. the ratio of the planned or actual government deficit to GDP exceeds a reference value (defined in the Protocol on the EDP as 3% of GDP), unless either:
 - (a) the ratio has declined substantially and continuously and reached a level that comes close to the reference value; or, alternatively,
 - (b) the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value;
2. the ratio of government debt to GDP exceeds a reference value (defined in the Protocol on the EDP as 60% of GDP), unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace.

In addition, the report prepared by the Commission must take into account whether the government deficit exceeds government investment expenditure and all other relevant factors, including the medium-term economic and budgetary position of the Member State. The Commission may also prepare a report if, notwithstanding the fulfilment of the criteria, it is of the opinion that there is a risk of an excessive deficit in a Member State. The Economic and Financial Committee formulates an opinion on the Commission's report. Finally, in accordance with Article 126(6), the EU Council, on the basis of a recommendation from the Commission and having considered any observations which the Member State concerned may wish to make, decides, acting by qualified majority and excluding the

Member State concerned, and following an overall assessment, whether an excessive deficit exists in a Member State.

The Treaty provisions under Article 126 are further clarified by Regulation (EC) No 1467/97⁷ as amended by Regulations (EU) Nos 1177/2011⁸ and 2024/1264⁹, which, among other things:

- confirms the equal footing of the debt criterion with the deficit criterion by making the former operational;
- specifies the conditions under which a ratio of government debt to GDP which exceeds the reference value shall be considered sufficiently diminishing and approaching the reference value at a satisfactory pace in accordance with Article 126(2)(b) of the Treaty. The reformed EU fiscal framework modifies the conditions under which a ratio of government debt to GDP which exceeds the reference value shall be considered sufficiently diminishing and approaching the reference value at a satisfactory pace in accordance with Article 126(2)(b). Notably, Article 2(2) of the Regulation provides that the requirement shall be considered fulfilled if the Member State concerned respects its net expenditure path. The Commission shall prepare a report in accordance with Article 126(3) of the Treaty when the ratio of government debt to GDP exceeds the reference value, the budgetary position is not close to balance or in surplus and the deviations recorded in the control account of the Member State exceed either 0.3 percentage points of GDP annually or 0.6 percentage points of GDP cumulatively;
- details the relevant factors that the Commission shall take into account when preparing a report under Article 126(3) of the Treaty. Most importantly, it mentions a series of factors considered relevant in assessing developments in medium-term economic, budgetary and government debt positions (see Article 2(3) of the Regulation and, below, details on the ensuing ECB analysis).

2. Application of Treaty provisions

For the purpose of examining convergence, the ECB expresses its view on fiscal developments. With regard to sustainability, the ECB examines key indicators of fiscal developments from 2014 to 2023, the outlook and the challenges for general government finances, focusing on the links between deficit and debt developments. Regarding the impact of the pandemic and Russia's war against Ukraine on general government finances, the ECB refers to the Stability and Growth Pact's general escape clause, which was activated from 20 March 2020 until 31 December 2023. In particular, before the reform of April 2024, for the preventive arm, Articles 5(1) and 9(1) of Regulation (EC) No 1466/97¹⁰ stated that "in periods of severe economic downturn for the euro area or the Union as a whole, Member States may be allowed temporarily to depart from the adjustment path towards the medium-term budgetary objective..., provided that this does not endanger fiscal sustainability in the medium term". For the corrective arm, Article 3(5) of Regulation (EC) No 1467/97 stipulated that "in

⁷ Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure (OJ L 209, 2.8.1997, p. 6).

⁸ Council Regulation (EU) No 1177/2011 of 8 November 2011 amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure (OJ L 306, 23.11.2011, p. 33).

⁹ Council Regulation (EU) No 2024/1264 of 29 April 2024 amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure (OJ L, 2024/1264, 30.4.2024).

¹⁰ Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (OJ L 209, 2.8.1997, p.1).

the case of a severe economic downturn in the euro area or in the Union as a whole, the Council may also decide, on a recommendation from the Commission, to adopt a revised recommendation under Article 126(7) TFEU provided that this does not endanger fiscal sustainability in the medium term”, while Article 5(2) of Regulation (EC) No 1467/97 stipulated that “in the case of a severe economic downturn in the euro area or in the Union as a whole, the Council may also decide, on a recommendation from the Commission, to adopt a revised notice under Article 126(9) TFEU, on condition that this does not endanger fiscal sustainability in the medium term”. The ECB also provides an analysis with regard to the effectiveness of national budgetary frameworks, as was referred to in Article 2(3)(b) of Regulation (EC) No 1467/97 and in Directive 2011/85/EU¹¹. With regard to Article 126, the ECB, in contrast to the Commission, has no formal role in the EDP. Therefore, the ECB report only states whether the country is subject to an EDP.

With regard to the Treaty provision that a debt ratio of above 60% of GDP should be “sufficiently diminishing and approaching the reference value at a satisfactory pace”, the ECB examines past and future trends in the debt ratio. For Member States in which the debt ratio exceeds the reference value, the ECB provides the European Commission’s latest assessment of compliance with the debt reduction benchmark that was laid down in Article 2(1a) of Regulation (EC) No 1467/97.

The examination of fiscal developments is based on data compiled on a national accounts basis, in compliance with the European System of Accounts 2010 (ESA 2010) (see Chapter 6). Most of the figures presented in this report were provided by the Commission in April 2024 and include government financial positions from 2014 to 2023 as well as Commission forecasts for 2024-25.

With regard to the sustainability of public finances, the outcome in the reference year, 2023, is reviewed in the light of the performance of the country under review over the past ten years. First, the development of the deficit ratio is investigated. It is useful to bear in mind that the change in a country’s annual deficit ratio is typically influenced by a variety of underlying forces. These influences can be divided into “cyclical effects” on the one hand, which reflect the reaction of deficits to changes in the economic cycle, and “non-cyclical effects” on the other, which are often taken to reflect structural or permanent adjustments to fiscal policies. However, such non-cyclical effects, as quantified in this report, cannot necessarily be seen as entirely reflecting a structural change to fiscal positions, because they include temporary effects on the budgetary balance stemming from the impact of both policy measures and special factors.

As a further step, the development of the government debt ratio in this period is considered, as well as the factors underlying it. These factors are the difference between nominal GDP growth and interest rates, the primary balance and the deficit-debt adjustment. Such a perspective can offer further information on the extent to which the macroeconomic environment, in particular the combination of growth and interest rates, has affected the dynamics of debt. In addition, the structure of government debt is considered, focusing in particular on the shares of debt with a short-term maturity and foreign currency debt, as well as their development. By

¹¹ Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States (OJ L 306, 23.11.2011, p. 41).

comparing these shares with the current level of the debt ratio, the sensitivity of fiscal balances to changes in exchange rates and interest rates can be highlighted.

For the period 2020-23, the general escape clause of the EU's Stability and Growth Pact was activated. This allowed countries to undertake the necessary policy coordination measures in the context of the pandemic and Russia's invasion of Ukraine within the framework of the Pact. Specifically, it allowed a departure from the budgetary requirements that would have normally applied.

In April 2024 a reformed Stability and Growth Pact entered into force, changing the rules on the opening of a debt-based EDP. The reformed rules aim to safeguard the sustainability of government debt and the countercyclicality of fiscal policy, to adopt a more medium-term approach to budgetary policies and to achieve, inter alia, increased national ownership of the framework. The rules also consider that reforms, investment and fiscal sustainability can be mutually reinforcing and should therefore be fostered. Finally, the rules aim to ensure more effective enforcement.¹² While the rules on the opening of a deficit-based EDP remain basically unchanged, the rules on the opening of a debt-based EDP are changed as described in Box 2. However, in 2024 no debt-based EDPs have been opened on the basis of the 2023 outcomes, as national fiscal-structural plans – as part of the reformed EU fiscal framework – will not be published until autumn 2024, covering fiscal strategies as of 2025.

Turning to a forward-looking perspective, recent forecasts by the European Commission for 2024-25 and the assessment of long-term challenges to debt sustainability are considered. This includes, in particular, the outlook for budget balances and debt ratios on the basis of current fiscal policies. In addition, long-term challenges to the sustainability of budgetary positions and broad areas for consolidation are emphasised, particularly those related to unfunded government pension systems in connection with demographic change and to contingent liabilities incurred by government. Unlike in previous reports, the assessment will not cover countries' medium-term budgetary plans as outlined in annual convergence programmes. This is because, under the new fiscal rules, countries will lay out their detailed medium-term budgetary plans as part of their national fiscal-structural plans, which will be due around 20 September 2024. These plans must present a net expenditure trajectory covering a period of at least four years and will outline government fiscal strategies as of 2025.

With regard to exchange rate developments, the legal provisions and their application by the ECB are outlined in Box 3.

¹² See [Opinion of the European Central Bank of 5 July 2023 on a proposal for economic governance reform in the Union \(CON/2023/20\)](#).

Box 3

Exchange rate developments

1. Treaty provisions

Article 140(1), third indent, of the Treaty requires the Convergence Report to examine the achievement of a high degree of sustainable convergence by reference to the fulfilment by each Member State of the following criterion:

“the observance of the normal fluctuation margins provided for by the exchange-rate mechanism of the European Monetary System, for at least two years, without devaluing against the euro”.

Article 3 of Protocol (No 13) on the convergence criteria stipulates that:

“The criterion on participation in the Exchange Rate mechanism of the European Monetary System referred to in the third indent of Article 140(1) of the said Treaty shall mean that a Member State has respected the normal fluctuation margins provided for by the exchange-rate mechanism on the European Monetary System without severe tensions for at least the last two years before the examination. In particular, the Member State shall not have devalued its currency’s bilateral central rate against the euro on its own initiative for the same period”.

2. Application of Treaty provisions

With regard to exchange rate stability, the ECB examines whether the country has participated in ERM II (which superseded the ERM as of January 1999) for a period of at least two years prior to the convergence examination without severe tensions, in particular without devaluing against the euro. In cases of shorter periods of participation, exchange rate developments are described over a two-year reference period.

The examination of exchange rate stability against the euro focuses on the exchange rate being close to the ERM II central rate, while also taking into account factors that may have led to an appreciation, which is in line with the approach taken in the past. In this respect, the width of the fluctuation band within ERM II does not prejudice the examination of the exchange rate stability criterion.

Moreover, the issue of the absence of “severe tensions” is generally addressed by: (i) examining the degree of deviation of exchange rates from the ERM II central rates against the euro; (ii) using indicators such as exchange rate volatility vis-à-vis the euro and its trend, as well as short-term interest rate differentials vis-à-vis the euro area and their development; (iii) considering the role played by foreign exchange interventions; and (iv) considering the role of international financial assistance programmes in stabilising the currency.

The reference period in this report is from 20 June 2022 to 19 June 2024. All bilateral exchange rates are official ECB reference rates (see Chapter 6).

In addition to ERM II participation and nominal exchange rate developments against the euro over the period under review, evidence relevant to the sustainability of the current exchange rate is briefly reviewed. This is derived from the development of the real effective exchange rates and the current, capital and financial accounts of the balance of payments. The evolution of gross external debt

and the net international investment position over longer periods is also examined. The section on exchange rate developments further considers measures of the degree of a country's integration with the euro area. This is assessed in terms of both external trade integration (exports and imports) and financial integration. Finally, the section on exchange rate developments reports, if applicable, whether the country under examination has during the two-year reference period benefited from central bank liquidity assistance or balance of payments support. Both actual and precautionary assistance are considered.

With regard to long-term interest rate developments, the legal provisions and their application by the ECB are outlined in Box 4.

Box 4

Long-term interest rate developments

1. Treaty provisions

Article 140(1), fourth indent, of the Treaty requires the Convergence Report to examine the achievement of a high degree of sustainable convergence by reference to the fulfilment by each Member State of the following criterion:

“the durability of convergence achieved by the Member State with a derogation and of its participation in the exchange-rate mechanism being reflected in the long-term interest-rate levels”.

Article 4 of Protocol (No 13) on the convergence criteria stipulates that:

“The criterion on the convergence of interest rates referred to in the fourth indent of Article 140(1) of the said Treaty shall mean that, observed over a period of one year before the examination, a Member State has had an average nominal long-term interest rate that does not exceed by more than two percentage points that of, at most, the three best performing Member States in terms of price stability. Interest rates shall be measured on the basis of long-term government bonds or comparable securities, taking into account differences in national definitions”.

2. Application of Treaty provisions

In the context of this report, the ECB applies the Treaty provisions as outlined below.

First, with regard to “an average nominal long-term interest rate” observed over “a period of one year before the examination”, the long-term interest rate has been calculated as an arithmetic average over the latest 12 months for which HICP data were available. The reference period considered in this report is from June 2023 to May 2024, in line with the reference period for the price stability criterion.

Second, the notion of “at most, the three best performing Member States in terms of price stability”, which is used for the definition of the reference value, has been applied by using the unweighted arithmetic average of the long-term interest rates of the same three Member States included in the calculation of the reference value for the criterion on price stability (see Box 1). Over the reference period considered in this report, the long-term interest rates of the three countries with the lowest inflation rate included in the calculation of the reference value for the price stability criterion were

2.6% (Denmark), 2.8% (Netherlands) and 3.1% (Belgium). As a result, the average rate is 2.8% and, adding 2 percentage points, the reference value is 4.8%.¹³

As mentioned above, the Treaty makes explicit reference to the “durability of convergence” being reflected in the level of long-term interest rates. Therefore, developments over the reference period from June 2023 to May 2024 are reviewed against the background of the path of long-term interest rates over the past ten years (or the period for which data are available) and the main factors underlying differentials vis-à-vis the average long-term interest rate prevailing in the euro area. During the reference period, the average euro area long-term interest rate may have partly reflected high country-specific risk premia in several euro area countries. Therefore, the euro area AAA long-term government bond yield (i.e. the long-term yield of the euro area AAA yield curve, which includes the euro area countries with an AAA rating) is also used for comparison purposes. As background to this analysis, this report also provides information about the size and development of the financial market. This is based on three different indicators (the outstanding amount of debt securities issued by non-financial corporations, stock market capitalisation and MFI credit to the domestic non-financial private sector), which together provide a measure of the size of financial markets.

Finally, Article 140(1) of the Treaty requires this report to take account of several other relevant factors (see Box 5). In this respect, an enhanced economic governance framework in accordance with Article 121(6) of the Treaty entered into force on 13 December 2011 with the aim of ensuring a closer coordination of economic policies and the sustained convergence of EU Member States’ economic performances. Box 5 below briefly outlines these legislative provisions and the way in which the above-mentioned additional factors are addressed in the assessment of convergence conducted by the ECB.

Box 5

Other relevant factors

1. Treaty and other legal provisions

Article 140(1) of the Treaty requires that “The reports of the Commission and the European Central Bank shall also take account of the results of the integration of markets, the situation and development of the balances of payments on current account and an examination of the development of unit labour costs and other price indices”.

In this respect, the ECB takes into account the legislative package on EU economic governance which entered into force on 13 December 2011. Building on the Treaty provisions under Article 121(6), the European Parliament and the EU Council adopted detailed rules for the multilateral surveillance procedure referred to in Article 121(3) and (4) of the Treaty. These rules were adopted “in

¹³ Interest rates have been measured on the basis of available harmonised long-term interest rates, which were developed for the purpose of examining convergence (see Chapter 6).

order to ensure closer coordination of economic policies and sustained convergence of the economic performances of the Member States” (Article 121(3)) in view of the “need to draw lessons from the first decade of functioning of the economic and monetary union and, in particular, for improved economic governance in the Union built on stronger national ownership”¹⁴. The legislative package includes an enhanced surveillance framework (the macroeconomic imbalance procedure or MIP) aimed at preventing excessive macroeconomic and macro-financial imbalances by helping diverging EU Member States to establish corrective plans before divergence becomes entrenched.

2. Application of Treaty provisions

In line with past practice, the additional factors referred to in Article 140(1) of the Treaty are reviewed in Chapter 5 under the headings of the individual criteria described in Boxes 1 to 4. For completeness, in Chapter 3 the scoreboard indicators are presented for the countries covered in this report (including in relation to the alert thresholds), thereby ensuring the provision of all available information relevant to the detection of macroeconomic and macro-financial imbalances that may be hampering the achievement of a high degree of sustainable convergence as stipulated in Article 140(1) of the Treaty. Notably, EU Member States with a derogation that are subject to an excessive imbalance procedure can hardly be considered as having achieved a high degree of sustainable convergence as stipulated in Article 140(1) of the Treaty.

2.2 Compatibility of national legislation with the Treaties

2.2.1 Introduction

Article 140(1) of the Treaty requires the ECB (and the European Commission) to report, at least once every two years or at the request of a Member State with a derogation, to the Council on the progress made by the Member States with a derogation in fulfilling their obligations regarding the achievement of economic and monetary union. These reports must include an examination of the compatibility of the national legislation of each Member State with a derogation, including the statutes of its NCB, with Articles 130 and 131 of the Treaty and the relevant Articles of the Statute. This Treaty obligation of Member States with a derogation is also referred to as ‘legal convergence’.

When assessing legal convergence, the ECB is not limited to making a formal assessment of the letter of national legislation but may also consider whether the implementation of the relevant provisions complies with the spirit of the Treaties and the Statute. The ECB is particularly concerned about any signs of pressure being put on the decision-making bodies of any Member State’s NCB which would be inconsistent with the spirit of the Treaty as regards central bank independence.

¹⁴ See recital 2 of [Regulation \(EU\) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances \(OJ L 306, 23/11/2011, p. 25\)](#).

The ECB also sees the need for the smooth and continuous functioning of the NCBs' decision-making bodies. In this respect, the relevant authorities of a Member State have, in particular, the duty to take the necessary measures to ensure the timely appointment of a successor if the position of a member of an NCB's decision-making body becomes vacant.¹⁵

The ECB will closely monitor any developments prior to making a positive final assessment concluding that a Member State's national legislation is compatible with the Treaty and the Statute.

Member States with a derogation and legal convergence

Bulgaria, the Czech Republic, Hungary, Poland, Romania and Sweden, whose national legislation is examined in this report, each have the status of a Member State with a derogation, i.e. they have not yet adopted the euro. Sweden was given the status of a Member State with a derogation by a decision of the Council in May 1998.¹⁶ As far as the other Member States are concerned, Articles 4¹⁷ and 5¹⁸ of the Acts concerning the conditions of accession provide that each of these Member States shall participate in the Economic and Monetary Union from the date of accession as a Member State with a derogation within the meaning of Article 139 of the Treaty.

This report does not cover Denmark, which is a Member State with a special status and which has not yet adopted the euro. Protocol (No 16) on certain provisions relating to Denmark, annexed to the Treaties, provides that, in view of the notice given to the Council by the Danish Government on 3 November 1993, Denmark has an exemption and that the procedure for the abrogation of the derogation will only be initiated at the request of Denmark. As Article 130 of the Treaty applies to Denmark, Denmark's Nationalbank has to fulfil the requirements of central bank independence. The EMI's Convergence Report of 1998 concluded that this requirement had been fulfilled. There has been no assessment of Danish convergence since 1998 due to Denmark's special status. Until such time as Denmark notifies the Council that it intends to adopt the euro, Denmark's Nationalbank does not need to be legally integrated into the Eurosystem and no Danish legislation needs to be adapted.

¹⁵ Opinions CON/2010/37 and CON/2010/91. All ECB opinions are available on EUR-Lex.

¹⁶ Council Decision 98/317/EC of 3 May 1998 in accordance with Article 109j(4) of the Treaty (OJ L 139, 11.5.1998, p. 30). Note: The title of Decision 98/317/EC refers to the Treaty establishing the European Community (prior to the renumbering of the Articles of this Treaty in accordance with Article 12 of the Treaty of Amsterdam); this provision has been repealed by the Treaty of Lisbon.

¹⁷ Act concerning the conditions of accession of the Czech Republic, the Republic of Estonia, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, the Republic of Hungary, the Republic of Malta, the Republic of Poland, the Republic of Slovenia and the Slovak Republic and the adjustments to the Treaties on which the European Union is founded (OJ L 236, 23.9.2003, p. 33).

¹⁸ For Bulgaria and Romania, see Article 5 of the Act concerning the conditions of accession of the Republic of Bulgaria and Romania and the adjustments to the Treaties on which the European Union is founded (OJ L 157, 21.6.2005, p. 203). For Croatia, see Article 5 of the Act concerning the conditions of accession of the Republic of Croatia and the adjustments to the Treaty on European Union, the Treaty on the Functioning of the European Union and the Treaty establishing the European Atomic Energy Community (OJ L 112, 24.4.2012, p. 21).

The aim of assessing legal convergence is to facilitate the Council's decisions as to which Member States fulfil 'their obligations regarding the achievement of economic and monetary union' (Article 140(1) of the Treaty). In the legal domain, such conditions refer in particular to central bank independence and to the NCBs' legal integration into the Eurosystem.

Structure of the legal assessment

The legal assessment broadly follows the framework of the previous reports of the ECB and the EMI on legal convergence.¹⁹

The compatibility of national legislation is considered in the light of legislation enacted before 27 March 2024.

2.2.2 Scope of adaptation

Areas of adaptation

For the purpose of identifying those areas where national legislation needs to be adapted, the following issues are examined:

- compatibility with provisions on the independence of NCBs, members of NCBs' decision-making bodies and Governors in the Treaty (Article 130) and the Statute (Articles 7 and 14.2);
- compatibility with provisions on confidentiality (Article 37 of the Statute);
- compatibility with the prohibitions on monetary financing (Article 123 of the Treaty) and privileged access (Article 124 of the Treaty);
- compatibility with the single spelling of the euro required by EU law; and
- legal integration of the NCBs into the Eurosystem (in particular as regards Articles 12.1 and 14.3 of the Statute).

¹⁹ In particular the ECB's Convergence Reports of June 2022 (on Bulgaria, the Czech Republic, Croatia, Hungary, Poland, Romania and Sweden), June 2020 (on Bulgaria, the Czech Republic, Croatia, Hungary, Poland, Romania and Sweden), May 2018 (on Bulgaria, the Czech Republic, Croatia, Hungary, Poland, Romania and Sweden), June 2016 (on Bulgaria, the Czech Republic, Croatia, Hungary, Poland, Romania and Sweden), June 2014 (on Bulgaria, the Czech Republic, Croatia, Lithuania, Hungary, Poland, Romania and Sweden), June 2013 (on Latvia), May 2012 (on Bulgaria, the Czech Republic, Latvia, Lithuania, Hungary, Poland, Romania and Sweden), May 2010 (on Bulgaria, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania and Sweden), May 2008 (on Bulgaria, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, Slovakia and Sweden), May 2007 (on Cyprus and Malta), December 2006 (on the Czech Republic, Estonia, Cyprus, Latvia, Hungary, Malta, Poland, Slovakia and Sweden), May 2006 (on Lithuania and Slovenia), October 2004 (on the Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Slovenia, Slovakia and Sweden), May 2002 (on Sweden) and April 2000 (on Greece and Sweden), and the EMI's Convergence Report of March 1998.

‘Compatibility’ versus ‘harmonisation’

Article 131 of the Treaty requires national legislation to be ‘compatible’ with the Treaties and the Statute; any incompatibility must therefore be remedied. Neither the primacy of the Treaties and the Statute over national legislation nor the nature of the incompatibility affects the need to comply with this obligation.

The requirement for national legislation to be ‘compatible’ does not mean that the Treaty requires ‘harmonisation’ of the NCBs’ statutes, either with each other or with the Statute. National particularities may continue to exist to the extent that they do not infringe the competence in monetary matters that is irrevocably conferred on the EU. Indeed, Article 14.4 of the Statute permits NCBs to perform functions other than those specified in the Statute, to the extent that they do not interfere with the objectives and tasks of the ESCB.²⁰ Provisions authorising such additional functions in NCBs’ statutes are a clear example of circumstances in which differences may remain. Rather, the term ‘compatible’ indicates that national legislation and the NCBs’ statutes need to be adjusted to eliminate inconsistencies with the Treaties and the Statute and to ensure the necessary degree of integration of the NCBs into the ESCB. In particular, any provisions that infringe an NCB’s independence, as defined in the Treaty, and its role as an integral part of the ESCB, should be adjusted. It is therefore insufficient to rely solely on the primacy of EU law over national legislation to achieve this.

The obligation in Article 131 of the Treaty only covers incompatibility with the Treaties and the Statute. However, national legislation that is incompatible with secondary EU legislation relevant for the areas of adaptation examined in this Convergence Report should be brought into line with such secondary legislation. The primacy of EU law does not affect the obligation to adapt national legislation. This general requirement derives not only from Article 131 of the Treaty but also from the case law of the Court of Justice of the European Union.²¹

The Treaties and the Statute do not prescribe the manner in which national legislation should be adapted. Compatibility may therefore be achieved by removing any national legislation which is incompatible with EU law or by referring to the Treaties and the Statute, or, exceptionally, by incorporating provisions thereof and referring to their provenance, subject to the following qualifications:

As a rule, a reproduction of relevant provisions of Union law directly applicable in the legal order of the Member State using the same language is to be avoided²². A reproduction may create uncertainty both as to the legal nature and origin of the applicable provisions and as to the date of their entry into force. This would not align with the principle of uniform application and interpretation of Union law throughout the

²⁰ As regards tasks and powers that have been partially conferred upon the ECB, any national legislation must be without prejudice to the tasks and powers conferred upon the ECB. See Opinion CON/2020/15.

²¹ See, amongst others, *Commission of the European Communities v French Republic*, C-265/95, EU:C:1997:595.

²² See paragraph 12 of Opinion CON/2005/21, paragraph 2.4 of Opinion CON/2022/15, and paragraph 2.6 of Opinion CON/2023/27.

Union²³. Moreover, if a national provision uses wording that is different from that used in the relevant Union provision, it creates regulatory content of its own. In accordance with Article 2(1) of the Treaty, the Union's exclusive competence in matters of monetary policy precludes Member States from adopting provisions which, in the light of their objective and content, establish legal rules governing the use of the euro as the single currency, unless Member States have been empowered to do so²⁴. In this context, the concept of monetary policy is not limited to its operational implementation, which, under Article 127(2), first indent, of the Treaty is one of the basic tasks of the Eurosystem. It also has a regulatory dimension intended to guarantee the status of the euro as the single currency²⁵.

In exceptional circumstances, a reproduction of relevant provisions of Union law directly applicable in the legal order of the Member State using the same language may be used for the sake of coherence and in order to make them comprehensible to the persons to whom they apply. Where such exceptional circumstances allowing for a reproduction of directly applicable provisions of Union law exist, provisions should be reproduced precisely, and the wording should not be modified²⁶. Furthermore, provisions should be reproduced only to the extent warranted by the exceptional circumstances. However, such exceptional circumstances do not exist where the directly applicable provisions of Union law are sufficiently coherent and comprehensive, making it unnecessary to repeat or reflect them in national law²⁷. Where directly applicable provisions of Union law are merely relevant in the context of the areas covered by the national law, the national law does not need to reference these provisions. To the extent that national law necessarily reproduces directly applicable provisions of Union law for the abovementioned reasons, it should do so in an explicit manner and clarify that its provisions are either 'in accordance with' or 'in compliance with' the relevant provisions of Union law, where the latter are merely reproduced to put the national law in the larger context, or 'without prejudice to' the relevant provisions of Union law, where a national authority exercises residual competences that go beyond those exercised within the ESCB and the Eurosystem²⁸.

Furthermore, as a tool for achieving and maintaining the compatibility of national legislation with the Treaties and the Statute, the ECB must be consulted by the EU institutions and by the Member States on draft legislative provisions in its fields of

²³ Judgment of the Court of Justice of 7 February 1973, *Commission v Italy*, C-39/72, EU:C:1973:13, paragraphs 16 and 17; Judgment of the Court of Justice of 10 October 1973, *Variola*, C-34/73, EU:C:1973:101, paragraphs 9 to 11; Judgment of the Court of Justice of 2 February 1977, *Amsterdam Bulb*, C-50/76, EU:C:1977:13, paragraphs 5 to 8. See also paragraph 12 of Opinion CON/2005/21, paragraph 2.1 of Opinion CON/2006/10, paragraph 2.4 of Opinion CON/2006/29, paragraph 2.1 of Opinion CON/2007/1, paragraph 2.2 of Opinion CON/2007/43, paragraph 2.3 of Opinion CON/2022/15 and paragraph 2.3 of Opinion CON/2023/27.

²⁴ E.g. under the relevant provisions of Council Regulation (EC) No 974/98 of 3 May 1998 on the introduction of the euro (OJ L 139, 11.5.1998, p. 1) or other provisions of Union law.

²⁵ Judgment of the Court of Justice of 26 January 2021, *Hessischer Rundfunk*, C-422/19 and C-423/19, EU:C:2021:63, paragraphs 38 and 39. Judgment of the Court of Justice of 20 April 2023, *Brink's Lithuania*, C-772/21, EU:C:2023:305, paragraphs 56 and 57.

²⁶ See paragraph 2.2 (footnote 6) of Opinion CON/2007/43, paragraph 2.4 of Opinion CON/2022/15 and paragraph 2.6 of Opinion CON/2023/27.

²⁷ See paragraph 13 of Opinion CON/2005/21, paragraphs 2.2 and 3.2 of Opinion CON/2006/10, paragraph 2.4 of Opinion CON/2022/15 and paragraph 2.6 of Opinion CON/2023/27.

²⁸ See paragraph 2.6 of Opinion CON/2023/27.

competence, pursuant to Articles 127(4) and 282(5) of the Treaty and Article 4 of the Statute. Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions²⁹ expressly requires Member States to take the measures necessary to ensure compliance with this obligation.

2.2.3 Independence of NCBs

As far as central bank independence is concerned, national legislation in the Member States that joined the EU in 2004, 2007 or 2013 had to be adapted to comply with the relevant provisions of the Treaty and the Statute, and be in force on 1 May 2004, 1 January 2007 and 1 July 2013 respectively.³⁰ Sweden had to bring the necessary adaptations into force by the date of establishment of the ESCB on 1 June 1998.

Central bank independence

In November 1995, the EMI established a list of features of central bank independence (later described in detail in its 1998 Convergence Report) which were the basis for assessing the national legislation of the Member States at that time, in particular the NCBs' statutes. The concept of central bank independence includes various types of independence that must be assessed separately, namely: functional, institutional, personal, and financial independence. Over the past few years there has been further refinement of the analysis of these aspects of central bank independence in the opinions adopted by the ECB. These aspects are the basis for assessing the level of convergence between the national legislation of the Member States with a derogation and the Treaties and the Statute.

Functional independence

Central bank independence is not an end in itself but is instrumental in achieving an objective that should be clearly defined and should prevail over any other objective. Functional independence requires each NCB's primary objective to be stated in a clear and legally certain way and to be fully in line with the primary objective of price stability established by the Treaty. The pursuit of this objective is served by providing the NCBs with the necessary means and instruments for achieving this objective independently of any other authority. The Treaty's requirement of central bank independence reflects the generally held view that the primary objective of price stability is best served by a fully independent institution with a precise definition of its mandate. Central bank independence is fully compatible with holding NCBs accountable for their decisions, which is an important aspect of enhancing confidence in their independent status. This entails transparency and dialogue with third parties.

²⁹ OJ L 189, 3.7.1998, p. 42.

³⁰ This also applies to the ESCB's confidentiality regime; see Section 2.2.4 of this Convergence Report.

As regards timing, the Treaty is not clear about when the NCBs of Member States with a derogation must comply with the primary objective of price stability set out in Articles 127(1) and 282(2) of the Treaty and Article 2 of the Statute. For those Member States that joined the EU after the date of the introduction of the euro in the EU, it is not clear whether this obligation should run from the date of accession or from the date of their adoption of the euro. While Article 127(1) of the Treaty does not apply to Member States with a derogation (see Article 139(2)(c) of the Treaty), Article 2 of the Statute does apply to such Member States (see Article 42.1 of the Statute). The ECB takes the view that the obligation of the NCBs to have price stability as their primary objective runs from 1 June 1998 in the case of Sweden, and from 1 May 2004, 1 January 2007 and 1 July 2013 for the Member States that joined the EU on those dates. This is based on the fact that one of the guiding principles of the EU, namely price stability (Article 119 of the Treaty), also applies to Member States with a derogation. It is also based on the Treaty objective that all Member States should strive for macroeconomic convergence, including price stability, which is the intention behind the regular reports of the ECB and the European Commission. This conclusion is also based on the underlying rationale of central bank independence, which is only justified if the overall objective of price stability has primacy.

The country assessments in this report are based on these conclusions as to the timing of the obligation of the NCBs of Member States with a derogation to have price stability as their primary objective.

Institutional independence

Institutional independence is reflected in Article 130 of the Treaty and Article 7 of the Statute. These two articles prohibit the NCBs and members of their decision-making bodies from seeking or taking instructions from EU institutions or bodies, from any government of a Member State or from any other body. In addition, they prohibit EU institutions, bodies, offices or agencies, and the governments of the Member States from seeking to influence those members of the NCBs' decision-making bodies whose decisions may affect the fulfilment of the NCBs' ESCB-related tasks. For national legislation to mirror Article 130 of the Treaty and Article 7 of the Statute, it should reflect both prohibitions and not narrow the scope of their application.³¹ The recognition that central banks have such independence does not have the consequence of exempting them from every rule of law or of shielding them from any kind of legislation.³²

Whether an NCB is organised as a state-owned body, a special public law body or simply a public limited company, there is a risk that influence may be exerted by the owner on its decision-making in relation to ESCB-related tasks by virtue of such

³¹ Opinion CON/2011/104.

³² See paragraph 2.3 of Opinion CON/2019/15 and *Commission v European Central Bank*, C-11/00, EU:C:2003:395, paragraphs 134 to 136.

ownership.³³ Such influence, whether exercised through shareholders' rights or otherwise, may affect an NCB's independence and should therefore be limited by law.

The legal framework for central banking needs to provide a stable and long-term basis for a central bank's functioning. Frequent changes to the institutional set-up of an NCB, affecting its organisational or governance stability, could adversely affect that NCB's institutional independence.³⁴

Institutional independence should also be respected in cases of emergency. Only where the conditions under Article 347 of the Treaty are met, may national authorities be justified in exercising, on a temporary and exceptional basis, powers that fall within the exclusive competence of the ESCB. The critical time for this assessment is when the measure is adopted. Due to the exceptional nature of Article 347 of the Treaty, Member States should refrain from adopting preventive legislation in the absence of the conditions prescribed by Article 347 of the Treaty.³⁵

Prohibition on giving instructions

Rights of third parties to give instructions to NCBs, their decision-making bodies or their members are incompatible with the Treaty and the Statute as far as ESCB-related tasks are concerned.

Any involvement of an NCB in the application of measures to strengthen financial stability must be compatible with the Treaty, i.e. NCBs' functions must be performed in a manner that is fully compatible with their functional, institutional, and financial independence so as to safeguard the proper performance of their tasks under the Treaty and the Statute.³⁶ To the extent that national legislation provides for a role of an NCB that goes beyond advisory functions and requires it to assume additional tasks, it must be ensured that these tasks will not affect the NCB's ability to carry out its ESCB-related tasks from an operational and financial point of view.³⁷ Additionally, the inclusion of NCB representatives in collegiate decision-making supervisory bodies or other authorities would need to give due consideration to safeguards for the personal independence of the members of the NCB's decision-making bodies.³⁸

Prohibition on approving, suspending, annulling or deferring decisions

Rights of third parties to approve, suspend, annul or defer an NCB's decisions are incompatible with the Treaty and the Statute as far as ESCB-related tasks are concerned.³⁹

³³ Opinion CON/2019/23.

³⁴ See paragraph 2.2 of Opinion CON/2011/104 and paragraph 3.2.2 of Opinion CON/2017/34.

³⁵ See paragraph 2.2. of Opinion CON/2021/35.

³⁶ Opinion CON/2010/31.

³⁷ Opinion CON/2009/93.

³⁸ Opinion CON/2010/94.

³⁹ Opinion CON/2016/33.

Prohibition on censoring decisions on legal grounds

A right for bodies other than independent courts to censor, on legal grounds, decisions relating to the performance of ESCB-related tasks is incompatible with the Treaty and the Statute, since the performance of these tasks may not be reassessed at the political level. A right of an NCB Governor to suspend the implementation of a decision adopted by the ESCB or by an NCB decision-making body on legal grounds and subsequently to submit it to a political body for a final decision would be equivalent to seeking instructions from third parties.

Prohibition on participation in decision-making bodies of an NCB with a right to vote

Participation by representatives of third parties in an NCB's decision-making body with a right to vote on matters concerning the performance by the NCB of ESCB-related tasks is incompatible with the Treaty and the Statute, even if such vote is not decisive.⁴⁰ Such participation even without the right to vote is incompatible with the Treaty and the Statute, if such participation interferes with the performance of ESCB-related tasks by that decision-making bodies or endangers compliance with the ESCB's confidentiality regime.⁴¹

Prohibition on ex ante consultation relating to an NCB's decision

An express statutory obligation for an NCB to consult third parties ex ante relating to an NCB's decision provides third parties with a formal mechanism to influence the final decision and is therefore incompatible with the Treaty and the Statute.

However, dialogue between an NCB and third parties, even when based on statutory obligations to provide information and exchange views, is compatible with central bank independence provided that:

- this does not result in interference with the independence of the members of the NCB's decision-making bodies;
- the special status of Governors in their capacity as members of the ECB's decision-making bodies is fully respected; and
- confidentiality requirements resulting from the Statute are observed.⁴²

Discharge provided for the duties of members of the NCB's decision-making bodies

Statutory provisions regarding the discharge provided by third parties (e.g. governments) regarding the duties of members of the NCB's decision-making bodies (e.g. in relation to accounts) should contain adequate safeguards, so that such a

⁴⁰ Regarding voting in general, the secret character of voting may contribute to safeguarding the independence of an NCB's decision-making bodies. However, the possibility of open voting is not excluded by the principle of institutional independence, see paragraph 2.3 of Opinion CON/2022/10.

⁴¹ Opinions CON/2014/25 and CON/2015/57.

⁴² Opinion CON/2018/17.

power does not impinge on the capacity of the individual NCB member independently to adopt decisions in respect of ESCB-related tasks (or implement decisions adopted at ESCB level). Inclusion of an express provision to this effect in NCB statutes is recommended.

Personal independence

Article 130 of the Treaty and Articles 7 and 14.2 of the Statute further safeguard central bank independence in relation to Governors and members of NCBs' decision-making bodies. Governors are members of the General Council of the ECB and become members of the Governing Council upon adoption of the euro by their Member States. Governors cannot be regarded as representatives of a Member State when they perform their duties as members of the Governing Council or the General Council of the ECB.⁴³ Article 14.2 of the Statute provides that NCB statutes must, in particular, provide for a minimum term of office of five years for Governors. It also protects against Governors being arbitrarily relieved from their office by providing that they may only be relieved from office if they no longer fulfil the conditions required for performing their duties or if they have been found guilty of serious misconduct. In such cases, Article 14.2 of the Statute provides for the possibility of recourse to the Court of Justice of the European Union, which has the power to annul the national decision taken to relieve a Governor from office.⁴⁴ The suspension of a Governor may effectively amount to relieving a Governor from office for the purposes of Article 14.2 of the Statute.⁴⁵ NCB statutes must comply with this provision as set out below.

Article 130 of the Treaty prohibits national governments and any bodies from influencing the members of NCBs' decision-making bodies in the performance of their tasks. In particular, Member States may not seek to influence the members of the NCB's decision-making bodies by amending national legislation affecting their remuneration, which, as a matter of principle, should apply only for future appointments.⁴⁶

Minimum term of office for Governors

In accordance with Article 14.2 of the Statute, NCB statutes must provide for a minimum term of office of five years for a Governor. This does not preclude longer terms of office, while an indefinite term of office does not require adaptation of the statutes provided the grounds for the relieving a Governor from office are in line with those of Article 14.2 of the Statute. Shorter periods cannot be justified even if only applied during a transitional period.⁴⁷ National legislation which provides for a

⁴³ See *LR Ģenerālprokuratūra*, C-3/20, ECLI:EU:C:2021:969, paragraph 43.

⁴⁴ See *Rimšēvičs and ECB v Latvia*, C-202/18 and C-238/18, EU:C:2019:139, paragraph 76.

⁴⁵ See *Rimšēvičs and ECB v Latvia*, C-202/18 and C-238/18, EU:C:2019:139, paragraph 52, and paragraph 3.7 of Opinion CON/2011/9.

⁴⁶ See, for example, Opinions CON/2010/56, CON/2010/80, CON/2011/104, CON/2011/106 and CON/2021/9.

⁴⁷ Opinion CON/2018/23.

compulsory retirement age should ensure that the retirement age does not interrupt the minimum term of office provided by Article 14.2 of the Statute, which prevails over any compulsory retirement age, if applicable to a Governor.⁴⁸ When NCB statutes are amended, the amending law should safeguard the security of tenure of the Governor and of other members of decision-making bodies who are involved in the performance of ESCB-related tasks.⁴⁹

Grounds for relieving Governors from office

NCB statutes must ensure that Governors may not be dismissed for reasons other than those mentioned in Article 14.2 of the Statute. The purpose of the requirement under that Article is to prevent the authorities involved in the appointment of Governors, particularly the relevant government or parliament, from arbitrarily dismissing a Governor. NCB statutes should delete any incompatibility with the grounds for relieving from office laid down in Article 14.2 of the Statute or omit any mention of grounds for relieving from office (since Article 14.2 is directly applicable).⁵⁰ Once elected or appointed, Governors may not be relieved from office under conditions other than those mentioned in Article 14.2 of the Statute even if they have not yet taken up their duties. As the conditions under which a Governor may be relieved from office are autonomous concepts of Union law, their application and interpretation do not depend on national contexts.⁵¹ Ultimately, it is for the Court of Justice of the European Union, in accordance with the powers conferred on it by the second subparagraph of Article 14.2 of the Statute, to interpret these concepts.⁵²

Security of tenure and grounds for relieving from office of members of NCBs' decision-making bodies, other than Governors, who are involved in the performance of ESCB-related tasks

Applying the same rules for the security of tenure and grounds for relieving of Governors from office to other members of the decision-making bodies of NCBs involved in the performance of ESCB-related tasks will also safeguard the personal independence of those persons.⁵³ Article 130 of the Treaty and Article 7 of the Statute refer to “members of the decision-making bodies” of NCBs, rather than to Governors specifically. This applies in particular where a Governor is “first among equals” with colleagues with equivalent voting rights or where such other members are involved in the performance of ESCB-related tasks.

⁴⁸ Opinion CON/2012/89.

⁴⁹ Opinions CON/2018/17, CON/2019/19 and CON/2019/36.

⁵⁰ Opinion CON/2018/53.

⁵¹ See Opinion CON/2019/36 and the Opinion of Advocate General Kokott in *Rimšēvičs and ECB v Latvia*, Joined Cases C-202/18 and C-238/18, EU:C:2018:1030, paragraph 77.

⁵² See *Rimšēvičs and ECB v Latvia*, Joined Cases C-202/18 and C-238/18, EU:C:2019:139, paragraph 92: “[I]t is for the Court, in the context of the powers conferred on it by the second subparagraph of Article 14.2 of the Statute of the ESCB and of the ECB, to verify that a temporary prohibition on the governor concerned performing his duties is taken only if there are sufficient indications that he has engaged in serious misconduct capable of justifying such a measure.”

⁵³ Opinions CON/2004/35, CON/2005/26, CON/2006/32, CON/2006/44, CON/2007/6, CON/2019/19 and CON/2019/24.

Right of judicial review

Governors as well as other members of the NCBs' decision-making bodies must have the right to submit any decision to relieve them from their office to an independent court of law, in order to limit the potential for political discretion in evaluating the grounds for such a decision.

Article 14.2 of the Statute stipulates that Governors who have been dismissed from office may refer such a decision to the Court of Justice of the European Union. The Court of Justice of the European Union has the power to annul the national measure of dismissal if it is found to be contrary to Union law.

On the basis of Article 130 of the Treaty and Article 7 of the Statute, national legislation should provide for a right of review by the national courts of a decision to dismiss members of NCBs' decision-making bodies (other than Governors) involved in the performance of ESCB-related tasks.⁵⁴ This right can either be a matter of general law or can it take the form of a specific provision. Even though this right may be available under the general law, for reasons of legal certainty it could be advisable to provide specifically for such a right of review.

Safeguards against conflicts of interest

Personal independence also entails ensuring that no conflict of interest arises between the duties of members of NCB decision-making bodies involved in the performance of ESCB-related tasks in relation to their respective NCBs (and of Governors also in relation to the ECB) and any other functions which such members of decision-making bodies may have and which may jeopardise their personal independence.⁵⁵ As a matter of principle, membership of a decision-making body involved in the performance of ESCB-related tasks is incompatible with the exercise of other functions that might create a conflict of interest. In particular, members of such decision-making bodies may not hold an office or have an interest that may influence their activities, whether through office in the executive or legislative branches of the state or in regional or local administrations, or through involvement in a business organisation. Particular care should be taken to prevent potential conflicts of interest on the part of non-executive members of decision-making bodies.

Financial independence

The overall independence of an NCB would be jeopardised if it could not autonomously avail itself of sufficient financial resources to fulfil its mandate, i.e. to perform the ESCB-related tasks required of it under the Treaty and the Statute.⁵⁶

⁵⁴ Opinion CON/2022/45.

⁵⁵ In this regard, Member States are free to set the conditions required for the appointment of the members of the decision-making bodies of their NCBs, provided that they do not conflict with the features of central bank independence flowing from the Treaties. See Opinions CON/2018/23, CON/2020/19 and CON/2021/9.

⁵⁶ Opinions CON/2021/7 and CON/2023/17.

Member States may not put their NCBs in a position where they have insufficient financial resources and inadequate net equity⁵⁷ to carry out their ESCB or Eurosystem-related tasks, as applicable. This would be the case if, for example, an NCB was precluded from building up adequate financial resources in the form of reserves or buffers to offset losses, particularly those resulting from monetary policy operations, and the Member State concerned did not ensure in advance that the NCB had the necessary funds to bear the financial burden resulting from exercising a function outside the scope of the ESCB (such as the funds necessary to be able to pay the compensation resulting from the liability regime for that function), while retaining its ability to carry out its ESCB tasks effectively and independently.⁵⁸ It should be noted that Articles 28.1 and 30.4 of the Statute provide for the possibility of the ECB making further calls on the NCBs to contribute to the ECB's capital and to make further transfers of foreign reserves.⁵⁹ Moreover, Article 33.2 of the Statute provides⁶⁰ that, in the event of a loss incurred by the ECB which cannot be fully offset against the general reserve fund, the ECB's Governing Council may decide to offset the remaining loss against the monetary income of the relevant financial year in proportion to and up to the amounts allocated to the NCBs. The principle of financial independence means that compliance with these provisions requires an NCB to be able to perform its functions unimpaired.

For all the reasons mentioned above, financial independence also implies that an NCB should always be sufficiently capitalised. In particular, any situation should be avoided whereby for a prolonged period of time an NCB's net equity is below the level of its statutory capital or is even negative, including where losses beyond the level of capital and the reserves are carried over.⁶¹ Any such situation may negatively impact on the NCB's ability to perform its ESCB-related tasks. Moreover, such a situation may affect the credibility of the Eurosystem's monetary policy. Therefore, the event of an NCB's net equity becoming less than its statutory capital or even negative would require that the respective Member State provides the NCB with an appropriate amount of capital at least up to the level of the statutory capital within a reasonable period of time so as to comply with the principle of financial independence. As concerns the ECB, the relevance of this issue has already been recognised by the Council by adopting Council Regulation (EC) No 1009/2000 of 8 May 2000 concerning capital increases of the European Central Bank.⁶² It enabled the Governing Council of the ECB to decide on an actual increase of the ECB's capital to sustain the adequacy of the capital base to support the operations of the ECB;⁶³ NCBs should be financially able to respond to such ECB decision.

⁵⁷ Opinions CON/2014/24, CON/2014/27, CON/2014/56 and CON/2017/17.

⁵⁸ Opinions CON/2023/17 and CON/2023/44. See also *Banka Slovenije*, Case C-45/21, ECLI:EU:C:2022:670, paragraph 105.

⁵⁹ Article 30.4 of the Statute only applies within the Eurosystem.

⁶⁰ Article 33.2 of the Statute only applies within the Eurosystem.

⁶¹ Opinions CON/2018/17, CON/2020/13, CON/2022/37, CON/2023/17 and CON/2023/24.

⁶² OJ L 115, 16.5.2000, p. 1.

⁶³ Decision ECB/2010/26 of 13 December 2010 on the increase of the ECB's capital (OJ L 11, 15.1.2011, p. 53).

The concept of financial independence should be assessed from the perspective of whether any third party is able to exercise either direct or indirect influence not only over an NCB's ESCB-related tasks but also over its ability to fulfil its mandate financially in terms of appropriate financial resources. The aspects of financial independence set out below are particularly relevant in this respect.⁶⁴ These are the features of financial independence where NCBs are most vulnerable to outside influence.

Determination of budget

If a third party has the power to determine or influence an NCB's budget, this is incompatible with financial independence unless the law provides a safeguard clause so that such a power is without prejudice to the financial means necessary for carrying out the NCB's ESCB-related tasks.⁶⁵

The accounting rules

The accounts should be drawn up either in accordance with general accounting rules or in accordance with rules specified by an NCB's decision-making bodies. If, instead, such rules are specified by third parties, the rules must at least take into account what has been proposed by the NCB's decision-making bodies.

The annual accounts should be adopted by the NCB's decision-making bodies, assisted by independent accountants, and may be subject to ex post approval by third parties (e.g. the government or parliament). The NCB's decision-making bodies should be able to decide on the calculation of the profits independently and professionally.

Where an NCB's operations are subject to the control of a state audit office or similar body charged with controlling the use of public finances, the scope of the control should be clearly defined by the legal framework,⁶⁶ should be without prejudice to the activities of the NCB's independent external auditors⁶⁷ and further, in line with the principle of institutional independence, it should comply with the prohibition on giving instructions to an NCB and its decision-making bodies and should not interfere with the NCB's ESCB-related tasks.⁶⁸ The state audit should be done on a non-political, independent and purely professional basis.⁶⁹

Distribution of profits, NCBs' capital and financial provisions

With regard to profit allocation, an NCB's statutes may prescribe how its profits are to be allocated. In the absence of such provisions, decisions on the allocation of profits

⁶⁴ The main formative ECB opinions in this area are: Opinions CON/2002/16, CON/2003/22, CON/2003/27, CON/2004/1, CON/2006/38, CON/2006/47, CON/2007/8, CON/2008/13, CON/2008/68 and CON/2009/32.

⁶⁵ Opinion CON/2019/12.

⁶⁶ Opinion CON/2019/19.

⁶⁷ For the activities of the independent external auditors of the NCBs see Article 27.1 of the Statute.

⁶⁸ Opinions CON/2011/9, CON/2011/53, CON/2015/57 and CON/2018/17.

⁶⁹ Opinions CON/2015/8, CON/2015/57, CON/2016/24, CON/2016/59 and CON/2018/17.

should be taken by the NCB's decision-making bodies on professional grounds, and should not be subject to the discretion of third parties unless there is an express safeguard clause stating that this is without prejudice to the financial means necessary for carrying out the NCB's ESCB-related tasks.⁷⁰

Profits may be distributed to the State budget only after any accumulated losses from previous years have been covered and financial provisions deemed necessary to safeguard the real value of the NCB's capital and assets have been created.⁷¹ Temporary or ad hoc legislative measures amounting to instructions to the NCBs in relation to the distribution of their profits are not permissible.⁷² Similarly, a tax on an NCB's unrealised capital gains would also impair the principle of financial independence.⁷³

A Member State may not impose reductions of capital on an NCB without the ex ante agreement of the NCB's decision-making bodies, which must aim to ensure that it retains sufficient financial means to fulfil its mandate under Article 127(2) of the Treaty and the Statute as a member of the ESCB. For the same reason, any amendment to the profit distribution rules of an NCB should only be initiated and decided in close cooperation with the NCB, which is best placed to assess its required level of reserve capital.⁷⁴ As regards financial provisions or buffers, NCBs must be free to independently create financial provisions to safeguard the real value of their capital and assets. Member States may also not hamper NCBs from building up their reserve capital to a level which is necessary for a member of the ESCB to fulfil its tasks.⁷⁵

Financial liability for supervisory authorities

Most Member States place their financial supervisory authorities within their NCB. This is unproblematic if such authorities are subject to the NCB's independent decision-making. However, if the law provides for separate decision-making by such supervisory authorities, it is important to ensure that decisions adopted by them do not endanger the finances of the NCB as a whole. In such cases, national legislation should enable the NCB to have ultimate control over any decision by the supervisory authorities that could affect an NCB's independence, in particular its financial independence.⁷⁶

Autonomy in staff matters

Member States may not impair an NCB's ability to employ and retain the qualified staff necessary for the NCB to perform independently the tasks conferred on it by the Treaty and the Statute.⁷⁷ Also, an NCB may not be put into a position where it has

⁷⁰ Opinions CON/2017/17 and CON/2018/17.

⁷¹ Opinions CON/2009/85, CON/2017/17, CON/2022/37 and CON/2023/24.

⁷² Opinions CON/2009/26 and CON/2013/15.

⁷³ Opinions CON/2009/59 and CON/2009/63.

⁷⁴ Opinions CON/2009/53, CON/2009/83 and CON/2019/21.

⁷⁵ Opinions CON/2009/26, CON/2012/69 and CON/2020/13.

⁷⁶ Opinion CON/2021/7.

⁷⁷ Opinion CON/2019/19.

limited control or no control over its staff, or where the government of a Member State can influence its policy on staff matters.⁷⁸ Any amendment to the legislative provisions on the remuneration for members of an NCB's decision-making bodies and its employees should be decided in close and effective cooperation with the NCB,⁷⁹ taking due account of its views, to ensure the ongoing ability of the NCB to independently carry out its tasks.⁸⁰ Autonomy in staff matters extends to issues relating to staff pensions. Further, amendments that lead to reductions in the remuneration for an NCB's staff should not interfere with that NCB's powers to administer its own financial resources, including the funds resulting from any reduction in salaries that it pays.⁸¹

Ownership and property rights

Rights of third parties to intervene or to issue instructions to an NCB in relation to the property held by an NCB are incompatible with the principle of financial independence.

2.2.4 Confidentiality

The obligation of professional secrecy for ECB and NCB staff as well as for the members of the ECB and NCB governing bodies under Article 37 of the Statute may give rise to similar provisions in NCBs' statutes or in the Member States' legislation. The primacy of Union law and rules adopted thereunder also means that national laws on access by third parties to documents should comply with relevant Union law provisions, including Article 37 of the Statute, and may not lead to infringements of the ESCB's confidentiality regime.⁸² The access of a state audit office or similar body to an NCB's confidential information and documents must be limited to what is necessary for the performance of the statutory tasks of the body that receives the information and must be without prejudice to the ESCB's independence and the ESCB's confidentiality regime to which the members of NCBs' decision-making bodies and staff are subject.⁸³ NCBs should ensure that such bodies protect the confidentiality of information and documents disclosed at a level corresponding to that applied by the NCBs.

2.2.5 Prohibition on monetary financing and privileged access

On the monetary financing prohibition and the prohibition on privileged access, the national legislation of the Member States that joined the EU in 2004, 2007 or 2013 had to be adapted to comply with the relevant provisions of the Treaty and the Statute and

⁷⁸ Opinions CON/2008/9, CON/2008/10, CON/2012/89 and CON/2023/37.

⁷⁹ Opinion CON/2019/19.

⁸⁰ Opinions CON/2010/42, CON/2010/51, CON/2010/56, CON/2010/69, CON/2010/80, CON/2011/104, CON/2011/106, CON/2012/6, CON/2012/86, CON/2014/7 and CON/2023/37.

⁸¹ Opinion CON/2014/38.

⁸² Opinion CON/2021/16.

⁸³ Opinions CON/2015/8 and CON/2015/57.

be in force on 1 May 2004, 1 January 2007 and 1 July 2013 respectively. Sweden had to bring the necessary adaptations into force by 1 January 1995.

Prohibition on monetary financing

Article 123(1) of the Treaty prohibits overdraft facilities or any other type of credit facility with the ECB or with the NCBs in favour of EU institutions, bodies, offices or agencies, central governments, regional, local, or other public authorities, other bodies governed by public law, or public undertakings of Member States.

It also prohibits the purchase directly from these public sector entities by the ECB or NCBs of debt instruments. The Treaty contains one exemption from this monetary financing prohibition: it does not apply to publicly-owned credit institutions which, in the context of the supply of reserves by central banks, must be given the same treatment as private credit institutions (Article 123(2) of the Treaty). The precise scope of application of the monetary financing prohibition is further clarified by Council Regulation (EC) No 3603/93 of 13 December 1993 specifying definitions for the application of the prohibitions referred to in Articles 104 and 104b (1) of the Treaty,⁸⁴ according to which the prohibition includes any financing of the public sector's obligations vis-à-vis third parties.

The monetary financing prohibition aims to encourage the Member States to follow a sound budgetary policy not allowing monetary financing of public deficits (or privileged access by public authorities to the financial markets) to lead to excessively high levels of debt or excessive Member State deficits.⁸⁵ Therefore the prohibition must be interpreted extensively in order to ensure its strict application, subject only to the limited exemptions contained in Article 123(2) of the Treaty and Regulation (EC) No 3603/93. Thus, even if Article 123(1) of the Treaty refers specifically to 'credit facilities', i.e. with the obligation to repay the funds, the prohibition applies a fortiori to other forms of funding, i.e. without the obligation to repay.

The ECB's general stance on the compatibility of national legislation with the prohibition has primarily been developed within the framework of consultations of the ECB by Member States on draft national legislation under Articles 127(4) and 282(5) of the Treaty.⁸⁶

National legislation relating to the scope of application of the monetary financing prohibition

National legislation may not narrow the scope of application of the monetary financing prohibition or extend the exemptions available under EU law. For example, national

⁸⁴ OJ L 332, 31.12.1993, p. 1. Articles 104 and 104b(1) of the Treaty establishing the European Community are now Articles 123 and 125(1) of the Treaty on the Functioning of the European Union.

⁸⁵ *Peter Gauweiler and Others*, C-62/14, EU:C:2015:400, paragraph 100. Article 123 of the Treaty also serves the objective of maintaining price stability and reinforces central bank independence.

⁸⁶ See Convergence Report 2008, footnote 13, containing a list of formative EMI/ECB opinions in this area adopted between May 1995 and March 2008.

legislation providing for the financing by the NCB of a Member State's financial commitments to international financial institutions or to third countries is, in principle, incompatible with the monetary financing prohibition. As an exemption, Regulation (EC) No 3603/93 allows for the financing by the NCBs of obligations falling upon the public sector vis-à-vis the IMF provided that it results in foreign claims which have all the characteristics of reserve assets.⁸⁷ The relevant characteristics that determine the reserve asset quality of the claims concern their availability on demand to meet balance of payments financing needs and other related purposes, which implies that the credit quality and liquidity of the claims must be ensured.⁸⁸

National legislation conferring tasks upon NCBs

National legislation assigning tasks to NCBs may not lead to any financing of the public sector's obligations vis-à-vis third parties. In accordance with Article 14.4 of the Statute, NCBs may perform functions other than those specified in the Statute unless the Governing Council finds that these functions interfere with the objectives and tasks of the ESCB. Where a Member State assigns such a function to its NCB, that NCB is responsible and liable for the performance of that function. Nevertheless, when defining the responsibility and liability of an NCB in relation to that function, Member States are required to comply with their obligations deriving from Union law and, in particular, Article 123(1) of the Treaty.⁸⁹

Article 1(1), point (b), of Council Regulation (EC) No 3603/93 defines the term 'other type of credit facility' for the purposes of Article 123 of the Treaty as, inter alia, any financing of the public sector's obligations vis-à-vis third parties. Accordingly, the NCB concerned must not assume obligations vis-à-vis third parties that could potentially be incumbent on the public sector. Consequently, the NCB concerned must not finance pre-existing obligations vis-à-vis third parties that are incumbent on other public authorities or bodies and the effective financing of the obligations vis-à-vis third parties by the NCB concerned must not result directly from the measures adopted or the policy choices made by other public authorities or bodies.⁹⁰

Advanced distribution of central bank profits

National legislation may not require the distribution of central bank profits which have not been fully realised, accounted for and audited. To comply with the monetary financing prohibition, the amount distributed to the State budget pursuant to the applicable profit distribution rules cannot be paid, even partially, from the NCB's reserve capital. Therefore, profit distribution rules should leave unaffected the NCB's reserve capital. Moreover, when NCB assets are transferred to the State, they must be

⁸⁷ Recital 14 and Article 7 of Regulation (EC) No 3603/93. See, for example, Opinions CON/2016/21, CON/2017/4, CON/2020/37 and CON/2021/23.

⁸⁸ See Opinion CON/2021/39.

⁸⁹ *Banka Slovenije*, C-45/21, EU:C:2022:670, paragraphs 53, 54, 57 and 97. See, for example, Opinions CON/2022/39, paragraph 2.2, CON/2023/17, paragraph 2.2.1, and CON/2023/44, paragraph 2.3.

⁹⁰ *Banka Slovenije*, C-45/21, EU:C:2022:670, paragraphs 67 to 75 and 84. See, for example, paragraph 3.1 of Opinion CON/2022/39, paragraph 2.2.2 of Opinion CON/2023/17, and paragraph 3.1.1 of Opinion CON/2023/44.

remunerated at market value and the transfer should take place at the same time as the remuneration.⁹¹

Similarly, intervention in the performance of other Eurosystem tasks, such as the management of foreign reserves, by introducing taxation of theoretical and unrealised capital gains is not permitted since this would result in a form of central bank credit to the public sector through the advanced distribution of future and uncertain profits.⁹²

Assumption of public sector liabilities

National legislation which requires an NCB to take over the liabilities of a previously independent public body, as a result of a national reorganisation of certain tasks and duties (for example, in the context of a transfer to the NCB of certain supervisory tasks previously carried out by the state or independent public authorities or bodies), without fully insulating the NCB from all financial obligations resulting from the prior activities of such a body, would be incompatible with the monetary financing prohibition.⁹³

National legislation holding an NCB liable on account of the exercise of a task assigned to it under national law would entail the assumption of a pre-existing obligation vis-à-vis third parties and be incompatible with the monetary financing prohibition if the third parties who have suffered harm were not compensated as a result of the NCB's actions, i.e. the infringement by the NCB of the rules imposed on it in that context.⁹⁴ In addition, in case of tasks that require implementation of highly complex and urgent measures, such as those relating to the reorganisation or resolution of banks, national legislation holding an NCB liable on account of the exercise of such tasks would amount to the effective financing of the obligations vis-à-vis third parties if the NCB's liability was not limited to infringements of a serious nature of the rules imposed on it in that context.⁹⁵

Financial support for credit and/or financial institutions

National legislation which provides for financing by an NCB, even if granted independently and at their full discretion, of insolvent credit and/or other financial institutions would be incompatible with the monetary financing prohibition.

The same would apply to the Eurosystem financing of a credit institution which has been recapitalised to restore its solvency by way of a direct placement of state-issued debt instruments where no alternative market-based funding sources exist (hereinafter "recapitalisation bonds"), and where such bonds are to be used as collateral. In such case of a state recapitalisation of a credit institution by way of direct placement of recapitalisation bonds, the subsequent use of the recapitalisation bonds as collateral in central bank liquidity operations raises monetary financing concerns.⁹⁶

⁹¹ Opinions CON/2011/91 and CON/2011/99.

⁹² Opinions CON/2009/59 and CON/2009/63.

⁹³ Opinion CON/2013/56.

⁹⁴ *Banka Slovenije*, C-45/21, EU:C:2022:670, paragraph 71.

⁹⁵ *Banka Slovenije*, C-45/21, EU:C:2022:670, paragraph 75. See, for example, paragraph 2.2.3 of Opinion CON/2023/17, and paragraphs 3.1.2. and 3.1.3 of Opinion CON/2023/44.

⁹⁶ Opinions CON/2012/50, CON/2012/64, and CON/2012/71.

Emergency liquidity assistance, granted by an NCB independently and at its full discretion to a solvent credit institution on the basis of collateral security in the form of a State guarantee, has to meet the following criteria: (i) it must be ensured that the credit provided by the NCB is as short term as possible; (ii) there must be systemic stability aspects at stake; (iii) there must be no doubts as to the legal validity and enforceability of the State guarantee under applicable national law; and (iv) there must be no doubts as to the economic adequacy of the State guarantee, which should cover both principal and interest on the loans.⁹⁷

Financial support for resolution funds or financial arrangements and deposit insurance or investor compensation schemes

The financing by an NCB of a resolution fund or a deposit guarantee fund that qualifies as a 'body governed by public law' within the meaning of Article 123(1) of the Treaty is not compatible with the monetary financing prohibition. A body is 'governed by public law' if it has all of the following characteristics: (a) it is established for the specific purpose of meeting needs in the general interest, not having an industrial or commercial character; (b) it has legal personality; and (c) it is closely dependent on the public sector entities referred to in Article 123(1) of the Treaty. A close dependence on those public sector entities is presumed when a body is financed, for the most part, by them; or is subject to management supervision by them; or has an administrative, managerial or supervisory board, more than half of whose members are appointed by them.⁹⁸

Even if the financing is not provided to a 'body governed by public law', the financing of any resolution fund or financial arrangement is not in line with the monetary financing prohibition.⁹⁹ Where an NCB acts as resolution authority, it should not, under any circumstances, assume or finance any obligation of either a bridge institution or an asset management vehicle.¹⁰⁰ To this end, national legislation should clarify that the NCB will not assume or finance any of these entities' obligations.¹⁰¹

The Deposit Guarantee Schemes Directive¹⁰² and the Investor Compensation Schemes Directive¹⁰³ provide that the costs of financing deposit guarantee schemes and investor compensation schemes must be borne, respectively, by credit institutions and investment firms themselves. With the exception of financing a 'body governed by public law', national legislation which provides for the financing by an NCB of a national deposit insurance scheme for credit institutions or a national investor compensation scheme for investment firms would be compatible with the monetary

⁹⁷ Opinion CON/2012/4, footnote 42 referring to further relevant Opinions in this field. See also Opinions CON/2016/55 and CON/2017/1.

⁹⁸ Opinions CON/2020/24 and CON/2021/17.

⁹⁹ Opinions CON/2015/22, CON/2016/28 and CON/2019/16.

¹⁰⁰ Opinions CON/2011/103, CON/2012/99, CON/2015/3 and CON/2015/22.

¹⁰¹ Opinions CON/2015/33, CON/2015/35 and CON/2016/60.

¹⁰² Recital 27 of Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes (OJ L 173, 12.6.2014, p. 149).

¹⁰³ Recital 23 of Directive 97/9/EC of the European Parliament and of the Council of 3 March 1997 on investor-compensation schemes (OJ L 84, 26.3.1997, p. 22).

financing prohibition only if it were short term, addressed urgent situations, systemic stability aspects were at stake, and decisions were at the NCB's discretion.¹⁰⁴ In particular, central bank support for deposit guarantee schemes should not amount to a systematic pre-funding operation.¹⁰⁵

Fiscal agency function

Article 21.2 of the Statute establishes that the 'ECB and the national central banks may act as fiscal agents' for 'Union institutions, bodies, offices or agencies, central governments, regional local or other public authorities, other bodies governed by public law, or public undertakings of Member States.' The purpose of Article 21.2 of the Statute is, following transfer of the monetary policy competence to the Eurosystem, to clarify that NCBs may continue to provide the fiscal agent service traditionally provided to governments and other public entities without infringing the monetary financing prohibition. In addition, Regulation (EC) No 3603/93 establishes a number of explicit and narrowly drafted exemptions from the monetary financing prohibition relating to the fiscal agency function, as follows: (i) intra-day credits to the public sector are permitted provided that they remain limited to the day and that no extension is possible;¹⁰⁶ (ii) crediting the public sector's account with cheques issued by third parties before the drawee bank has been debited is permitted if a fixed period of time corresponding to the normal period for the collection of cheques by the NCB concerned has elapsed since receipt of the cheque, provided that any float which may arise is exceptional, is of a small amount and averages out in the short term;¹⁰⁷ and (iii) the holding of coins issued by and credited to the public sector is permitted where the amount of such assets remains at less than 10 % of coins in circulation.¹⁰⁸

National legislation on the fiscal agency function should be compatible with EU law in general, and with the monetary financing prohibition in particular.¹⁰⁹ Taking into account the express recognition in Article 21.2 of the Statute of the provision of fiscal agency services, which is a legitimate function traditionally performed by NCBs, the provision by central banks of fiscal agency services complies with the monetary financing prohibition, provided that such services remain within the field of the fiscal agency function and do not constitute central bank financing of public sector obligations vis-à-vis third parties or central bank crediting of the public sector outside the narrowly defined exceptions specified in Regulation (EC) No 3603/93.¹¹⁰ National legislation that enables an NCB to hold government deposits and to service government accounts does not raise concerns about compliance with the monetary financing prohibition as long as such provisions do not enable the extension of credit, including overnight overdrafts. However, there would be a concern about compliance with the monetary financing prohibition if, for example, national legislation were to

¹⁰⁴ Opinions CON/2020/24 and CON/2021/17.

¹⁰⁵ Opinion CON/2011/84.

¹⁰⁶ Article 4 of Regulation (EC) No 3603/93 and Opinion CON/2013/2.

¹⁰⁷ Article 5 of Regulation (EC) No 3603/93.

¹⁰⁸ Article 6 of Regulation (EC) No 3603/93.

¹⁰⁹ Opinion CON/2013/3.

¹¹⁰ Opinions CON/2009/23, CON/2009/67 and CON/2012/9.

enable the remuneration of deposits or current account balances above, rather than at or below, market rates. Remuneration that is above market rates constitutes a de facto credit, contrary to the objective of the prohibition on monetary financing, and might therefore undermine that objective. It is essential for any remuneration of an account to reflect market parameters and it is particularly important to correlate the remuneration rate of the deposits with their maturity.¹¹¹ Moreover, the provision without remuneration by an NCB of fiscal agent services does not raise monetary financing concerns, provided they are core fiscal agent services.¹¹²

Prohibition on privileged access

Article 124 of the Treaty provides that '[a]ny measure, not based on prudential considerations, establishing privileged access by Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States to financial institutions, shall be prohibited.' As with the monetary financing prohibition, the prohibition of privileged access aims to encourage the Member States to follow a sound budgetary policy, not allowing (monetary financing of public deficits or) privileged access by public authorities to the financial markets to lead to excessively high levels of debt or excessive Member State deficits.¹¹³

Under Article 1(1) of Council Regulation (EC) No 3604/93,¹¹⁴ privileged access is understood as any law, regulation or other binding legal instrument adopted in the exercise of public authority which: (a) obliges financial institutions to acquire or to hold liabilities of EU institutions or bodies, central governments, regional, local or other public authorities, other bodies governed by public law or public undertakings of Member States, or (b) confers tax advantages that only benefit financial institutions or financial advantages that do not comply with the principles of a market economy, in order to encourage those institutions to acquire or hold such liabilities.

As public authorities, NCBs may not take measures granting privileged access to financial institutions by the public sector if such measures are not based on prudential considerations. Furthermore, the rules on the mobilisation or pledging of debt instruments enacted by the NCBs must not be used as a means of circumventing the prohibition on privileged access.¹¹⁵ Member States' legislation in this area may not establish such privileged access.

¹¹¹ See, among others, Opinions CON/2010/54, CON/2010/55 and CON/2013/62.

¹¹² Opinion CON/2012/9.

¹¹³ See, to that effect, *Smaranda Bara and Others v Casa Națională de Asigurări de Sănătate and Others*, C-201/14, EU:C:2015:638, paragraph 22; and *Peter Gauweiler and Others*, C-62/14, EU:C:2015:400, paragraph 100.

¹¹⁴ Council Regulation (EC) No 3604/93 of 13 December 1993 specifying definitions for the application of the prohibition of privileged access referred to in Article 104a of the Treaty [establishing the European Community] (OJ L 332, 31.12.1993, p. 4). Article 104a of the Treaty establishing the European Community is now Article 124 of the Treaty.

¹¹⁵ Article 3(2) of and recital 10 of Regulation (EC) No 3604/93.

Article 2 of Regulation (EC) No 3604/93 defines 'prudential considerations' as those which underlie national laws, regulations or administrative actions based on, or consistent with, EU law and designed to promote the soundness of financial institutions so as to strengthen the stability of the financial system as a whole and the protection of the customers of those institutions. Prudential considerations seek to ensure that banks remain solvent with regard to their depositors.¹¹⁶ In the area of prudential supervision, EU secondary legislation has established a number of requirements to ensure the soundness of credit institutions.¹¹⁷ A 'credit institution' has been defined as an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account.¹¹⁸ Additionally, credit institutions, commonly referred to as 'banks', require an authorisation by a competent Member State authority to provide services.¹¹⁹

Although minimum reserves might be seen as a part of prudential requirements, they are part of an NCB's operational framework and used as a monetary policy tool in most economies, including in the euro area.¹²⁰ In this respect, paragraph 2 of Annex I to Guideline ECB/2014/60¹²¹ states that the Eurosystem's minimum reserve system primarily pursues the aims of stabilising the money market interest rates and creating (or enlarging) a structural liquidity shortage.¹²² The ECB requires credit institutions established in the euro area to hold the required minimum reserves (in the form of deposits) on account with their NCB.¹²³

This report focuses on the compatibility both of national legislation or rules adopted by NCBs and of the NCBs' statutes with the Treaty prohibition on privileged access. However, this report is without prejudice to an assessment of whether laws, regulations, rules or administrative acts in Member States are used under the cover of prudential considerations as a means of circumventing the prohibition on privileged access. Such an assessment is beyond the scope of this report.

¹¹⁶ Opinion of Advocate General Elmer in *Société civile immobilière Parodi v Banque H. Albert de Bary et Cie.*, C-222/95, EU:C:1997:345, paragraph 24.

¹¹⁷ Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.06.2013, p. 1) and Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.06.2013, p. 338).

¹¹⁸ Article 4(1)(1) of Regulation (EU) No 575/2013.

¹¹⁹ Article 8 of Directive 2013/36/EU.

¹²⁰ This is supported by Article 3(2) and recital 9 of Regulation (EC) No 3604/93.

¹²¹ Guideline (EU) 2015/510 of the European Central Bank of 19 December 2014 on the implementation of the Eurosystem monetary policy framework (General Documentation Guideline) (ECB/2014/60) (OJ L 91, 2.4.2015, p. 3).

¹²² The higher the reserve requirement is set, the fewer funds banks will have to loan out, leading to lower money creation.

¹²³ See: Article 19 of the Statute; Council Regulation (EC) No 2531/98 of 23 November 1998 concerning the application of minimum reserves by the European Central Bank (OJ L 318, 27.11.1998, p. 1); Regulation (EC) No 1745/2003 of the European Central Bank of 12 September 2003 on the application of minimum reserves (ECB/2003/9) (OJ L 250, 2.10.2003, p. 10); and Regulation (EU) No 1071/2013 of the European Central Bank of 24 September 2013 concerning the balance sheet of the monetary financial institutions sector (ECB/2013/33) (OJ L 297, 7.11.2013, p. 1).

2.2.6 Single spelling of the euro

Article 3(4) of the Treaty on European Union lays down that the ‘Union shall establish an economic and monetary union whose currency is the euro’. In the texts of the Treaties in all the authentic languages written using the Roman alphabet, the euro is consistently identified in the nominative singular case as ‘euro’. In the Greek alphabet text, the euro is spelled ‘ευρώ’ and in the Cyrillic alphabet text the euro is spelled ‘евро’.¹²⁴ Consistent with this, Council Regulation (EC) No 974/98 of 3 May 1998 on the introduction of the euro¹²⁵ makes it clear that the name of the single currency must be the same in all the official languages of the EU, taking into account the existence of different alphabets. The Treaties thus require a single spelling of the word ‘euro’ in the nominative singular case in all EU and national legislative provisions, taking into account the existence of different alphabets.

In view of the exclusive competence of the EU to determine the name of the single currency, any deviations from this rule are incompatible with the Treaties and should be eliminated.¹²⁶ While this principle applies to all national legislation, the assessment in the country chapters focuses on the NCBs’ statutes and the euro changeover laws.

2.2.7 Legal integration of NCBs into the Eurosystem

Provisions in national legislation (in particular an NCB’s statutes, but also other legislation) which would prevent the performance of Eurosystem-related tasks or compliance with the ECB’s decisions are incompatible with the effective operation of the Eurosystem once the Member State concerned has adopted the euro. National legislation therefore has to be adapted to ensure compatibility with the Treaty and the Statute in respect of Eurosystem-related tasks. To comply with Article 131 of the Treaty, national legislation had to be adjusted to ensure its compatibility by the date of establishment of the ESCB (as regards Sweden) and by 1 May 2004, 1 January 2007 and 1 July 2013 (as regards the Member States that joined the EU on these dates). Nevertheless, statutory requirements relating to the full legal integration of an NCB into the Eurosystem need only enter into force at the moment that full integration becomes effective, i.e. the date on which the Member State with a derogation adopts the euro.

The main areas examined in this report are those in which statutory provisions may hinder NCBs’ compliance with the Eurosystem’s requirements. These include provisions (a) that could prevent NCBs from taking part in implementing the single monetary policy, as defined by the ECB’s decision-making bodies, or (b) that could

¹²⁴ The ‘Declaration by the Republic of Latvia, the Republic of Hungary and the Republic of Malta on the spelling of the name of the single currency in the Treaties’, annexed to the Treaties, states that; ‘Without prejudice to the unified spelling of the name of the single currency of the European Union referred to in the Treaties as displayed on banknotes and on coins, Latvia, Hungary and Malta declare that the spelling of the name of the single currency, including its derivatives as applied throughout the Latvian, Hungarian and Maltese text of the Treaties, has no effect on the existing rules of the Latvian, Hungarian or Maltese languages’.

¹²⁵ OJ L 139, 11.5.1998, p. 1.

¹²⁶ Opinion CON/2012/87.

hinder a Governor from fulfilling their duties as a member of the ECB's Governing Council, or (c) that do not respect the ECB's prerogatives, or (d) that do not recognise that the exclusive competence for ESCB-related tasks in Member States whose currency is the euro is irrevocably conferred on the Union,¹²⁷ or (e) pursuant to which NCBs in the performance of their ESCB-related tasks are bound by decisions of national authorities that conflict with legal acts of the ECB. Distinctions are made between economic policy objectives, tasks, financial provisions, exchange rate policy and international cooperation. Finally, other areas where NCBs' statutes may need to be adapted are mentioned.

Economic policy objectives

The full integration of an NCB into the Eurosystem requires its statutory objectives to be compatible with the ESCB's objectives, as laid down in Article 2 of the Statute. Among other things, this means that statutory objectives with a 'national flavour' – for example, where statutory provisions refer to an obligation to conduct monetary policy within the framework of the general economic policy of the Member State concerned – need to be adapted. Furthermore, an NCB's secondary objectives must be consistent and not interfere with its obligation to support the general economic policies in the EU with a view to contributing to the achievement of the objectives of the EU as laid down in Article 3 of the Treaty on European Union, which is itself an objective expressed to be without prejudice to maintaining price stability.¹²⁸

Tasks

The tasks of an NCB of a Member State whose currency is the euro are predominantly determined by the Treaty and the Statute, given that NCB's status as an integral part of the Eurosystem. In order to comply with Article 131 of the Treaty, provisions on tasks in an NCB's statutes therefore need to be compared with the relevant provisions of the Treaty and the Statute, and any incompatibility must be removed.¹²⁹ This applies to any provision that, after adoption of the euro and integration into the Eurosystem, constitutes an impediment to carrying out ESCB-related tasks and in particular to provisions which do not respect the ESCB's powers under Chapter IV of the Statute.

Any national legislative provisions relating to monetary policy must recognise that the EU's monetary policy is to be carried out through the Eurosystem.¹³⁰ An NCB's statutes may contain provisions on monetary policy instruments. Such provisions should be comparable to those in the Treaty and the Statute, and any incompatibility must be removed in order to comply with Article 131 of the Treaty.

¹²⁷ Opinion CON/2020/2.

¹²⁸ Opinions CON/2010/30 and CON/2010/48.

¹²⁹ See, in particular, Articles 127 and 128 of the Treaty and Articles 3 to 6 and 16 of the Statute.

¹³⁰ First indent of Article 127(2) of the Treaty.

Monitoring fiscal developments is a task that an NCB carries out on a regular basis to assess properly the stance to be taken in monetary policy. NCBs may also present their views on relevant fiscal developments on the basis of their monitoring activity and the independence of their advice, with a view to contributing to the proper functioning of the European Monetary Union. The monitoring of fiscal developments by an NCB for monetary policy purposes should be based on the full access to all relevant public finance data. Accordingly, the NCBs should be granted unconditional, timely and automatic access to all relevant public finance statistics. However, an NCB's role should not go beyond monitoring activities that result from or are linked – directly or indirectly – to the discharge of their monetary policy mandate.¹³¹ A formal mandate for an NCB to assess forecasts and fiscal developments implies a function for the NCB in (and a corresponding responsibility for) fiscal policymaking which may risk undermining the discharge of the Eurosystem's monetary policy mandate and the NCB's independence.¹³²

In the context of the national legislative initiatives to address the turmoil in the financial markets, the ECB has emphasised that any distortion in the national segments of the euro area money market should be avoided, as this may impair the implementation of the single monetary policy. In particular, this applies to the extension of State guarantees to cover interbank deposits.¹³³

Member States must ensure that national legislative measures addressing liquidity problems of businesses or professionals, for example their debts to financial institutions, do not have a negative impact on market liquidity. In particular, such measures may not be inconsistent with the principle of an open market economy, as reflected in Article 3 of the Treaty on European Union, as this could hinder the flow of credit, materially influence the stability of financial institutions and markets and therefore affect the performance of Eurosystem tasks.¹³⁴

National legislative provisions assigning the exclusive right to issue banknotes to the NCB must recognise that, once the euro is adopted, the ECB's Governing Council has the exclusive right to authorise the issue of euro banknotes, pursuant to Article 128(1) of the Treaty and Article 16 of the Statute,¹³⁵ while the right to issue euro banknotes belongs to the ECB and the NCBs. Once the euro is adopted, national legislative provisions enabling the government to influence issues such as the denominations, production, volume or withdrawal of banknotes must also either be repealed or recognition must be given to the ECB's powers with regard to euro banknotes, as set out in the provisions of the Treaty and the Statute. Irrespective of the division of responsibilities in relation to coins between governments and NCBs, the relevant provisions must recognise the ECB's power to approve the volume of issue of euro coins once the euro is adopted. A Member State may not consider currency in

¹³¹ Opinions CON/2012/105, CON/2013/90 and CON/2013/91.

¹³² For example, national legislative provisions transposing Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States (OJ L 306, 23.11.2011, p. 41). See Opinions CON/2013/90 and CON/2013/91.

¹³³ Opinions CON/2009/99, CON/2011/79 and CON/2017/1.

¹³⁴ Opinion CON/2010/8.

¹³⁵ Paragraph 3.1 of Opinion CON/2024/1.

circulation as its NCB's debt to the government of that Member State, as this would defeat the concept of a single currency and be incompatible with the requirements of Eurosystem legal integration.¹³⁶

With regard to foreign reserve management,¹³⁷ any Member State that has adopted the euro and which does not transfer its official foreign reserves¹³⁸ to its NCB is in breach of the Treaty. In addition, any right of a third party – for example, the government or parliament – to influence an NCB's decisions with regard to the management of the official foreign reserves would be inconsistent with the third indent of Article 127(2) of the Treaty. Furthermore, NCBs have to provide the ECB with foreign reserve assets in proportion to their shares in the ECB's subscribed capital. This means that there must be no legal obstacles to NCBs transferring foreign reserve assets to the ECB.

With regard to statistics, although regulations adopted under Article 34.1 of the Statute in the field of statistics do not confer any rights or impose any obligations on Member States that have not adopted the euro, Article 5 of the Statute, which concerns the collection of statistical information, applies to all Member States, regardless of whether they have adopted the euro. Accordingly, Member States whose currency is not the euro are under an obligation to design and implement, at national level, all measures they consider appropriate to collect the statistical information needed to fulfil the ECB's statistical reporting requirements¹³⁹ and to make timely preparations in the field of statistics in order for them to become Member States whose currency is the euro.¹⁴⁰ National legislation laying down the framework for cooperation between the NCBs and national statistical offices should guarantee the NCBs' independence in the performance of their tasks within the ESCB's statistical framework.¹⁴¹

Financial provisions

The financial provisions in the Statute comprise rules on financial accounts,¹⁴² auditing,¹⁴³ capital subscription,¹⁴⁴ the transfer of foreign reserve assets¹⁴⁵ and the allocation of monetary income.¹⁴⁶ NCBs must be able to comply with their obligations

¹³⁶ Opinion CON/2008/34.

¹³⁷ Third indent of Article 127(2) of the Treaty.

¹³⁸ With the exception of foreign-exchange working balances, which Member State governments may retain pursuant to Article 127(3) of the Treaty.

¹³⁹ In this regard, national legislation should ensure consistency with the reporting requirements set out in Union legislation. See Opinion CON/2020/29.

¹⁴⁰ Opinion CON/2013/88.

¹⁴¹ Opinions CON/2015/5 and CON/2015/24.

¹⁴² Article 26 of the Statute.

¹⁴³ Article 27 of the Statute.

¹⁴⁴ Article 28 of the Statute.

¹⁴⁵ Article 30 of the Statute.

¹⁴⁶ Article 32 of the Statute.

under these provisions and therefore any incompatible national provisions must be repealed.¹⁴⁷

Exchange rate policy

A Member State with a derogation may retain national legislation which provides that the government is responsible for the exchange rate policy of that Member State, with a consultative and/or executive role being granted to the NCB. However, by the time that a Member State adopts the euro, such legislation must reflect the fact that responsibility for the euro area's exchange rate policy has been transferred to the EU level in accordance with Articles 138 and 219 of the Treaty.

International cooperation

For the adoption of the euro, national legislation must be compatible with Article 6.1 of the Statute, which provides that in the field of international cooperation involving the tasks entrusted to the Eurosystem, the ECB decides how the ESCB is represented. National legislation allowing an NCB to participate in international monetary institutions must make such participation subject to the ECB's approval (Article 6.2 of the Statute).

Miscellaneous

In addition to the above issues, for certain Member States there are other areas where national provisions need to be adapted (for example in the area of clearing and payment systems and the exchange of information).

¹⁴⁷ Paragraphs 2.1 and 3.2 to 3.4 of Opinion CON/2022/37; paragraphs 2.1, 2.2 and 3.1 to 3.5 of Opinion CON/2023/24.

3 The state of economic convergence

This chapter provides a horizontal overview. Some factors relevant for the overall assessment are not covered here, but in Chapters 4 and 5.

Reflecting challenging economic conditions, limited progress has been made as regards compliance with the convergence criteria since the ECB's 2022 Convergence Report. In all six countries examined in this report, HICP inflation is above the reference value, and well above it in five countries (Table 3.1). Since April 2022 the 12-month average of long-term interest rate differentials versus the euro area has increased in one country, declined in four countries and remained unchanged in one country. As in 2022, three countries are not compliant with the long-term interest rate criterion, with their rate being above the reference value. The currencies of some of the countries examined in this report have experienced sizeable fluctuations against the euro over the last few years. Public finances improved in most of the countries following the COVID-19 pandemic as their economies recovered and pandemic support measures were phased out. However, in most cases, public deficits and debt ratios remain above pre-pandemic levels, partly owing to the economic impact of Russia's war against Ukraine and the fiscal policy measures taken in response to the resulting high energy prices.

Table 3.1

Overview table of economic indicators of convergence

	Price stability	Government budgetary developments and projections			Exchange rate		Long-term interest rate ⁶
	HICP inflation ¹	Country in excessive deficit ^{2,3}	General government surplus (+)/ deficit (-) ⁴	General government debt ⁴	Currency participating in ERM II ³	Exchange rate vis-à-vis the euro ⁵	
Bulgaria							
2022	13.0	No	-2.9	22.6	Yes	0.0	1.5
2023	8.6	No	-1.9	23.1	Yes	0.0	3.8
2024	5.1	No	-2.8	24.8	Yes	0.0	4.0
Czech Republic							
2022	14.8	No	-3.2	44.2	No	4.2	4.3
2023	12.0	No	-3.7	44.0	No	2.3	4.4
2024	6.3	No	-2.4	45.2	No	-4.2	4.2
Hungary							
2022	15.3	No	-6.2	74.1	No	-9.1	7.6
2023	17.0	No	-6.7	73.5	No	2.4	7.5
2024	8.4	No	-5.4	74.3	No	-2.0	6.8
Poland							
2022	13.2	No	-3.4	49.2	No	-2.6	6.1
2023	10.9	No	-5.1	49.6	No	3.1	5.8
2024	6.1	No	-5.4	53.7	No	4.9	5.6
Romania							
2022	12.0	Yes	-6.3	47.5	No	-0.2	7.5
2023	9.7	Yes	-6.6	48.8	No	-0.3	6.7
2024	7.6	Yes	-6.9	50.9	No	-0.6	6.4
Sweden							
2022	8.1	No	1.2	33.2	No	-4.8	1.5
2023	5.9	No	-0.6	31.2	No	-8.0	2.5
2024	3.6	No	-1.4	32.0	No	0.7	2.5
Reference value⁷	3.3		-3.0	60.0			4.8

Sources: European Commission (Eurostat, Directorate-General for Economic and Financial Affairs) and European System of Central Banks.

1) Average annual percentage change. Data for 2024 refer to the period from June 2023 to May 2024.

2) Refers to whether a country was subject to an EU Council decision on the existence of an excessive deficit for at least part of the year.

3) The information for 2024 refers to the period up to the cut-off date for statistics (19 June 2024).

4) As a percentage of GDP. Data for 2024 are taken from the European Commission's Spring 2024 Economic Forecast.

5) Annual percentage change. A positive (negative) number denotes appreciation (depreciation) vis-à-vis the euro. Data for 2024 refer to the period from 1 January 2024 to 19 June 2024.

6) Average annual interest rate. Data for 2024 refer to the period from June 2023 to May 2024.

7) The reference values for HICP inflation and long-term interest rates refer to the period from June 2023 to May 2024; for the general government balance and debt, the reference values referred to in Article 126(2) of the Treaty are specified in the related Protocol (No 12) on the excessive deficit procedure.

Over the past two years the EU has been hit by the economic fallout from Russia's invasion of Ukraine, which led to a significant weakening of economic activity and soaring inflation rates. Since early 2022 Russia's war against Ukraine has weighed on economic activity in the countries under review owing to the associated uncertainty, trade and supply chain disruptions, and deteriorating business and consumer confidence. At the same time, the surge in energy and commodity prices reduced demand and held back production. The central and eastern European

countries under review have been particularly strongly affected by the economic impact of the war given their high energy intensity of production, their economic openness and integration in global supply chains, and their trade with and financial exposures to Russia (see also Section 3.1). In addition, the tightening of monetary policy, which in most of the countries under review started earlier than in the euro area, has weighed on economic activity. The Czech Republic, Hungary and Sweden were particularly strongly affected, with their economies contracting in 2023 as a whole. In the same year, weak growth was recorded in Poland, while the economies of Bulgaria and Romania remained somewhat more resilient, growing at rates of around 2%, supported by relatively strong domestic demand.

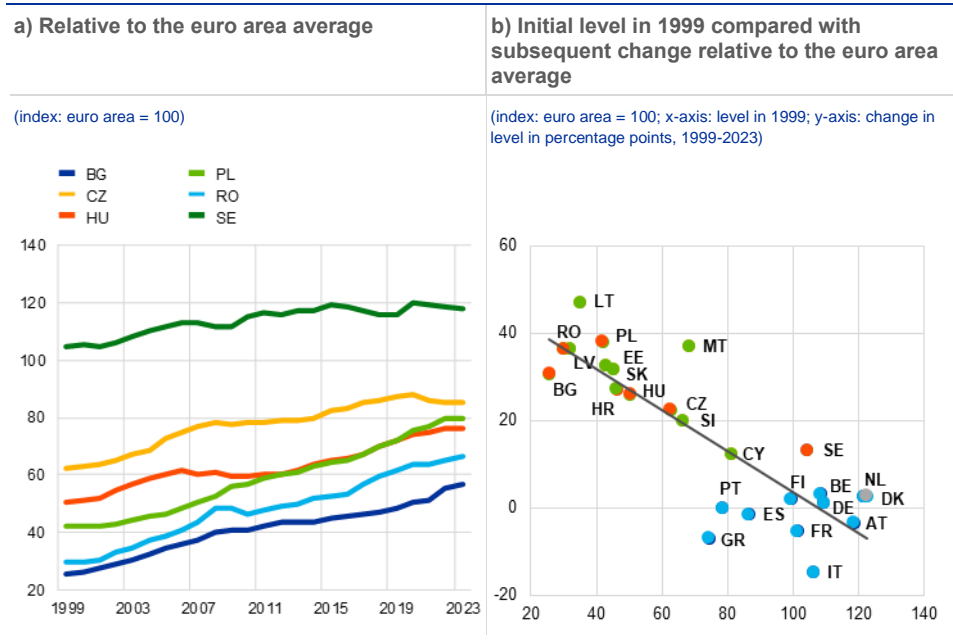
Economic activity is expected to strengthen in the near term in all the countries under review, but geopolitical tensions are clouding their economic prospects.

The easing of price pressures and supply bottlenecks observed since the beginning of 2023, along with improved confidence and resilient labour markets, is expected to support the economic recovery of the countries under review in 2024. At the same time, economic activity will continue to be dampened by tight financing conditions and uncertainty. A key source of uncertainty is geopolitical tensions, which might exacerbate fragmentation trends, potentially further disrupting trade and investment flows and increasing risk perceptions. The economic outlook is also clouded by losses in price competitiveness over recent years in most of the countries under review and uncertainty surrounding the path of inflation.

Over recent decades the central and eastern European countries under review have made progress in terms of real convergence towards the euro area average.

Since 1999 these countries have significantly narrowed their gaps to the euro area average in terms of real GDP per capita (Chart 3.1). However, since 2019 the catching-up process has stalled, or even reversed, in some countries, particularly the Czech Republic, which experienced substantial real exchange rate appreciation between the end of 2019 and spring 2023. At the same time, significant macroeconomic and financial vulnerabilities persist, albeit to differing degrees depending on the country. If not adequately addressed, such vulnerabilities are likely to expose countries to adverse external shocks and slow their convergence progress over the long term. Some of the key challenges related to the long-term real convergence of these countries include (i) a changing and uncertain geopolitical landscape, which might not only affect trade and investment flows in the near future but also shape long-term production trends; (ii) shifting industrial structures, which is typically a challenge for countries moving from middle to high income levels; (iii) persistent labour shortages and adverse demographic developments, particularly the outflow of highly skilled people; and (iv) limited progress on improving the quality of governance, institutional capacity and the business environment.

Chart 3.1
Real GDP per capita

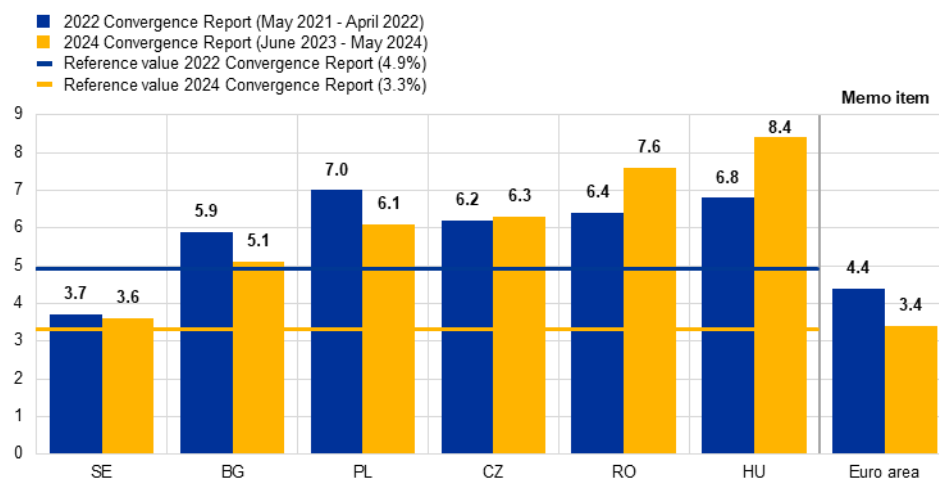


Sources: European Commission (Directorate-General for Economic and Financial Affairs) and ECB calculations.
Notes: Based on real GDP per capita in terms of purchasing power standard. In panel b), the red dots indicate the countries under review; the green dots indicate countries that joined the euro area from 2003 onwards; the light blue dots indicate countries that joined the euro area before 2003; the grey dot indicates Denmark. Ireland is excluded because of the exceptional GDP revision made for 2015, which did not reflect an actual increase in economic activity. Luxembourg is excluded because GDP per capita computations are distorted by the high number of cross-border workers.

Regarding the price stability criterion, the 12-month average inflation rate was above the reference value of 3.3% in all of the six countries examined in the report (Chart 3.2). Bulgaria, the Czech Republic, Hungary, Poland and Romania recorded inflation rates well above the reference value, while inflation was slightly above the reference rate in Sweden. In the 2022 Convergence Report, Bulgaria, the Czech Republic, Hungary, Poland and Romania also recorded inflation rates well above the reference value applicable at that time, which was 4.9%.

Chart 3.2
HICP inflation

(average annual percentage changes)



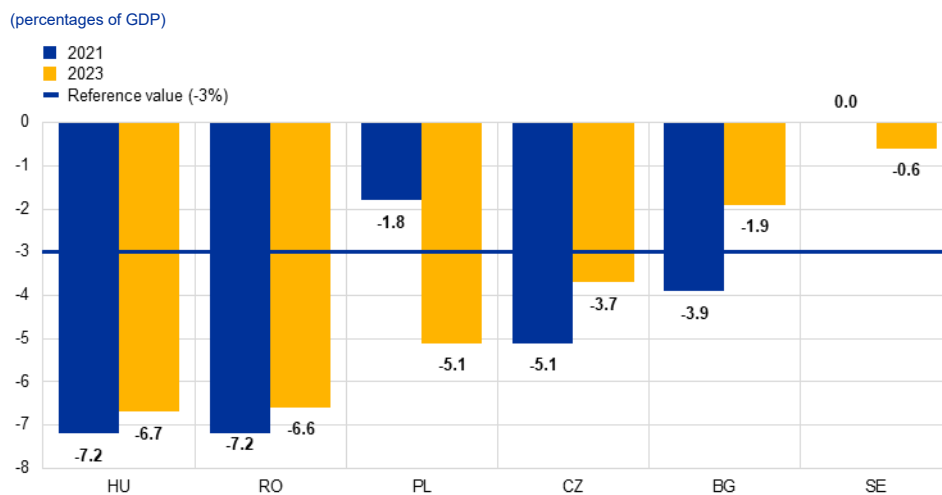
Source: Eurostat.

At the time of publication of this report, Romania is the subject of an EU Council decision on the existence of an excessive deficit. In addition, the European Commission found in June 2024 that Hungary and Poland did not fulfil the deficit criterion of the Stability and Growth Pact. After sharp increases during the pandemic, budget deficits mostly decreased but remained at elevated levels in all the countries except Sweden in 2023. Compared with the 2022 Convergence Report, the budget balance improved in four of the countries under review, while it deteriorated strongly in Poland and to a lesser extent in Sweden. In 2023 the budget deficit was above the reference value in four of the countries under review: in Hungary and Romania, it was significantly above the reference value, at 6.7% and 6.6% of GDP respectively, in Poland it was well above the reference value, at 5.1% of GDP, and in the Czech Republic, it was above the reference value, at 3.7% of GDP (Chart 3.3). In 2024 the deficit-to-GDP ratio is expected to deteriorate in four of the countries, according to the European Commission's Spring 2024 Economic Forecast, and it is expected to remain above the 3% reference value in Hungary, Poland and Romania. In 2025 the budget balance is expected to improve in four of the countries, but is expected to continue to exceed the reference value in Hungary, Poland and Romania. Regarding the debt criterion, in 2023 the debt ratio was well below the reference value in both Bulgaria and Sweden (Chart 3.4). In the Czech Republic, Poland and Romania it was below the reference value, between 40% and 50% of GDP. Hungary was the only country under review with a general government debt-to-GDP ratio above the 60% reference value in 2023. At the cut-off date for this report, Romania was still subject to a Council decision on the existence of an excessive deficit. An excessive deficit procedure was launched in April 2020, and in June 2024 the Commission found that Romania had not taken effective action to put an end to its excessive deficit situation. At the same time, the Commission also concluded that the government deficit criterion of the Stability and Growth Pact was not fulfilled either in Hungary or Poland, based on their outcomes in 2023 and planned deficits for 2024. Consequently, the Commission announced its intention to propose in July 2024 to the EU Council to

adopt a decision under Article 126(6) of the Treaty establishing the existence of an excessive deficit situation in Hungary and Poland.

Chart 3.3

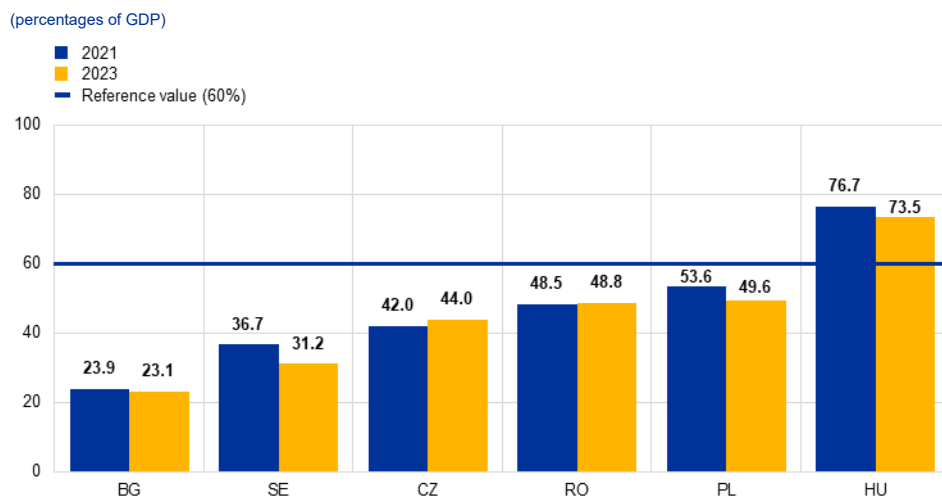
General government surplus (+) or deficit (-)



Source: Eurostat.
Note: Data for 2021 have been revised slightly since the 2022 Convergence Report.

Chart 3.4

General government gross debt



Source: Eurostat.
Note: Data for 2021 have been revised slightly since the 2022 Convergence Report.

As regards the exchange rate criterion, only the Bulgarian lev is participating in the exchange rate mechanism (ERM II) at the time of publication of this report.

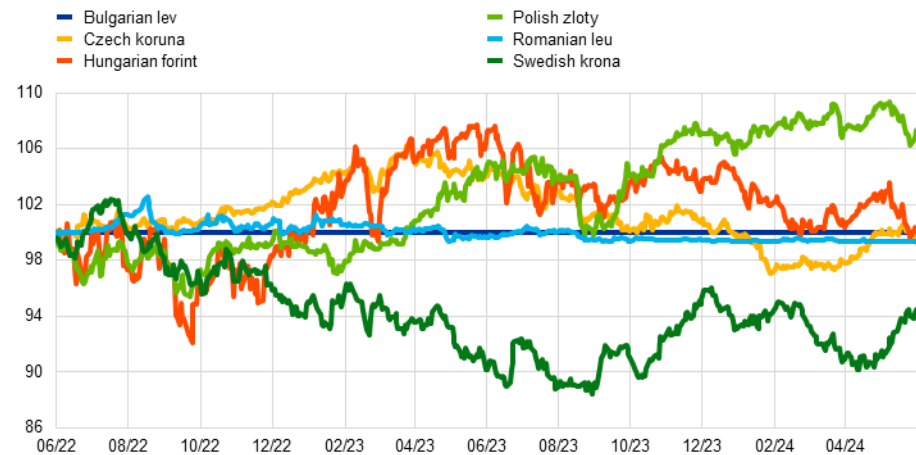
The Bulgarian lev was included in ERM II as of July 2020 at a central rate of 1.95583 levs per euro and is subject to the standard fluctuation band of $\pm 15\%$. Bulgaria joined ERM II with its existing currency board in place as a unilateral commitment, placing no additional obligations on the ECB. The agreement on participation in ERM II was based on a number of policy commitments made by the Bulgarian authorities. Over the two-year reference period the Bulgarian lev did not exhibit any deviation from its

central rate. With the exception of the Romanian leu, which showed low volatility, the other currencies not participating in ERM II exhibited relatively high volatility. The Czech koruna, the Romanian leu and the Swedish krona were weaker against the euro in June 2024 than in June 2022. At the same time, the Hungarian forint was trading at almost the same level, while the Polish zloty was stronger (Chart 3.5).¹⁴⁸

Chart 3.5

Bilateral exchange rates vis-à-vis the euro

(index: average of June 2022 = 100; daily data; 20 June 2022 - 19 June 2024)



Source: ECB.

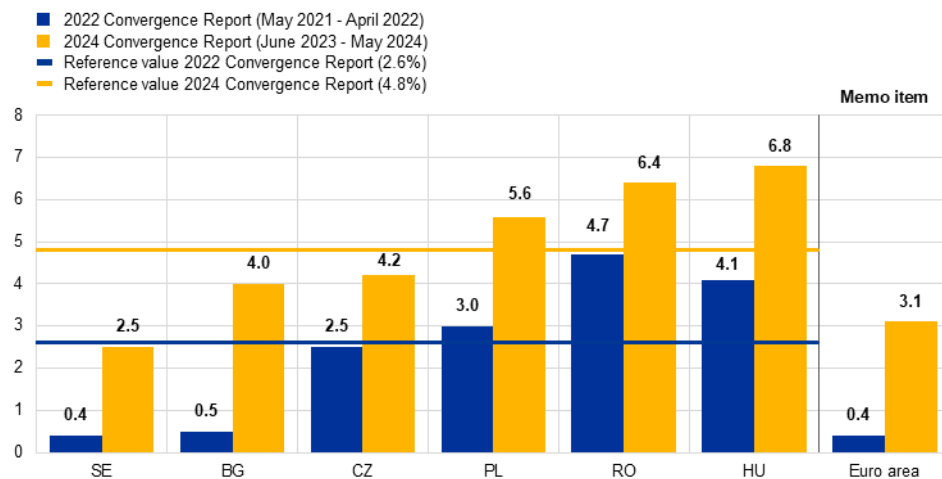
Note: An upward (downward) movement indicates appreciation (depreciation) of the currency.

With regard to the convergence of long-term interest rates, three of the six countries under review recorded long-term interest rates above the reference value, which was 4.8% (Chart 3.6). Interest rates were above the reference value in Poland, Romania and Hungary. The lowest value was recorded in Sweden. In the 2022 Convergence Report, long-term interest rates in Poland and Hungary were above the reference value, which at that time was 2.6%, while in Romania they were well above that value.

¹⁴⁸ For the purpose of this report, exchange rates are quoted in units of national currency per euro. Thus a decrease in the exchange rate corresponds to an appreciation of the currency against the euro, and an increase in the exchange rate corresponds to a depreciation of the currency against the euro, while the percentage changes indicate the degree of appreciation or depreciation of the currency.

Chart 3.6
Long-term interest rates

(percentages, annual averages)



Sources: Eurostat and ECB.

When considering compliance with the convergence criteria, sustainability is essential. Convergence must be achieved on a lasting basis and not just at a given point in time. The first decade of Economic and Monetary Union (EMU) showed that weak fundamentals, an excessively loose macroeconomic stance, inadequate statistical capacity at the country level and overly optimistic expectations about convergence in real incomes pose risks not only to the countries concerned but also to the smooth functioning of the euro area as a whole. The second decade showed that economic convergence can be challenging and take a long time if initial macroeconomic imbalances are large, adjustment and reform processes are difficult, and/or resilience to adverse shocks is weak. Addressing these challenges is the responsibility of national authorities and is first and foremost in the country's own interest, but it is also important for the smooth functioning of the of the euro area in general and the transmission of monetary policy in particular. Compliance with the numerical convergence criteria at a single point in time is, by itself, not a guarantee of smooth and beneficial economic and financial developments as a member of the euro area in the future. Countries joining the euro area should therefore demonstrate the sustainability of their convergence processes and their capacity to live up to the ongoing commitments and challenges which euro adoption represents, taking into account that the monetary union is not a fiscal union and that risk-sharing mechanisms within EMU are thus very limited.

To achieve sustainable convergence, lasting policy adjustments are required in many of the countries under review. Prerequisites for sustainable convergence include macroeconomic stability, a supportive business environment with efficient economic structures and public institutions, and, in particular, a sound fiscal policy. A high degree of flexibility in product and labour markets is essential to cope with macroeconomic shocks. A stability culture needs to exist, with well-anchored inflation expectations helping to achieve an environment of price stability. The conditions of an open market economy with free competition are needed to ensure the efficient use of

capital and labour in the economy, and to support productivity and long-run economic growth. A high degree of economic integration with the euro area is needed to achieve the synchronisation of business cycles. Moreover, appropriate macroprudential policies need to be in place to prevent the build-up of macroeconomic and financial imbalances, such as excessive asset price increases and socially costly boom-bust credit cycles. An appropriate framework for the supervision of financial institutions also needs to be in place. In the case of countries subject to in-depth reviews by the European Commission in the context of the macroeconomic imbalance procedure (MIP), it is essential that they address the identified imbalances in their economies. Finally, the strength of the institutional environment, including a country's ability to implement economic adjustment and sound structural policies, is a major factor in economic integration and convergence. The Next Generation EU (NGEU) package represents a unique opportunity to accelerate the process of convergence with the euro area, with efficient and effective implementation of investment plans and reforms being crucial for its success.

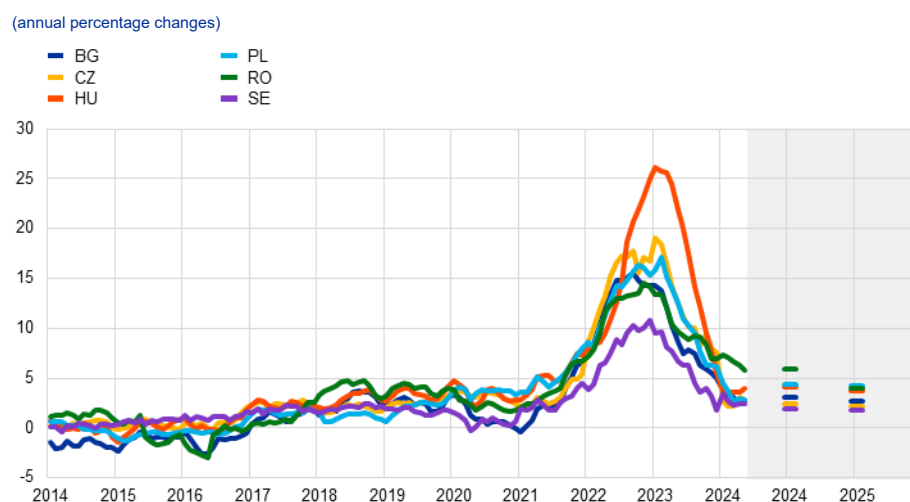
3.1 The price stability criterion

In May 2024 five of the six countries under review recorded a 12-month average inflation rate well above the reference value of 3.3% for the price stability criterion. Inflation rose sharply in 2021, largely driven by base effects, strong increases in energy prices, supply bottlenecks triggered by the pandemic, and a sharp rise in global demand for goods. Since early 2022 Russia's war against Ukraine has exacerbated inflationary pressures through higher energy and commodity prices and by adding strains to already stretched supply chains. Consequently, inflation increased further in all countries under review in 2022, albeit to differing degrees owing partly to domestic policies. Since the 2022 Convergence Report, inflation has followed a similar pattern in most of the countries under review; between June 2023 and May 2024 inflation moderated significantly in all countries, but was higher in Bulgaria, the Czech Republic, Hungary, Poland and Romania than in Sweden, mainly reflecting their greater vulnerability to recent adverse global shocks, as well as the tightness of their labour markets. Against this background, these five countries recorded inflation rates well above the reference value, while in Sweden the inflation rate was slightly above the reference value.

Longer-term price developments have mirrored the volatile macroeconomic environment, particularly over the past few years. Over the past ten years both the average rate and the volatility of inflation have varied significantly across the countries examined (Chart 3.7). During this period, average inflation was consistently higher than in the euro area in all the countries under review. Initially, from 2014 to 2016, inflation was subdued in all the countries, mainly reflecting developments in global commodity prices, low imported inflationary pressures and, in some countries, persistent spare capacity, reductions in administered prices and indirect taxes, and a strengthening of the nominal effective exchange rate. Against this backdrop, monetary policy conditions were loosened considerably. From 2017 inflation accelerated owing to the strengthening of economic activity, solid domestic demand, increasingly tight labour market conditions and rising energy and commodity prices, prompting a

tightening of the monetary policy stance in some of the countries under review. The outbreak of the pandemic in 2020 resulted in a large drop in economic activity in that year. Inflation slowed in some countries, while it remained more persistent in others, reflecting higher food and services prices, as well as the tightness of the labour market. Inflation increased significantly in all the countries under review in 2021 and 2022, largely driven by sharp increases in energy prices, and by the supply-demand mismatches triggered by the pandemic and the macroeconomic policy responses. Since early 2022 Russia's war against Ukraine has added to the inflationary pressures. To combat this rise in inflation, most central banks started to strongly increase their main policy rates in 2021, while governments introduced discretionary fiscal support measures to alleviate the burden of high inflation on the economy. In the countries under review, these measures were concentrated in 2022 and 2023, and mainly took the form of increases in subsidies, largely in relation to energy products, and, to a lesser extent, reduced indirect taxes. After peaking around the end of 2022/beginning of 2023, inflation started to fall sharply, driven by previous monetary policy tightening, the fall in global energy prices and the easing of pipeline pressures and supply bottlenecks. Given the moderation in inflation dynamics, central banks in the Czech Republic, Hungary and Poland started to ease their monetary policy stance, while fiscal support measures have gradually been withdrawn in all the countries under review.

Chart 3.7
Long-term HICP inflation developments and outlook



Sources: Eurostat, European Commission (Directorate-General for Economic and Financial Affairs) and ECB.
Notes: Solid lines depict annual percentage changes in the monthly HICP. In the shaded area, projections of annual HICP inflation from the European Commission's Spring 2024 Economic Forecast are shown.

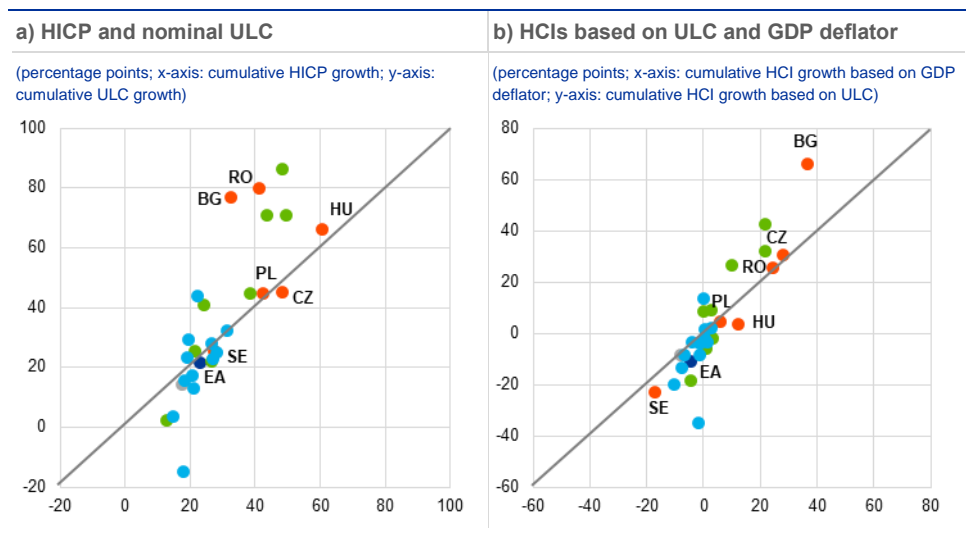
Most of the countries under review were particularly exposed to recent global shocks, largely owing to certain structural features of their economies.

Countries in central and eastern Europe experienced significantly higher inflation rates than the euro area and Sweden, reflecting their vulnerability to the impact of the war in Ukraine and associated geopolitical changes. First, these countries typically display a higher energy intensity of production than the euro area, mainly owing to larger energy-intensive sectors (i.e. manufacturing and transport) and fewer energy-efficient appliances and buildings. Second, the share of energy and food in their consumption

baskets is higher than in the euro area, which can often be seen in economies with lower average incomes. Third, most of these economies were heavily dependent on Russian energy prior to the outbreak of the war, making them more vulnerable to energy supply disruptions. Fourth, these countries are deeply integrated in global supply chains, implying a larger impact of global supply bottlenecks. While external shocks were an important driver of initial inflation differentials, domestic factors also played a prominent role. In particular, labour market conditions have remained tight in most of the countries under review, with historically low unemployment rates and persistent labour shortages resulting in robust wage growth (Chart 3.8, panel a) (see also Section 3.5).

Chart 3.8

Cumulative growth in the HICP, nominal unit labour costs (ULC) and harmonised competitiveness indicators (HCIs) between 2014 and 2023



Sources: Eurostat and ECB.

Notes: Panel a) shows cumulative ULC growth on the y-axis and cumulative HICP growth on the x-axis; panel b) shows cumulative growth of HCIs based on the GDP deflator on the x-axis and cumulative growth of HCIs based on total ULC on the y-axis. The solid lines in each panel represent the bisector. HICP growth is computed from monthly data aggregated to average annual data. HCIs based on the GDP deflator for individual countries are calculated relative to the 20 euro area countries and the EER-41 group of trading partners; HCIs based on total ULC for individual countries are calculated relative to the 20 euro area countries and the EER-18 group of trading partners. For the euro area, HCIs based on the GDP deflator and total ULC are calculated relative to the EER-41 and the EER-18 group of trading partners, respectively. The red dots indicate the countries under review (labelled); the green dots indicate countries that joined the euro area from 2003 onwards (unlabelled); the light blue dots indicate countries that joined the euro area before 2003 (unlabelled); the grey dot indicates Denmark; the dark blue dot indicates the euro area aggregate.

While inflationary pressures are expected to moderate further over the forecast horizon, over the longer term there are concerns about the sustainability of inflation convergence in most of the countries examined.

According to the European Commission's Spring 2024 Economic Forecast, inflation is expected to decrease from 2023 levels in all the countries under review in 2024, owing to the ongoing easing of pipeline pressures and supply bottlenecks and to the past monetary policy tightening. However, inflation is expected to remain elevated in Hungary, Poland and Romania in 2024 and 2025, owing to a recovery in domestic demand and high labour cost growth, while in Sweden it is projected to already converge to the target in 2024. These forecasts are subject to considerable uncertainty given the current circumstances. The risks to the inflation outlook are tilted to the upside in almost all the countries under review, as renewed global supply bottlenecks and tensions in energy markets might result in stronger than expected inflation, which,

given the tightness of the labour markets, could also exert further upward pressure on wages. Looking further ahead, since GDP per capita and price levels are still lower than in the euro area in all the central and eastern European countries under review, the catching-up process is likely to result in positive inflation differentials vis-à-vis the euro area, unless counteracted by an appreciation of nominal exchange rates.

An environment that is conducive to sustainable price stability in the countries covered in this report requires stability-oriented economic policies, structural reforms and measures to safeguard financial stability. Achieving or maintaining an environment supportive of price stability will crucially depend on the functioning of labour markets. Looking ahead, an important factor will be how wages react to high realised inflation and how they reflect labour productivity growth and take into account labour market conditions and developments in price and cost competitiveness relative to competitor countries (Chart 3.8). Continued reform efforts are needed to further improve the functioning of labour and product markets and to maintain favourable conditions for economic expansion and employment growth. To this end, measures to support stronger governance and further improvements in the quality of institutions are essential. Given the limited room for manoeuvre in monetary policy, especially for Bulgaria, which participates in ERM II, it is imperative that other policy areas support the capacity of these economies to maintain price stability, cope with country-specific shocks and avoid the build-up of macroeconomic imbalances.

3.2 The government budgetary position criterion

At the time of publication of this report, Romania remains the subject of an EU Council decision on the existence of an excessive deficit, while three other countries also exceeded the deficit reference value in 2023. The deficit in Romania exceeded the 3% of GDP reference value in 2019 and an excessive deficit procedure was opened in April 2020. The deadline for correction of the excessive deficit was later set to 2024. The fiscal deficit-to-GDP ratios of four of the countries under review exceeded the reference value in 2023. The deficits were above the reference value in the Czech Republic, at 3.7% of GDP, well above the reference value in Poland, at 5.1% of GDP, and significantly above the reference value in Romania, at 6.6% of GDP, and in Hungary, at 6.7% of GDP. In Bulgaria and Sweden the deficit remained well below the reference value, at 1.9% of GDP and 0.6% of GDP respectively.

The fiscal deficit in 2023 was below its 2021 level in four of the countries covered in this report on account of the economic recovery after the pandemic and the phasing-out of the fiscal policy measures taken in response to it. After having risen above the 3% reference value in all the countries under review except Sweden in 2020, as the pandemic led to a substantial deterioration in economic activity and fiscal measures were adopted to mitigate its impact, the deficit remained above the reference value in four of the countries in 2021. In 2022 the budget balance improved in most of the countries as their economies continued to recover and parts of the fiscal support measures were withdrawn. However, in 2023 this was partly counteracted by the ongoing economic impact of Russia's war against Ukraine, the

fiscal policy measures taken in response to the resulting high energy prices and the weakening of economic activity, leading to a worsening of the budget balance in 2023 compared with 2022 in five of the countries, most notably in Poland, where the budget deficit in 2023 was 3.3 percentage points higher than in 2021.

For 2024 the European Commission forecasts that the deficit-to-GDP ratio will remain above the 3% reference value in Hungary, Poland and Romania. In 2024 the government balance is projected to deteriorate in four of the countries under review, and it is projected to remain well above the reference value in Hungary and Poland, and significantly above it in Romania. At the same time, it is expected to return to below the 3% reference value in the Czech Republic.

In 2023 the debt ratio was above 60% of GDP in Hungary, while in the other countries under review the debt levels were below or well below this threshold (Table 3.1 and Chart 3.4). The government debt-to-GDP ratio was below its 2021 level in four of the countries under review in 2023, mostly on account of the recovery after the pandemic. While the debt ratio increased notably, by 2.0 percentage points of GDP, in the Czech Republic and slightly, by 0.3 percentage points of GDP, in Romania, it fell by 5.5 percentage points of GDP in Sweden, 4.0 percentage points in Poland, 3.2 percentage points in Hungary and 0.8 percentage points in Bulgaria. Taking a longer perspective, between 2014 and 2023 the government debt-to-GDP ratio increased significantly in Romania (by 9.7 percentage points) and notably in the Czech Republic (by 2.1 percentage points), while it declined in the other countries.

For 2024 the European Commission projects an increase in debt-to-GDP ratios in all of the countries under review. The debt ratio is expected to increase notably in Poland and Romania and moderately in the other four countries. The Commission's projections indicate that the debt ratio will remain below or well below the 60% reference value in all the countries in 2024, with the exception of Hungary.

In June 2024 the European Commission found that Romania had not taken effective action to address its excessive deficit, and that Hungary and Poland did not fulfil the deficit criterion of the Stability and Growth Pact. On 19 June 2024 the Commission issued a report prepared in accordance with Article 126(3) of the Treaty based on data validated by Eurostat on 22 April 2024 for 12 Member States, including the Czech Republic, Hungary and Poland.¹⁴⁹ It found that in 2023 the budget deficit was above, and not close to, the 3% of GDP reference value in the Czech Republic, Hungary and Poland. Moreover, it found that Hungary and Poland were planning a deficit above, and not close to, the reference value in 2024. The excess over the reference value was not considered to be exceptional (as defined by the Treaty) in all three countries. It was not expected to be temporary in Hungary or Poland, whereas it was expected to be temporary in the Czech Republic, as its deficit was projected not to exceed the reference value in 2024 and 2025. Overall, it assessed that the deficit criterion was not fulfilled by either Hungary or Poland, while it was assessed as being fulfilled by the Czech Republic. On the basis of the report, the

¹⁴⁹ Report prepared in accordance with Article 126(3) of the Treaty on the Functioning of the European Union ([COM\(2024\) 598 final](#)).

Commission announced its intention to propose in July 2024 to the EU Council to adopt a decision under Article 126(6) of the Treaty establishing the existence of an excessive deficit situation in Hungary and Poland. It is expected that the Commission will propose to the Council in autumn 2024 recommendations to put an end to the excessive deficit situation. Moreover, the Commission found that Romania had missed the deficit target of its ongoing excessive deficit procedure in 2023, and that the fiscal effort fell significantly short of what had been recommended by the Council. On that basis, the Commission issued a recommendation for a Council decision establishing that Romania had not taken effective action in response to the Article 126(7) recommendation to put an end to the excessive deficit situation by 2024 at the latest.

Looking ahead, it is essential for the countries examined in this report to achieve and/or maintain sound and sustainable fiscal positions. Romania, which is subject to an excessive deficit procedure and was found to be at high medium-term fiscal sustainability risk in the European Commission's Debt Sustainability Monitor 2023, should ensure compliance with the rules of the Stability and Growth Pact and correct its excessive deficit in line with the recommendation of the EU Council.¹⁵⁰ In all the countries under review except Sweden, the deficits in 2023 clearly exceeded those from before the pandemic. Those countries should return their budget balance to below the 3% reference value as soon as possible, or keep it below it, and they should build up the buffers needed to allow automatic stabilisers to work and raise resilience to adverse shocks. Moreover, Hungary, whose debt-to-GDP ratio exceeds the reference value, should ensure that its ratio is declining sufficiently to ensure that fiscal buffers are available for any future downturn. All countries need to ensure compliance with the revised Stability and Growth Pact, which will set recommendations for 2025 onwards. Generally, further consolidation would make it easier to deal with the budgetary challenges related to adverse demographic developments. Strong national fiscal frameworks that are fully in line with EU rules and implemented effectively should support fiscal consolidation and limit slippages in public expenditure, while helping to prevent a re-emergence of macroeconomic imbalances. Overall, fiscal strategies should be consistent with reprioritising government investment as well as comprehensive structural reforms to increase potential growth and employment. The NGEU programme needs to be implemented efficiently and effectively in order to support economic development and adjust to the structural changes that are under way.

3.3 The exchange rate criterion

At the time of publication of this report, the Bulgarian lev is the only currency participating in ERM II. The currencies of the other Member States under review operate under different exchange rate regimes.

¹⁵⁰ European Commission, [Debt Sustainability Monitor 2023](#), European Economy Institutional Paper, No 271, March 2024.

On 10 July 2020 the ERM II parties decided, by mutual agreement, to include the Bulgarian lev in ERM II and it therefore participated in ERM II for the two-year reference period from 20 June 2022 to 19 June 2024. The Bulgarian lev was included in ERM II at a central rate of 1.95583 levs per euro with a standard fluctuation band of $\pm 15\%$. Bulgaria joined ERM II with its existing currency board in place as a unilateral commitment, thus placing no additional obligations on the ECB. The agreement on participation in ERM II was based on a number of policy commitments made by the Bulgarian authorities (some of which had already fulfilled by the time of the inclusion of the lev in ERM II) with the aim of achieving a high degree of sustainable economic convergence by the time of euro adoption. The ECB and the European Commission have been monitoring the effective implementation of Bulgaria's post-entry commitments, acting within their respective areas of competence as provided for by the Treaties and secondary legislation. In its role as the supervisory authority, and given its shared responsibility for macroprudential policy, the ECB is closely monitoring the implementation of the commitments related to the financial sector, i.e. the insolvency framework and the anti-money laundering framework, owing to their potential impact on prudential aspects. Bulgaria is currently working towards completing these commitments and is encouraged to accelerate its efforts to fulfil the elements of the Action Plan as adopted by the Financial Action Task Force following the grey-listing of Bulgaria in October 2023. Over the reference period the lev did not exhibit any deviation from the central rate.

The currencies not participating in ERM II traded under flexible or managed floating exchange rate regimes, in most cases amid relatively high exchange rate volatility. The Romanian leu, which traded under a managed floating exchange rate regime, exhibited a low degree of volatility. The other currencies not participating in ERM II traded under flexible exchange rate regimes and were subject to a relatively strong degree of volatility. The Czech koruna, the Romanian leu and the Swedish krona were weaker against the euro in June 2024 than in June 2022. At the same time, the Hungarian forint was trading at almost the same level, while the Polish zloty was stronger.

3.4 The long-term interest rate criterion

Over the reference period, three of the six countries under review recorded average long-term interest rates that were above the 4.8% reference value. The countries with the lowest average long-term interest rates were Sweden and Bulgaria at 2.5% and 4.0% respectively. The Czech Republic also recorded an average long-term interest rate below the reference value at 4.2%, while Poland and Romania remained above at 5.6% and 6.4% respectively. The highest average long-term interest rate was recorded in Hungary at 6.8%. In 2022 12-month averages of long-term interest rates continued to rise owing to mounting inflationary pressures following the initial shock related to the impact of Russia's invasion of Ukraine. Since the beginning of 2023 long-term interest rates in all the countries appear to have stabilised, or even declined somewhat, albeit still remaining at high levels in almost all of them.

Since the 2022 Convergence Report, long-term interest rate spreads vis-à-vis the euro area average have declined in all of the countries under review except Bulgaria.

Nonetheless, a significant degree of heterogeneity persists in long-term interest rate differentials across the countries under review, reflecting differences both in the countries' cyclical positions and in financial markets' assessments of their external and internal vulnerabilities, including developments in budgetary performance and the prospects for sustainable convergence. In May 2024 Bulgaria's long-term interest rate was 60 basis points above the euro area level, representing a 0.9 percentage point increase in the differential compared with its level at the beginning of the review period in May 2022. These developments are presumably linked to country risk arising from political instability, as Bulgaria's banking system is predominantly owned by euro area-based banks and the central bank operates a currency board which de facto imports euro area monetary conditions. Hungary, Poland, the Czech Republic and Romania experienced the largest declines in the interest rate differential over the review period, by between 1.8 percentage points and 2.9 percentage points. Sweden's interest rate differential declined the least (by 0.8 percentage points).

3.5 Other relevant factors

According to the European Commission, concerns related to cost competitiveness pressures have increased significantly. In its [Alert Mechanism Report 2024](#) the Commission refers in particular to the significant increase in nominal unit labour costs in the central and eastern European countries under review, amidst large cumulated inflation differentials and tight labour markets. The Commission concluded that in-depth reviews were warranted for Hungary, Romania and Sweden. As regards Hungary, the Commission found that there are still concerns related to strong price and cost pressures, government and external financing needs, and house prices. For Romania, it found that concerns related to cost competitiveness, external sustainability and the government deficit remain substantial. In the case of Sweden, the Commission found that concerns related to house prices, high household debt and corporate debt remain. Although the Commission classified the other countries under review in this report as having no imbalances, those countries also face various challenges. In its [2024 European Semester Spring Package](#), the Commission confirmed that Hungary and Sweden continue to experience imbalances, while Romania was found to be experiencing excessive imbalances after experiencing imbalances until 2023, as vulnerabilities related to external accounts, mainly linked to large and increasing government deficits, remain, while significant price and cost pressures have increased and policy action has been weak.

The external positions of most of the countries under review have deteriorated in recent years. The MIP scoreboard shows that three-year average current account balances moved further into negative territory in most of the countries under review in 2023 (Table 3.2). Widened deficits reflected surging commodity prices, resulting in worsening terms of trade, together with resilient domestic demand and weak import demand in major trading partners. In 2023 the three-year average current account deficit was beyond the lower band of the indicative threshold of -4.0% of GDP in

Romania and at -4.0% in Hungary. It was above the upper band of the indicative threshold of 6.0% in Sweden.

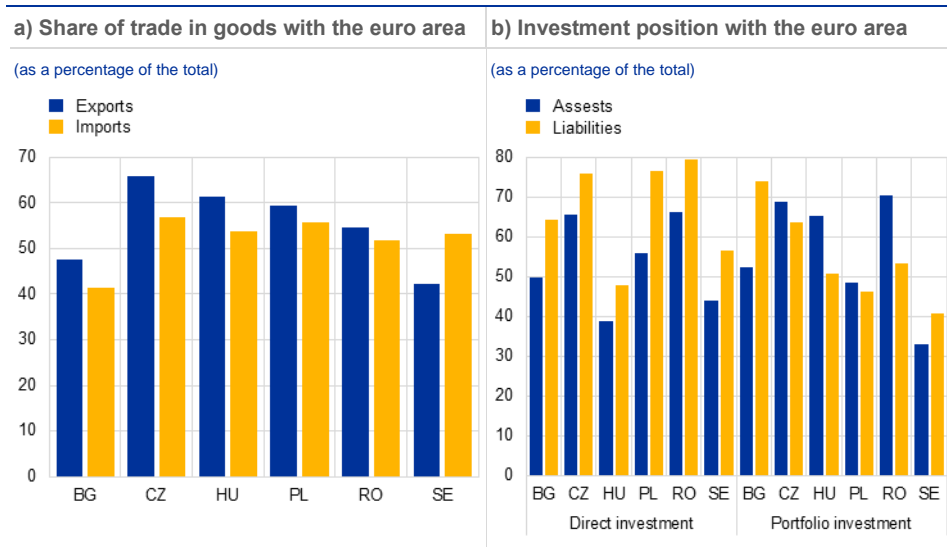
In most of the countries under review, negative net international investment positions as a share of GDP have diminished but remain at high levels. The net foreign liabilities of the central and eastern European countries are mainly in foreign direct investment, which is considered a more stable form of financing. In 2023 the net international investment position was beyond the indicative threshold of -35% of GDP in Hungary and Romania. Net foreign liabilities were lower in Poland (31.5% of GDP), the Czech Republic (13.2% of GDP) and Bulgaria (7.6% of GDP), while Sweden recorded a positive net international investment position (33.2% of GDP).

In terms of price and cost competitiveness, between 2021 and 2023 HICP-deflated real effective exchange rates appreciated to different degrees in many of the countries examined, with Sweden being an exception. The three-year growth rate of unit labour costs, stood at very high levels in almost all the countries under review. It exceeded the indicative threshold of 12% in all the countries except Sweden in 2023. In Bulgaria, Hungary and Romania, unit labour costs increased by more than twice the threshold. Despite the deterioration in price and cost competitiveness, export market shares improved somewhat in all countries in 2023 and also over a multi-year horizon (owing to, for example, the expansion of export production capacities).

The economies of the countries under review remain well integrated with the euro area through trade and financial linkages. The euro area is the main trading and financial partner of all the countries under review (Chart 3.9). In 2023 exports of goods to the euro area ranged from around 40.7% of total exports in Sweden to 62.4% in the Czech Republic. In the same year, imports from the euro area varied between 41.8% of total imports in Bulgaria and 55.8% in Poland. As regards financial investment, the share of the euro area in the stock of inward direct investment exceeded 70% in the Czech Republic, Romania and Poland, while the share of the euro area in the stock of portfolio investment liabilities was above that threshold in Bulgaria. For both direct investment and portfolio investment, the share of the stock of foreign assets invested in the euro area was highest in Romania, followed by the Czech Republic. In addition, banks owned by financial institutions domiciled in the euro area play an important role in the banking systems of the central and eastern European countries under review, especially in Bulgaria, the Czech Republic and Romania. Overall, the business cycles of all the countries under review continue to be highly synchronised with that of the euro area.

Chart 3.9

Trade and financial linkages with the euro area



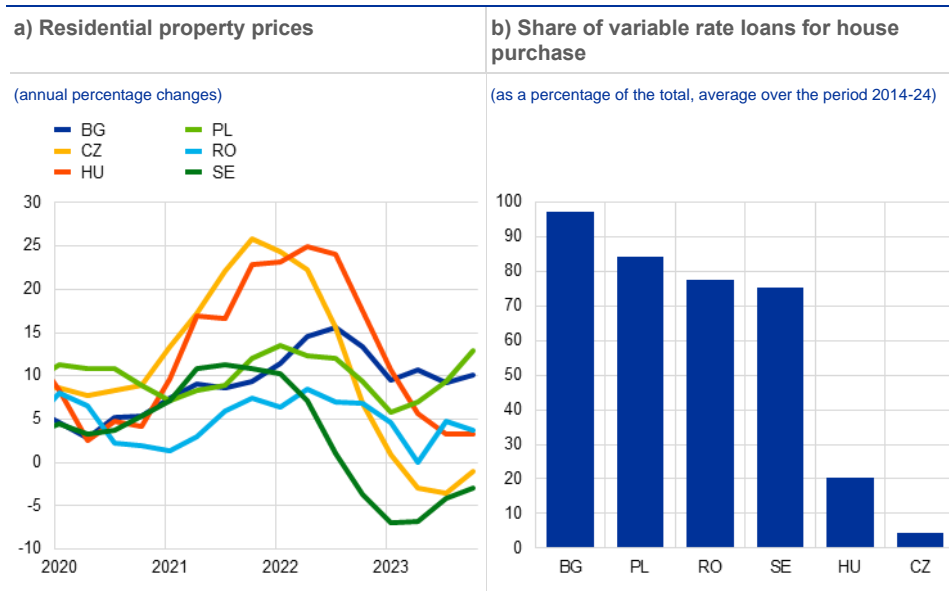
Sources: Eurostat and ECB.
Note: Data refer to 2023.

Since 2022 house price growth has decelerated in all the countries under review.

In the period 2021-22 house prices increased at rates not seen since before the global financial crisis in most of the countries under review. Since 2022 the steep increase in borrowing costs, coupled with deteriorating consumer confidence, has had a dampening impact on mortgage lending and residential property prices, albeit to different degrees across the countries (Chart 3.10, panel a). In Bulgaria and Poland, the correction in the housing market was relatively mild, while house prices contracted sharply in Sweden, where risks remain high owing to elevated levels of household indebtedness and the large exposure of the banking sector to real estate. Higher interest rates increased debt service costs, particularly in countries where the share of variable rate mortgages has historically been high, such as Poland, Romania and Sweden (Chart 3.10, panel b). Looking ahead, the debt servicing capacity of households might be eroded further should energy prices soar again, interest rates remain higher for longer or labour market conditions deteriorate significantly.

Chart 3.10

House prices and share of variable rate mortgage loans

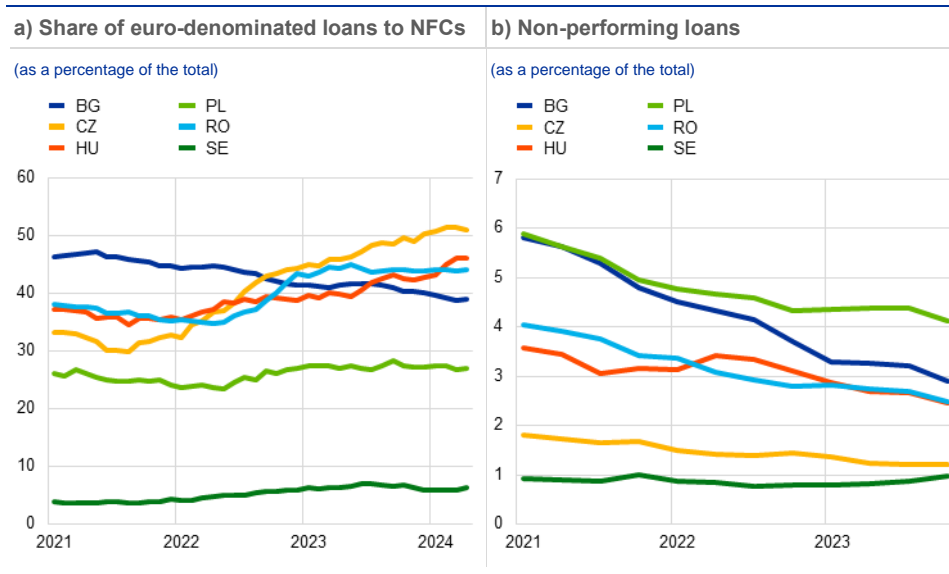


Sources: Eurostat, ECB, and ECB calculations.
Notes: Panel a): residential property prices in nominal terms; panel b): share of new loans to households for house purchase with a floating rate or an initial rate fixation period of up to one year in total new loans to households for house purchase. Average over the period from January 2014 to April 2024.

Exposures to foreign exchange risk increased in most of the countries under review, while the banking sector has remained resilient overall. Since 2022 the share of loans to firms denominated in euro has increased significantly (Chart 3.11, panel a), especially in the Czech Republic, Hungary and Romania, reflecting the widening of interest rate differentials vis-à-vis the euro area. By contrast, euro-denominated loans to households have remained at relatively low levels in all of the countries under review. Besides potentially reducing the effectiveness of domestic monetary policy, high euroisation increases the vulnerability of the financial system to exchange rate swings, as it could lead to currency mismatches on private sector balance sheets. Financial stability risks associated with higher foreign exchange exposures, higher interest rates and the ongoing correction in housing markets are mitigated by the resilience of the banking sectors, which have continued to display sound capital positions and liquidity buffers, stable access to funding and adequate profitability in all of the countries under review. In addition, non-performing loan ratios have declined further, reaching or remaining close to historical lows in 2023 (Chart 3.11, panel b), albeit remaining above the euro area level in most of the countries under review.

Chart 3.11

Euro-denominated and non-performing loans



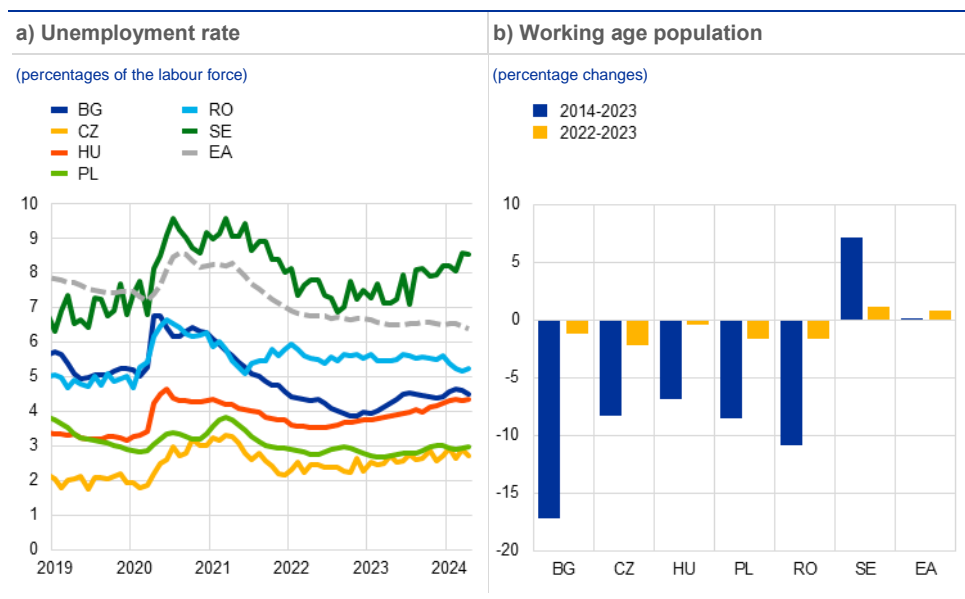
Sources: ECB and ECB calculations.
Note: Panel a): based on outstanding amounts.

Financial sector policies in the countries under review should be aimed at ensuring that the financial sector makes a sound contribution to sustainable economic growth and price stability, and supervisory policies should be geared towards ensuring a financially healthy and resilient banking system, which is a precondition for joining the Single Supervisory Mechanism (SSM). In order to further support confidence in the financial system, the national competent authorities should continue to improve their supervisory practices by, among other things, following the applicable recommendations of the relevant international and European bodies and by collaborating closely with national supervisors of other EU Member States within the supervisory colleges. Since the entry into force of the close cooperation framework with Българска народна банка (Bulgarian National Bank) in 2020, the ECB has assumed responsibility for (i) the direct supervision of significant institutions in Bulgaria, (ii) common procedures for all supervised entities, and (iii) the oversight of less significant institutions, which continue to be supervised by the national supervisor. Since establishing close cooperation, the ECB has worked closely with Българска народна банка (Bulgarian National Bank) to ensure its smooth integration into the SSM.

Labour market conditions have remained tight in most of the countries under review. Since the publication of the 2022 Convergence Report, the unemployment rate has increased somewhat in most countries under review, but it has remained close to historical lows and below the euro area level (Chart 3.12, panel a). Most of the countries continued to face labour shortages in certain segments of the labour market, which added to strong wage pressures. Shortages in labour supply are apparent from less favourable developments in the labour force and working age population in the central and eastern European countries under review compared with the euro area (Chart 3.12, panel b). These trends are due to migration outflows of highly skilled young people and rapid population ageing. Other structural challenges in the labour

markets of some of the countries under review include low labour market participation (especially for women) and significant skill mismatches. Although the tightness of the labour market represents an upward risk for the wage and inflation outlook in the near term, risks of a wage-price spiral seem to be contained, owing to broadly anchored longer-term inflation expectations, which reflect the markets' belief in the commitment of central banks to price stability. In the medium term, adverse demographics and structural issues in labour markets represent a major challenge for the central and eastern European countries in trying to further catch up with the euro area. Risks are particularly pronounced in Bulgaria and Romania, whose populations are expected to continue shrinking at a fast pace over the coming decade.

Chart 3.12
Labour market indicators



Sources: Eurostat and ECB calculations.
Note: Panel b): percentage changes between the first quarter of 2014 and the fourth quarter of 2023 (blue bars); percentage changes between the first quarter of 2022 and the fourth quarter of 2023 (yellow bars).

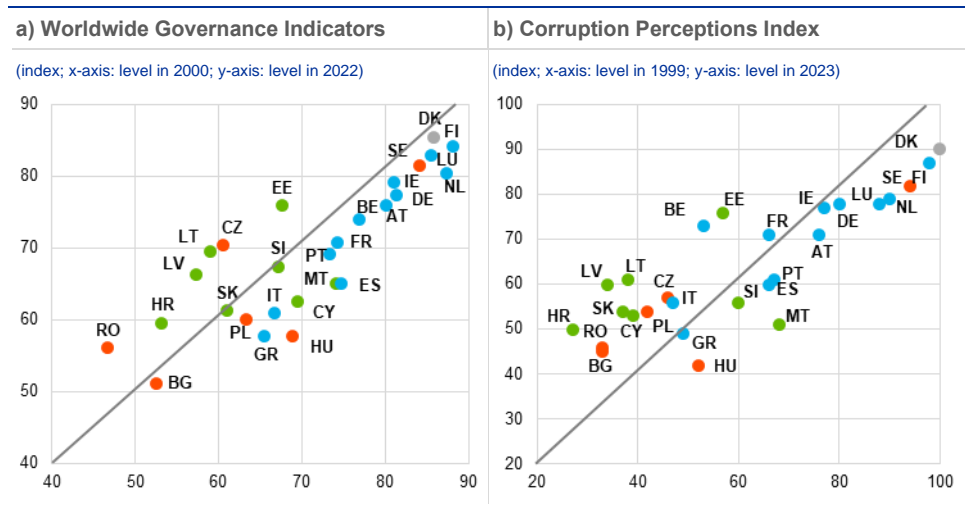
The strength of the institutional environment is another important factor in the analysis of the sustainability of economic integration and convergence. Low quality of institutions and weak governance may be associated with, for example, weaknesses in the business environment, an inefficient public administration, tax evasion, corruption, a lack of social inclusion, a lack of transparency, a lack of judicial independence and/or poor access to online services. In most of the countries under review, enhancing institutional quality would contribute to removing existing rigidities and impediments to the efficient allocation and use of production factors, thereby strengthening long-term growth capacity. By hampering potential output growth, a weak institutional environment may also undermine a country's debt servicing ability and make economic adjustment more difficult. It may also affect a country's ability to implement necessary policy measures.

The quality of institutions and governance is relatively weak in all the central and eastern European countries under review – especially in Bulgaria, Romania and Hungary. This can pose risks for economic resilience and the sustainability of

convergence. Specific institutional indicators broadly confirm an overall picture of poor-quality institutions and poor governance in most of the countries, although some of them have experienced an improvement over recent decades (Chart 3.13).¹⁵¹ In this respect, Bulgaria, Romania and Hungary are among the countries facing the greatest challenges within the EU. The implementation of the reforms set out in their respective Recovery and Resilience Plans would help strengthen the rule of law and governance in these countries.

Chart 3.13

Overview of EU countries in terms of institutional quality



Sources: Worldwide Governance Indicators 2023 (World Bank), Transparency International and ECB calculations.
Notes: Panel a): The index is computed as the average of the percentile scores (relative to the scale) of the following World Governance Indicators: voice and accountability, political stability and absence of violence/terrorism, government effectiveness, regulatory quality, rule of law, and control of corruption. Panel b): The Corruption Perceptions Index ranks countries by their perceived levels of public sector corruption on a scale of 0 (highly corrupt) to 100 (very clean). For the Corruption Perceptions Index, the reference years for Cyprus and Malta are 2003 and 2004 respectively. The red dots indicate the countries under review; the green dots indicate countries that joined the euro area from 2003 onwards; the light blue dots indicate countries that joined the euro area before 2003; the grey dot indicates Denmark.

Wide-ranging structural reforms are required in most of the countries under review to improve economic growth and competitiveness. Improving local institutions, governance and the business environment, along with further progress on the reform and privatisation of state-owned enterprises and the efficient absorption of EU funds, would help speed up productivity growth. This would in turn contribute to

¹⁵¹ Measuring institutional quality is challenging and inevitably involves a degree of judgement. On the one hand, perception-based indicators can have some merit when compared with other indicators. One advantage of perception-based surveys resides in their catch-all nature, whereas more specific measures may provide highly distorted information. Also, while the absolute value of perception-based indicators may be questionable, they are useful for cross-country comparisons, unless it is clear that there is a systematic bias against one or more specific countries. Moreover, indicators that are based solely on the content of laws, but not on detailed knowledge of their actual implementation, can be misleading. Furthermore, as no institutional model may be presumed to be preferable ex ante, perception-based surveys may prevent the emergence of measurement biases when gauging the various dimensions of economic governance directly. On the other hand, perception-based surveys also produce distortions. For instance, they may be heavily influenced by a recent episode or poorly designed questions. Moreover, as regards EU countries, the institutional focus has only gained analytical and policy prominence in recent years. There is thus, generally speaking, still ample scope for measurement improvements. Finally, cross-country approaches to an issue as complex as institutional quality or good governance are necessarily somewhat insufficient and clearly need to be complemented with more country-specific and longer-term assessments. At the same time, measurement difficulties should not lead to a down-playing of these crucially important determinants of long-term prosperity, social fairness and well-being.

increasing competition in key regulated sectors (e.g. energy and transport), lowering barriers to entry and encouraging much-needed private investment.

Table 3.2

Scoreboard for the surveillance of macroeconomic imbalances

Table 3.2a – External imbalances and competitiveness indicators

	Current account balance ¹	Net international investment position ²	Real effective exchange rate, HICP-deflated ³	Export market share ⁴	Nominal unit labour costs ⁵
Bulgaria					
2020	1.0	-25.6	7.0	15.4	19.9
2021	0.1	-18.6	3.7	10.9	16.4
2022	-1.0	-12.9	5.6	14.7	23.6
2023	-1.1	-7.6	8.6	15.9	27.4
Czech Republic					
2020	0.9	-16.3	5.5	7.8	18.7
2021	-0.1	-14.5	5.0	-2.0	13.9
2022	-1.9	-18.7	13.3	-7.5	14.8
2023	-2.4	-13.2	24.1	0.6	15.8
Hungary					
2020	-0.5	-52.5	-5.1	7.1	13.6
2021	-2.0	-53.6	-4.2	-3.0	12.5
2022	-4.5	-52.1	-8.9	-5.2	24.0
2023	-4.0	-46.6	10.3	4.4	34.0
Poland					
2020	0.1	-43.9	0.8	33.3	14.0
2021	0.3	-39.8	-0.7	23.3	12.1
2022	-0.4	-33.3	-0.5	15.8	15.7
2023	-0.7	-31.4	9.3	23.0	22.0
Romania					
2020	-4.8	-47.6	3.4	19.5	20.7
2021	-5.7	-47.0	1.1	9.2	14.7
2022	-7.1	-40.8	2.5	6.0	16.9
2023	-7.8	-39.8	6.7	10.6	26.7
Sweden					
2020	4.6	7.4	-4.8	2.8	8.1
2021	6.1	19.1	2.2	0.6	4.5
2022	6.2	31.6	-1.6	-3.2	7.8
2023	6.5	33.7	-7.3	3.7	11.1
Threshold	-4.0/+6.0	-35.0	+/-11.0	-6.0	+12.0

Table 3.2b – Internal imbalances and unemployment indicators

	Internal imbalances					Unemployment indicators			
	House prices, consumption-deflated ⁶	Private sector credit flow, consolidated ²	Private sector debt, consolidated ²	Financial sector liabilities ⁶	General government debt ²	Unemployment rate ⁷	Activity rate ⁸	Long-term unemployment ⁸	Youth unemployment ⁸
Bulgaria									
2020	5.2	4.2	92.1	10.5	24.6	5.8	0.9	-1.2	1.3
2021	2.5	4.9	84.0	10.4	23.9	5.5	0.6	-1.0	-0.1
2022	-2.1	5.9	74.6	11.8	22.6	5.2	0.6	-0.7	-1.5
2023	2.7	.	.	.	23.1	4.6	1.8	-0.4	-5.3
Czech Republic									
2020	5.4	0.6	81.7	4.8	37.7	2.3	0.5	-0.4	0.1
2021	16.4	2.9	78.8	8.2	42.0	2.5	0.0	0.1	1.5
2022	1.6	4.5	76.0	3.2	44.2	2.5	0.5	0.0	1.2
2023	-10.0	.	.	.	44.0	2.5	0.7	0.2	0.3
Hungary									
2020	1.5	8.2	76.9	54.9	79.3	3.7	2.0	-0.5	2.0
2021	9.6	12.9	80.9	16.9	76.7	3.8	2.1	-0.1	3.6
2022	5.2	9.2	79.0	8.7	74.1	3.9	2.5	0.1	-0.6
2023	-7.7	.	.	.	73.5	3.9	2.9	0.3	0.3
Poland									
2020	6.7	1.7	76.0	11.7	57.2	3.5	1.5	-0.9	-4.1
2021	3.5	3.7	71.2	12.9	53.6	3.3	3.5	-0.1	0.1
2022	-1.9	3.0	63.4	3.0	49.2	3.2	3.5	0.2	1.1
2023	-1.9	0.9	57.0	10.9	49.6	3.0	4.3	0.2	0.6
Romania									
2020	2.3	1.3	48.1	13.4	46.7	5.4	2.3	-0.6	-1.4
2021	-0.2	3.8	47.9	14.3	48.5	5.5	3.2	-0.2	0.5
2022	-6.4	3.3	43.7	8.2	47.5	5.8	3.5	0.2	1.8
2023	-5.9	2.0	40.4	16.7	48.8	5.6	2.7	0.4	0.2
Sweden									
2020	3.3	14.5	212.7	10.4	40.2	7.3	-0.1	-0.1	6.5
2021	8.1	16.2	213.5	11.2	36.7	8.1	0.1	0.9	7.9
2022	-3.0	10.4	208.0	3.0	33.2	8.3	0.7	1.1	2.4
2023	-10.9	.	.	.	31.2	8.0	1.9	0.6	-1.5
Threshold	+6.0	+14.0	+133.0	+16.5	+60.0	+10.0	-0.2	0.5	2.0

Sources: European Commission (Eurostat, Directorate-General for Economic and Financial Affairs) and European System of Central Banks.

Notes: This table includes data available as at 19 June 2024, i.e. the cut-off date for this report, and therefore differs from the scoreboard published in the Alert Mechanism Report 2024, which was published in November 2023.

1) As a percentage of GDP, three-year average.

2) As a percentage of GDP.

3) Three-year percentage change relative to 41 other industrial countries. A positive value indicates a loss of competitiveness.

4) Five-year percentage change.

5) Three-year percentage change.

6) Year-on-year percentage change.

7) Three-year average.

8) Three-year percentage point change.

4 Country summaries

4.1 Bulgaria

In May 2024 the 12-month average rate of HICP inflation in Bulgaria was 5.1%, i.e. well above the reference value of 3.3% for the criterion on price stability.

This rate is expected to decrease gradually over the coming months, as pipeline pressures and supply bottlenecks continue to ease. Core inflation is expected to remain persistently high, mainly reflecting strong wage pressures amid tight labour markets. Unit labour costs grew by 27.4% over the period from 2020 to 2023, which is well above the euro area rate of 9.5%. There are concerns about the sustainability of inflation convergence in Bulgaria over the longer term. The catching-up process is likely to result in positive inflation differentials vis-à-vis the euro area, since GDP per capita and price levels are still significantly lower in Bulgaria than in the euro area.

Bulgaria is currently not subject to a Council Decision on the existence of an excessive deficit. Bulgaria's general government budget deficit was 1.9% of GDP in 2023, i.e. well below the 3% reference value, and its debt-to-GDP ratio was 23.1%, i.e. well below the 60% reference value.

The Bulgarian lev participated in ERM II in the two-year reference period from 20 June 2022 to 19 June 2024. Over the reference period the lev did not exhibit any deviation from the central rate. The agreement on participation in ERM II was based on a number of policy commitments by the Bulgarian authorities. Bulgaria is currently working towards completing these post-entry commitments and is encouraged to accelerate its efforts to fulfil the elements of the action plan that was adopted by the Financial Action Task Force (FATF) after Bulgaria was placed on the FATF's "grey list" of jurisdictions under increased monitoring in October 2023.

Over the reference period from June 2023 to May 2024, long-term interest rates in Bulgaria stood at 4.0% on average and were thus below the 4.8% reference value for the interest rate convergence criterion. The differential between long-term interest rates in Bulgaria and the euro area (GDP-weighted) interest rate declined slightly, standing at 0.9 percentage points at the end of the reference period. Capital markets in Bulgaria remain smaller and much less developed than those in the euro area.

Bulgarian law is compatible with the Treaties and the Statute of the ESCB as required under Article 131 of the Treaty, subject to the conditions and interpretations set out in Section 7.1.

4.2 Czech Republic

In May 2024 the 12-month average rate of HICP inflation in the Czech Republic was 6.3%, i.e. well above the reference value of 3.3% for the criterion on price

stability. This rate is expected to decrease gradually over the coming months, driven by the past monetary policy tightening and the ongoing easing of pipeline pressures and supply bottlenecks. At the same time, the very tight labour market will continue to exert upward pressure on inflation. There are some concerns about the sustainability of inflation convergence in the Czech Republic over the longer term. Unless counteracted by an appreciation of the nominal exchange rate, the catching-up process may result in positive inflation differentials vis-à-vis the euro area, since GDP per capita and price levels are still relatively lower in Czech Republic than in the euro area.

The Czech Republic is currently not subject to a Council Decision on the existence of an excessive deficit. The Czech Republic's general government budget deficit was 3.7% of GDP in 2023, i.e. above the 3% reference value, while its debt-to-GDP ratio was 44.0%, i.e. below the 60% reference value. In June 2024, the European Commission assessed the excess deficit as being temporary since the deficits in 2024 and 2025 were projected not to exceed the reference value. After considering the relevant factors, it assessed the deficit criterion of the Stability and Growth Pact as being fulfilled.

In the two-year reference period from 20 June 2022 to 19 June 2024, the Czech koruna did not participate in ERM II, but traded under a flexible exchange rate regime. The exchange rate of the Czech koruna against the euro exhibited, on average, a relatively high degree of volatility over the reference period. On 19 June 2024 the exchange rate stood at 24.9100 korunas per euro, i.e. the koruna was 0.8% weaker than its average level in June 2022.

Over the reference period from June 2023 to May 2024, long-term interest rates in the Czech Republic stood at 4.2% on average and were thus below the 4.8% reference value for the interest rate convergence criterion. The differential between long-term interest rates in the Czech Republic and the euro area (GDP-weighted) interest rate declined slightly, standing at 1.1 percentage points at the end of the reference period. Capital markets in the Czech Republic are smaller and much less developed than those in the euro area.

Czech law does not comply with all the requirements for central bank independence, the monetary financing prohibition and legal integration into the Eurosystem. The Czech Republic is an EU Member State with a derogation and must therefore comply with all adaptation requirements under Article 131 of the Treaty.

4.3 Hungary

In May 2024 the 12-month average rate of HICP inflation in Hungary was 8.4%, i.e. considerably above the reference value of 3.3% for the criterion on price stability. This rate is expected to decrease gradually over the coming months, driven by the past monetary policy tightening and the ongoing easing of pipeline pressures and supply bottlenecks. At the same time, the tight labour market and strong repricing in the services sector will continue to exert upward pressure on inflation. Unit labour

costs grew by 34.0% over the period from 2020 to 2023, which is well above the euro area rate of 9.5%. There are concerns about the sustainability of inflation convergence in Hungary over the longer term. Unless counteracted by an appreciation of the nominal exchange rate, the catching-up process is likely to result in positive inflation differentials vis-à-vis the euro area, since GDP per capita and price levels are still lower in Hungary than in the euro area.

The European Commission found, in June 2024, that Hungary did not fulfil the deficit criterion of the Stability and Growth Pact. Hungary's general government budget deficit was 6.7% of GDP in 2023, i.e. significantly above the 3% reference value, and its debt-to-GDP ratio was 73.5%, i.e. above the 60% reference value. In June 2024, the Commission found that Hungary did not fulfil the deficit criterion of the Stability and Growth Pact and announced its intention to propose to the Council, in July, that a decision be adopted under Article 126(6) establishing the existence of an excessive deficit situation in Hungary.

In the two-year reference period from 20 June 2022 to 19 June 2024, the Hungarian forint did not participate in ERM II, but traded under a flexible exchange rate regime. The exchange rate of the Hungarian forint against the euro exhibited, on average, a very high degree of volatility over the reference period. On 19 June 2024 the exchange rate stood at 396.3400 forints per euro, i.e. the forint was trading almost at the same level (0.1%) as its average level in June 2022. The Magyar Nemzeti Bank entered a repo line arrangement with the ECB in June 2020, under which it could borrow up to €4 billion against high-quality euro-denominated collateral to provide euro liquidity to Hungarian financial institutions. This agreement remained in place over the reference period as it was extended again in January 2024.

Over the reference period from June 2023 to May 2024, long-term interest rates in Hungary stood at 6.8 % on average and were thus above the 4.8% reference value for the interest rate convergence criterion. The differential between long-term interest rates in Hungary and the euro area (GDP-weighted) interest rate declined sizeably, standing at 3.7 percentage points at the end of the reference period. Capital markets in Hungary are smaller and much less developed than those in the euro area.

Hungarian law does not comply with all the requirements for central bank independence, the prohibition of monetary financing, the requirements for the single spelling of the euro and legal integration into the Eurosystem. Hungary is an EU Member State with a derogation and must therefore comply with all adaptation requirements under Article 131 of the Treaty.

4.4 Poland

In May 2024 the 12-month average rate of HICP inflation in Poland was 6.1%, i.e. well above the reference value of 3.3% for the criterion on price stability. This rate is expected to decrease gradually over the coming months, driven by the past monetary policy tightening and the ongoing easing of pipeline pressures and supply

bottlenecks. At the same time, the tight labour market will continue to exert upward pressure on inflation. Unit labour costs grew by 22.0% over the period from 2020 to 2023, which is well above the euro area rate of 9.5%. There are concerns about the sustainability of inflation convergence in Poland over the longer term. Unless counteracted by an appreciation of the nominal exchange rate, the catching-up process is likely to result in positive inflation differentials vis-à-vis the euro area, since GDP per capita and price levels are still lower in Poland than in the euro area.

The European Commission found, in June 2024, that Poland did not fulfil the deficit criterion of the Stability and Growth Pact. Poland's general government budget deficit was 5.1% of GDP in 2023, i.e. well above the 3% reference value, while its debt-to-GDP ratio was 49.6%, i.e. below the 60% reference value. In June 2024, the Commission found that Poland did not fulfil the deficit criterion of the Stability and Growth Pact and announced its intention to propose to the Council, in July, that a decision be adopted under Article 126(6) establishing the existence of an excessive deficit situation in Poland.

In the two-year reference period from 20 June 2022 to 19 June 2024, the Polish zloty did not participate in ERM II, but traded under a flexible exchange rate regime. The exchange rate of the Polish zloty against the euro exhibited, on average, a relatively high degree of volatility over the reference period. On 19 June 2024 the exchange rate stood at 4.3300 zlotys per euro, i.e. the zloty was 6.8% stronger than its average level in June 2022. Between March 2022 and mid-January 2024 Narodowy Bank Polski had a swap line arrangement with the ECB, under which it could borrow up to €10 billion against zlotys in order to address potential euro liquidity needs in the Polish financial system.

Over the reference period from June 2023 to May 2024, long-term interest rates in Poland stood at 5.6% on average and were thus above the reference value of 4.8% for the interest rate convergence criterion. The differential between long-term interest rates in Poland and the euro area (GDP-weighted) interest rate declined slightly, standing at 2.6 percentage points at the end of the reference period. Capital markets in Poland are smaller and much less developed than those in the euro area.

Polish law does not comply with all the requirements for central bank independence, confidentiality, the monetary financing prohibition and legal integration into the Eurosystem. Poland is an EU Member State with a derogation and must therefore comply with all adaptation requirements under Article 131 of the Treaty.

4.5 Romania

In May 2024 the 12-month average rate of HICP inflation in Romania was 7.6%, i.e. considerably above the reference value of 3.3% for the criterion on price stability. This rate is expected to decrease gradually over the coming months, driven by past monetary policy tightening and the ongoing easing of pipeline pressures and

supply bottlenecks. At the same time, core inflation is expected to remain sticky, fuelled by strong wage developments in the context of a tight labour market. Unit labour costs grew by 26.7% over the period from 2020 to 2023, which is well above the euro area rate of 9.5%. There are concerns about the sustainability of inflation convergence in Romania over the longer term. Unless counteracted by an appreciation of the nominal exchange rate, the catching-up process is likely to result in positive inflation differentials vis-à-vis the euro area, since GDP per capita and price levels are still lower in Romania than in the euro area.

Romania is currently subject to an excessive deficit procedure and the European Commission found, in June 2024, that it had not taken effective action. Romania's general government budget deficit was 6.6% in 2023, i.e. significantly above the 3% reference value, while its debt-to-GDP ratio was 48.8%, i.e. below the 60% reference value. Since April 2020, Romania has been subject to an excessive deficit procedure, as its fiscal position exceeded the 3% reference value in 2019. Its headline deficit in 2023 was much higher than the recommended target. In June 2024, the European Commission assessed that Romania's response had been insufficient and recommended a Council Decision establishing that Romania had not taken effective action to address its excessive deficit.

Over the reference period from 20 June 2022 to 19 June 2024, the Romanian leu did not participate in ERM II, but traded under a flexible exchange rate regime involving a managed floating of the currency's exchange rate. The exchange rate of the Romanian leu against the euro exhibited, on average, a low degree of volatility over the reference period. On 19 June 2024 it stood at 4.9768 lei per euro, i.e. the leu was 0.7% weaker than its average level in June 2022. Between June 2020 and mid-January 2024 Banca Națională a României had a repo line arrangement with the ECB, under which it could borrow up to €4.5 billion against high-quality euro-denominated collateral to provide euro liquidity to Romanian financial institutions.

Over the reference period from June 2023 to May 2024, long-term interest rates in Romania stood at 6.4% on average and were thus above the 4.8% reference value for the interest rate convergence criterion. The differential between long-term interest rates in Romania and the euro area (GDP-weighted) interest rate increased slightly, standing at 3.2 percentage points at the end of the reference period. Capital markets in Romania are much smaller than those in the euro area and are still underdeveloped.

Romanian law does not comply with all the requirements for central bank independence, the monetary financing prohibition and legal integration into the Eurosystem. Romania is an EU Member State with a derogation and must therefore comply with all adaptation requirements under Article 131 of the Treaty.

4.6 Sweden

In May 2024 the 12-month average rate of HICP inflation in Sweden was 3.6%, i.e. above the reference value of 3.3% for the criterion on price stability. This rate is expected to decrease gradually over the coming months, driven by a restrictive monetary policy stance, a fall in energy prices and the ongoing easing of pipeline pressures. Consumer price inflation is expected to converge to Sveriges Riksbank's 2% target in 2024 and remain close to it in 2025. Looking ahead, Sweden's monetary policy and its stability-oriented institutional framework should continue to support the achievement of price stability.

Sweden is currently not subject to a Council Decision on the existence of an excessive deficit. Sweden's general government budget deficit was 0.6% of GDP in 2023, i.e. well below the 3% reference value, and its debt-to-GDP ratio was 31.2%, i.e. well below the 60% reference value. Sweden has never been subject to an excessive deficit procedure.

In the two-year reference period from 20 June 2022 to 19 June 2024, the Swedish krona did not participate in ERM II, but traded under a flexible exchange rate regime. The exchange rate of the Swedish krona against the euro exhibited, on average, a high degree of volatility over the two-year period. On 19 June 2024 it stood at 11.2140 kronor per euro, i.e. the krona was 5.8% weaker than its average level in June 2022. Over the reference period Sveriges Riksbank maintained a swap agreement with the ECB for borrowing up to €10 billion in exchange for Swedish kronor, which has been in place since 20 December 2007.

Over the reference period from June 2023 to May 2024, long-term interest rates in Sweden stood at 2.5% on average and thus remained well below the 4.8% reference value for the interest rate convergence criterion. The differential between long-term interest rates in Sweden and the euro area (GDP-weighted) interest rate declined slightly, standing at -0.7 percentage points at the end of reference period. Capital markets in Sweden are highly developed compared with those in the euro area.

Swedish law does not comply with all the requirements for central bank independence, the monetary financing prohibition and legal integration into the Eurosystem. Sweden is an EU Member State with a derogation and must therefore comply with all adaptation requirements under Article 131 of the Treaty. Pursuant to the Treaty, Sweden has been under the obligation to adopt national legislation with a view to integration into the Eurosystem since 1 June 1998. As yet no legislative action has been taken by the Swedish authorities to remedy the incompatibilities described in this and previous reports.

5 Examination of economic convergence in individual countries

5.1 Bulgaria

5.1.1 Price developments

In May 2024 the 12-month average rate of HICP inflation in Bulgaria was 5.1%, i.e. well above the reference value of 3.3% for the criterion on price stability (Chart 5.1.1). This rate is expected to decrease gradually over the coming months, as pipeline pressures and supply bottlenecks continue to ease.

Over the past ten years the 12-month average rate of HICP inflation has fluctuated within a very wide range, from -1.7% to 14.1%. After a prolonged period in negative territory, inflation turned positive again in 2017. Robust economic growth and falling unemployment, together with a longer-term decline in the working age population, as well as administrative and policy factors, led to a sharp rise in nominal wages and unit labour costs. In 2018 and 2019 the annual average rate of HICP inflation rose further, to around 2.5%, owing to upward pressure from both buoyant domestic demand on the back of strong wage growth and hikes in food and services prices. Thereafter, the contraction of the Bulgarian economy as a result of the COVID-19 pandemic and declines in oil and energy prices kept HICP inflation at low levels, averaging 1.2% in 2020 (Table 5.1.1). Rising global energy and food prices, changes in administered prices and the rebound in economic activity and private consumption pushed up prices in the first half of 2021. From September that year the rate of inflation accelerated markedly, owing to high electricity, fuel and gas prices, and the associated direct and indirect effects. Russia's invasion of Ukraine in late February 2022 exacerbated the increase in global commodity prices and supply bottlenecks, leading to a sharp rise in HICP inflation, which peaked at 15.6% in September 2022 before starting to decrease. As with the other central and eastern European countries under review, Bulgaria has been particularly vulnerable to recent global shocks, owing mainly to certain structural features of its economy and its exposure to Russia (see Chapter 3). By December 2023 annual HICP inflation had slowed to 5% on account of lower commodity prices, easing supply bottlenecks and government measures to mitigate the impact of the energy price rises. These were mainly in the form of transfers to households and firms, and to a lesser extent changes in indirect taxes. The strongest contribution to this decline in HICP inflation came from energy and food prices, the same components that fuelled inflation in the period 2021-22.

In May 2024 the annual rate of HICP inflation reached 2.7%. This is the lowest it has been since the third quarter of 2021 after the 2.5% inflation rate recorded in April 2024. The decline in inflation over the first five months of 2024 can be attributed to lower commodity prices and the easing of supply bottlenecks. Core inflation, defined

as HICP inflation excluding energy and food, remains above headline inflation, owing to persistent wage pressures amid tight labour markets, strong domestic demand and limited spillover effects of monetary policy tightening in the euro area in the context of ample liquidity and competition in the banking sector.

The orientation of monetary policy towards price stability has played an important role in shaping inflation dynamics in Bulgaria over the past decade.

On 1 July 1997 Българска народна банка (Bulgarian National Bank) introduced a currency board arrangement. The Bulgarian lev was initially pegged at par to the Deutsche Mark and since 1 January 1999 it has been pegged to the euro at a rate of 1.95583 levs per euro. Prudent fiscal policy has supported the stability of the currency board since 1997. Given the limited spillover effects of monetary policy tightening in the euro area, in 2023 Българска народна банка (Bulgarian National Bank) raised banks' minimum reserve requirements to withdraw some of the excess liquidity from the banking system.

Inflation is expected to continue to decline in the coming months, but over the longer term there are concerns about the sustainability of inflation

convergence in Bulgaria. According to the European Commission's Spring 2024 Economic Forecast, HICP inflation will fall to 3.1% in 2024 and 2.6% in 2025. Over the forecast horizon, falling import prices are set to put downward pressure on the energy, food and non-energy industrial goods components in 2024. Core inflation is also projected to decelerate, driven by indirect effects from lower input prices and an expected moderation in wage growth. However, these forecasts are subject to considerable uncertainty about the evolution of energy prices and the geopolitical situation. Risks to the inflation outlook are tilted to the upside, as labour shortages and related wage pressures are expected to continue in the medium term, and an escalation of geopolitical tensions could disrupt trade and cause volatility in energy prices, adding further to inflation. Looking further ahead, there are concerns about the sustainability of inflation convergence in Bulgaria over the longer term, also taking into account the marked increase in unit labour costs and the tightness of labour markets. Unit labour costs grew by 27.4% over the period from 2020 to 2023 – well above the euro area rate of 9.5% – challenging the competitiveness of the Bulgarian economy (Table 3.2). The catching-up process is likely to result in positive inflation differentials vis-à-vis the euro area, since GDP per capita and price levels are still significantly lower in Bulgaria than in the euro area. In order to prevent the build-up of excessive price pressures and macroeconomic imbalances, the catching-up process must be supported by appropriate policies. In particular, while hourly labour costs in Bulgaria are still the lowest in the EU, growth in wages needs to be consistent with that in productivity, among other things, in order to safeguard price competitiveness and the country's attractiveness to foreign investors. Moreover, as Bulgaria has been participating in the exchange rate mechanism (ERM II) since July 2020 with its existing currency board arrangement in place, it is important to contain inflationary pressures with appropriate policies, not least to enhance productivity growth, especially in the non-traded goods sector.

Achieving an environment that is conducive to sustainable convergence in Bulgaria requires stability-oriented economic policies and wide-ranging

structural reforms. Given monetary policy's limited room for manoeuvre under the currency board, other policy areas (fiscal, macroprudential) should provide the economy with the means to cope with potential country-specific shocks and macroeconomic imbalances. This is also of utmost importance for a smooth participation in ERM II, as reflected in a number of Bulgaria's ERM II post-entry commitments, which are discussed in more detail in Section 5.1.3. In addition, structural reforms to enhance the business and institutional environment are crucial in order to attract foreign direct investment and boost potential growth. These include Bulgaria's commitment to further reduce corruption, ensure an independent and effective judicial system, and improve the education system. A continued reduction in the declining – but still elevated – corporate debt burden would support corporate profitability and investment. It is also essential to strengthen national policies aimed at enhancing competition in product markets, to proceed with the liberalisation of regulated sectors and to manage a smooth transition to a digital and greener economy. In this context, sustained efforts are needed to build up administrative capacity and to further increase the absorption of EU funds. With long-term unemployment accounting for a large percentage of total unemployment, active labour market policy measures are required to enhance the employability and strengthen the skill level of the workforce, and to promote the economic inclusion of the most vulnerable segments of the population. With regard to macroeconomic imbalances, the European Commission did not select Bulgaria for an in-depth review in its Alert Mechanism Report 2024.

The convergence in banking supervision achieved under the close cooperation framework ensures the application of uniform supervisory standards and thus contributes to safeguarding financial stability. Following the inclusion of the Bulgarian lev in ERM II, the ECB and Българска народна банка (Bulgarian National Bank) have been working together under the close cooperation framework since 1 October 2020. The ECB is responsible for the direct supervision of four significant institutions and the common procedures for all supervised entities, as well as the oversight of 13 less significant institutions. Българска народна банка (Bulgarian National Bank) has been integrated into the Single Supervisory Mechanism and is participating in its structures and networks. With regard to the oversight of less significant institutions, which have a domestic market share of roughly 30%, the ECB is working closely with national supervisors to further harmonise implementation of the rules governing banking supervision, while also ensuring that joint supervisory standards are applied consistently across the system. Given the limited spillover effects of monetary policy tightening in the euro area, lending activity has remained elevated, particularly in the loans to households segment. The stepwise increase in the countercyclical capital buffer rate since 2022 to strengthen the resilience of the banking sector seems appropriate.

5.1.2 Fiscal developments

Bulgaria's general government budget deficit was well below the 3% reference value in 2023 and its debt level was well below the 60% reference value. In the reference year 2023, the general government budget recorded a deficit of 1.9% of

GDP, thus standing well below the 3% deficit reference value. The general government gross debt-to-GDP ratio was 23.1%, well below the 60% reference value (Table 5.1.2). Compared with the previous year, the general government deficit declined by 1.0 percentage points and the debt ratio increased slightly by 0.5 percentage point. With regard to other fiscal factors, the deficit ratio was below the ratio of public investment to GDP in 2023. The budget deficits in 2022 and 2023 were affected by the economic impact of Russia's war against Ukraine and the discretionary fiscal policy measures taken in response to the related high energy prices.

Bulgaria is currently not subject to a Council Decision on the existence of an excessive deficit. Bulgaria has been subject to the preventive arm of the Stability and Growth Pact since 2012. During the period in which the general escape clause under the Stability and Growth Pact applied (due to the COVID-19 pandemic and the invasion of Ukraine by Russia), the European Commission found, in May 2022, that the general government deficit-to-GDP ratio in 2021 had been above and not close to the reference value of 3%, and in May 2023, that the planned deficit in 2024 was also above and not close to the reference value. In both cases, the Commission's analysis suggested that the deficit criterion had not been fulfilled. However, given the high uncertainty surrounding the macroeconomic outlook, the Commission considered that at that juncture a decision on whether to place Member States under the excessive deficit procedure should not be taken. Bulgaria was once subject to an excessive deficit procedure between 2010 and 2012, while the general government debt has been below the 60% of GDP reference value since 2004.

The budget balance improved over the period 2021-23, but the deficit remains significantly above its level prior to the pandemic. Prior to the pandemic, prudent fiscal policy had allowed Bulgaria to record improving structural balances, turning the deficit of 5.4% of GDP in 2014 into a surplus of 2.1% of GDP in 2019. As a consequence of the pandemic and the government's fiscal support to buffer its impact, the structural balance deteriorated strongly, reaching a deficit of 3.9% of GDP in 2021. In addition, cyclical factors reflecting the deterioration in the economic situation contributed to the overall increase in the budget deficit by 6 percentage points between 2019 and 2021. The improvement in the budget balance since the pandemic by 2.0% of GDP between 2021 and 2023 was mostly related to an increase in the structural balance by 1.7 percentage points as a result of lower current expenditure. The budget balance in 2023 was 4.0% of GDP lower than in 2019, i.e. the year before the outbreak of the pandemic, which was entirely attributable to a deterioration in the structural balance by 4.0% of GDP.

The government debt-to-GDP ratio has remained well below the 60% reference value over the past two decades. Prior to the pandemic, the debt ratio had declined between 2014 and 2019 by 7.0 percentage points to 20% of GDP, mostly owing to high primary surpluses and, to a lesser extent, favourable interest-growth differentials. After increasing by 4.6% of GDP in 2020 at the start of the pandemic, the debt ratio then fell between 2020 and 2023 slightly by 1.5% of GDP thanks to favourable interest-growth differentials, which compensated somewhat for the debt-increasing impact arising from primary deficits. The debt ratio in 2023 was 3.1 percentage points higher than in 2019.

In the presence of a long-standing currency board, the level and structure of public debt allow Bulgaria to manage its debt effectively. The share of government debt with a short-term maturity has generally been negligible. Taking into account the low share of debt with a variable interest rate and the level of the debt ratio, fiscal balances are relatively insensitive to changes in interest rates. At the same time, the proportion of foreign currency-denominated government debt is high (74.8% in 2023). It is almost entirely denominated in euro – the anchor currency of Bulgaria’s currency board framework. Fiscal balances are thus insensitive to changes in exchange rates other than the euro/lev exchange rate, which is fixed under the currency board.

The European Commission’s Spring 2024 Economic Forecast predicts an increase in the budget deficit and a moderate increase in the public debt ratio. According to the European Commission’s Spring 2024 Economic Forecast, the headline balance deficit is expected to increase to 2.8% of GDP in 2024 and thus remain below the 3% deficit reference value. The budget balance is projected to deteriorate slightly in 2025 and reach a deficit of 2.9% of GDP. The debt ratio is projected to increase moderately to stand at 24.8% of GDP in 2024 and 24.6% of GDP in 2025.

Bulgaria’s fiscal framework has helped it to maintain a low debt ratio, but there is still scope for further improvement. Bulgaria has a large number of fiscal rules at the general government and subnational levels, which comprise budget balance, debt and expenditure rules. While those rules mitigate the risk of increasing debt, in practice they are difficult to implement and therefore need to be streamlined and simplified in order to strengthen their credibility in terms of ensuring continued sound public finances over the longer run. The Public Finance Act was last amended in 2020 as a response to the pandemic. Those amendments were aimed at increasing the flexibility of the fiscal rules in the case of economic downturns, by allowing deviations from the 3% general government deficit ceiling and the expenditure rule in the case of extraordinary circumstances outside the control of the government which seriously impact the fiscal position. Moreover, the ceiling for the cash-based budget deficit was increased from 2% to 3% and the maximum amount of expenditure under the consolidated fiscal programme was effectively increased, as EU funds and national co-financing were exempted from the scope of expenditure, while the maximum amount of 40% of GDP remained. While those revisions lowered the stringency of the two rules, they do not compromise fiscal sustainability if the rules are adhered to. The Fiscal Council was introduced in 2016 in line with EU requirements, and its mandate and the quality of its work have been strengthened over time; further improvements in the areas of its technical and administrative capacities could help to increase transparency. While progress has been made in increasing tax collection and improving tax compliance, further progress is still desirable.

Bulgaria faces medium risks to fiscal sustainability over the medium and long term. The European Commission’s 2023 Debt Sustainability Monitor found that

Bulgaria faces medium fiscal sustainability risks over the medium term.¹⁵² This assessment has remained unchanged as compared with the 2021 results. While Bulgaria was found to have available fiscal consolidation space, it was considered to be at medium risk owing to the very high uncertainty about the debt dynamics over the next five years, based on historical volatility. Over the long term, Bulgaria was found to face medium risks, which were mainly driven by a projected increase in ageing-related costs, as well as an unfavourable initial budgetary position. According to the baseline from the 2024 Ageing Report prepared by the Ageing Working Group (AWG) of the EU's Economic Policy Committee,¹⁵³ age-related public expenditure is projected to increase moderately by 0.6 percentage points of GDP over the period 2022-70, from a level of 18.2% of GDP in 2022. Under the AWG's risk scenario, the increase in costs was significantly higher and amounted to 3.9 percentage points of GDP, mainly owing to a larger rise in healthcare and in long-term care spending (by 2.1 percentage points of GDP by comparison with the baseline scenario). These projections signalled a need for further reforms in order to enhance the long-term sustainability of public finances.

Looking ahead, Bulgaria needs to continue to pursue its prudent fiscal policies in order to ensure compliance with the requirements of the Stability and Growth Pact. A consistent and prudent fiscal policy will ensure that Bulgaria continues to comply with the Stability and Growth Pact and maintains its buffers to alleviate adverse shocks. In addition, the Next Generation EU programme needs to be implemented efficiently and effectively in order to support the potential for growth and to adjust to the structural changes that are under way. Moreover, the quality and efficiency of capital spending should be enhanced by improved public investment management, including a long-term investment strategy. Further reducing tax collection gaps and the informal economy, improving the performance of state-owned enterprises as well as increasing spending efficiency are all essential measures for preserving medium-term fiscal sustainability.

5.1.3 Exchange rate developments

The Bulgarian lev participated in ERM II in the two-year reference period from 20 June 2022 to 19 June 2024. Over the reference period the lev did not exhibit any deviation from the central rate. As implied by the currency board framework, Българска народна банка (Bulgarian National Bank) has continued to exchange on demand domestic currency against the anchor currency (the euro) and vice versa at the fixed rate. Short-term interest rate differentials against the three-month EURIBOR stood at a very low level throughout the reference period. The Bulgarian lev was included in ERM II at a central rate of 1.95583 levs per euro with a standard fluctuation band of $\pm 15\%$ in July 2020. Bulgaria joined the exchange rate mechanism with its

¹⁵² This assessment was confirmed by the updated debt sustainability analysis that was published as part of the European Commission's Country Report for Bulgaria on 19 June 2024.

¹⁵³ European Commission and Economic Policy Committee, "The 2024 Ageing Report: Economic and Budgetary Projections for the EU Member States (2022-2070)", *European Economy Institutional Paper*, No 279, European Commission, 2024.

existing currency board in place, as a unilateral commitment, thus placing no additional obligations on the ECB.

The agreement on participation in ERM II was based on a number of policy commitments by the Bulgarian authorities, with the aim of achieving a high degree of sustainable economic convergence by the time of the adoption of the euro. These commitments relate to implementing specific policy measures pertaining to the non-bank financial sector, state-owned enterprises, the insolvency framework and the anti-money laundering (AML) framework. The ECB and the European Commission have been monitoring the effective implementation of Bulgaria's post-entry commitments, acting within their respective areas of competence as provided for by the Treaties and secondary legislation. In its role as the supervisory authority and given its shared responsibility for macroprudential policy, the ECB is monitoring the implementation of the commitments related to the financial sector, i.e. the insolvency and AML frameworks, owing to their importance for the functioning of the financial system. Bulgaria is currently working towards completing these commitments and is encouraged to accelerate its efforts to fulfil the elements of the action plan that was adopted by the Financial Action Task Force (FATF) after Bulgaria was placed on the FATF's "grey list" of jurisdictions under increased monitoring in October 2023.

The HICP-based real effective exchange rate of the Bulgarian lev has appreciated over the past ten years (Chart 5.1.4). This appreciation reflected developments in the nominal effective exchange rate. However, the relatively high level of inflation following the sharp rise in energy prices in 2021, which was exacerbated in the wake of Russia's invasion of Ukraine in February 2022, put upward pressure on the real effective exchange rate. However, this indicator should be interpreted with caution, as Bulgaria is subject to a process of economic convergence, which complicates any long-term assessment of real exchange rate developments.

Bulgaria's combined current and capital account balance has mostly remained in surplus over the past ten years and the country's net foreign liabilities have declined markedly (Table 5.1.3). From 2014 to 2019 the combined current and capital account balance increased, primarily reflecting a substantial reduction in the goods deficit as a result of the export-led recovery. However, a deficit was recorded in 2021 and 2022 – two years characterised by high volatility owing to the pandemic and Russia's war against Ukraine. Over the period 2019-23 the substantial adjustment in the balance of payments was associated with a significant contraction in net direct investment inflows – which fell from double-digit levels before the global financial crisis to an average of -2.8% of GDP, while the balance on other investment was slightly negative. Gross external debt decreased further, falling from 61.3% of GDP in 2019 to 48.3% in 2023. At the same time, the country's net international investment position, largely consisting of foreign direct investment, continued to improve, rising from -30.2% of GDP in 2019 to -7.6% of GDP in 2023, on account of a further accumulation of reserve assets. Nevertheless, fiscal and structural policies continue to be important for supporting external sustainability and the competitiveness of the economy, especially in a more volatile environment characterised by geopolitical and commodity price shocks.

The Bulgarian economy is well integrated with the euro area through trade and investment linkages.

In 2023 exports of goods and services to the euro area constituted 45.2% of total exports, with the corresponding figure for imports standing at 41.8%. In the same year the share of the euro area in Bulgaria's stock of inward direct investment stood at 64.3% and its share in the country's stock of portfolio investment liabilities was 73.9%. The share of Bulgaria's stock of foreign assets invested in the euro area amounted to 49.9% in the case of direct investment and 52.4% for portfolio investment in 2023.

5.1.4 Long-term interest rate developments

Over the reference period from June 2023 to May 2024, long-term interest rates in Bulgaria increased and stood at 4.0% on average, below the 4.8% reference value for the interest rate convergence criterion (Chart 5.1.5).

Long-term interest rates in Bulgaria increased slightly from 3.5% in January 2014 to 3.9% in May 2024. During the first half of the past decade, long-term interest rates declined almost continuously, converging to euro area levels in 2018. The decline occurred as the diminishing impact of the global financial crisis led to a reduction in macro-financial risk and to a significant improvement in the outlook for the public budget. Domestic and global cyclical factors also contributed to the declining trend in long-term interest rates in the first part of the decade. These included spillovers from low interest rates in the euro area, Bulgarian banks' continued demand for government debt securities in the context of scarce opportunities for lending to the private sector, a high private savings rate, and the effect of global trade tensions on growth expectations and, consequently, interest rates. In the period 2020-21 the negative impact of the pandemic on global and domestic economic activity and inflation drove long-term interest rates in Bulgaria down to a historically low level of 0.1% from March to August 2021. Since 2022, in a context of mounting domestic and global inflationary pressures, long-term interest rates have increased significantly in line with global monetary policy and financial market developments. Renewed political uncertainty between the end of 2022 and the spring of 2023 – which resulted in two general elections being held in October 2022 and April 2023 – also contributed to a sharp increase of around 200 basis points in long-term interest rates over this period. Long-term interest rates in Bulgaria have stabilised since April 2023 and stood at 3.9% in May 2024, up from 1.6% in May 2022, the beginning of the review period (Chart 5.1.5). However, developments in long-term interest rates in Bulgaria must be interpreted with caution, as the bond used to derive the relevant interest rate was not traded between 20 March and 12 December 2023. The renewed domestic political uncertainty at the end of 2022 caused a sudden spike in the default risk on long-term Bulgarian debt, as measured by ten-year credit default swap spreads. These stood at more than 230 basis points in October 2022, up from 90 basis points in February 2022, when Russia launched its invasion of Ukraine. The spreads then gradually declined to around 115 basis points in May 2024, thus returning to the levels seen at the beginning of the review period in May 2022. Bulgaria's government debt is rated investment grade by all three main rating agencies (Moody's: Baa1; S&P: BBB; Fitch: BBB).

The long-term interest rate differential of Bulgarian government bonds vis-à-vis the euro area average stood at 0.9 percentage points in May 2024.

Since 2014 Bulgarian long-term interest rates have gradually and almost continuously converged towards the euro area average rate of corresponding maturity (Chart 5.1.6). Initially, the stable and relatively high rates in Bulgaria combined with a decline in the average long-term interest rate in the euro area resulted in some widening of the differential, which peaked at 1.9 percentage points in November 2014 and oscillated between 0.7 and 1.8 percentage points from 2015 until late 2016. The differential then steadily declined and remained quite low – also spending some time in negative territory – until March 2023, when it turned significantly positive. In May 2024 it stood at 0.9 percentage points (1.2 percentage points vis-à-vis the euro area AAA yield).

Capital markets in Bulgaria are smaller and much less developed than those in the euro area (Table 5.1.4).

In the past few years there have been only a few indications of a deepening of capital markets compared with early 2014. In recent years stock market capitalisation, as a percentage of GDP, has declined from an average of 15.4% over the period 2014-18 to 9.3% in 2023. Market-based debt financing of domestic monetary financial institutions (MFIs) has increased since 2014 to stand at 1.8% of GDP. Over the same period, the access of non-financial corporations in Bulgaria to the corporate debt market seems to have declined, as outstanding debt securities issued by this sector accounted for 1.7% of GDP in 2023, 1.5 percentage points lower than in the period 2014-18. In 2023 the reliance of the Bulgarian banking system on euro area banks for its funding needs increased significantly in comparison with the average over the period 2014-18. Euro area banks' claims on Bulgarian banks increased to 5.7% of the latter's total liabilities in 2023, up from an average level of 4.4% over the period 2014-18. The degree of financial intermediation remains quite low in Bulgaria compared with the euro area average, although it is comparable to that of peer countries in the region. MFI credit to non-government residents stood at 50.0% of GDP in 2023, 5 percentage points below its average for the period 2014-18. At the end of 2022 foreign-owned banks continued to play a major role in the banking system in Bulgaria, accounting for around 72% of total banking assets. The banking system is largely funded by resident private non-financial sector deposits. The banking system's assets vis-à-vis the non-financial private sector were dominated by loans, 76% of which were denominated in local currency.

5.1.5 Statistical tables and charts

Bulgaria

5.2 Czech Republic

5.2.1 Price developments

In May 2024 the 12-month average rate of HICP inflation in the Czech Republic was 6.3%, i.e. well above the reference value of 3.3% for the criterion on price stability (Chart 5.2.1). This rate is expected to decrease gradually over the coming months, driven by the past monetary policy tightening and the ongoing easing of pipeline pressures and supply bottlenecks.

Over the past ten years the 12-month average rate of HICP inflation has fluctuated within a very wide range, from 0.2% to 16.8%. In 2014 and 2015 HICP inflation was close to zero as a result of utility price cuts, relatively muted wage growth and subdued external price pressures. Import price growth accelerated in 2014, owing partly to the exchange rate floor of 27 korunas per euro set by Česká národní banka. In the second half of the decade the Czech economy returned to a path of solid economic growth, which led to a notable appreciation of the koruna against the euro in real effective terms. The outbreak of the COVID-19 pandemic in 2020 resulted in a marked contraction of real GDP and a gradual decline in HICP inflation that year. To counteract the economic impact of the pandemic, Česká národní banka reduced its main policy rate significantly, bringing it down to 0.25%. In 2021 large increases in energy and commodity prices, coupled with global supply bottlenecks, put significant upward pressure on inflation, which was fuelled further by government support measures aimed at stabilising employment and providing emergency liquidity. In 2022, after Russia's invasion of Ukraine in late February, inflation continued to rise (Table 5.2.1), largely as a result of soaring energy, food and commodity prices. As with the other central and eastern European countries under review, the Czech Republic has been particularly vulnerable to recent global shocks, owing mainly to certain structural features of its economy and its exposure to Russia (see Chapter 3). To counter the rise in inflation, which reached an average of 14.8% in 2022, Česká národní banka had started a monetary policy tightening cycle in June 2021. This resulted in a cumulative 675 basis point hike in its main policy rate, up to 7% in June 2022. The central bank also intervened on foreign exchange markets in 2022 to avert a longer-term weakening of the koruna. After peaking at 19% in January 2023, the annual rate of inflation slowed gradually to 12% for the year as whole. This was due to the tighter monetary policy, government measures to mitigate the impact of the domestic energy price rises (mainly in the form of transfers to households and firms), the fall in global energy prices and the unwinding of supply bottlenecks. Česká národní banka responded to this decline with a rate cut of 25 basis points in December that year.

In May 2024 the annual rate of HICP inflation reached 2.8%. The downward trend in inflation that had begun in 2023 continued in the first quarter of 2024, with inflation approaching the central bank's 2% target. This trend reflected the waning impact of global shocks, subdued domestic demand pressures amid persistently weak economic growth and the tight monetary policy stance, and the base effect of the phasing-out of the government's energy savings tariff. Against this background, Česká

národní banka lowered its key policy rate again on three occasions by a total of 150 basis points, down to 5.25% in May 2024.

The orientation of monetary policy towards price stability has played an important role in shaping inflation dynamics in the Czech Republic over the past decade. Since 2001 the inflation target has been defined in terms of consumer price inflation, originally as a continuously declining band and since 2006 as a flat point target. The target was set at 3% (± 1 percentage point) in 2006 and reduced to 2% (± 1 percentage point) in 2010. In November 2013, in order to fulfil its mandate to maintain price stability, Česká národní banka intervened to weaken the domestic currency and set the aforementioned exchange rate floor. When the central bank abandoned its commitment to a minimum exchange rate vis-à-vis the euro in 2017, the related policy shift was smooth, with a gradual appreciation of the koruna. The exit from the exchange rate floor was the first step towards normalising domestic monetary conditions and was followed by several interest rate adjustments in both directions in order to maintain price stability.

Inflation in the Czech Republic is expected to remain close to the 2% target over the forecast horizon. According to the European Commission's Spring 2024 Economic Forecast, HICP inflation is expected to average 2.5% in 2024 and to moderate to 2.2% in 2025. This outlook is based on the expectation that energy prices will moderate, with the past monetary policy tightening and the planned fiscal consolidation package also contributing to disinflationary pressures. However, these forecasts are subject to considerable uncertainty about the evolution of energy prices and the geopolitical situation. Risks to the inflation outlook are tilted to the upside. Given the high degree of openness and high energy intensity of the Czech economy, an escalation of geopolitical tensions could disrupt trade and cause volatility in energy prices, which may result in stronger than expected inflationary pressures in the coming years. These may also be exacerbated by robust wage growth in the context of a very tight labour market. Looking further ahead, unless counteracted by an appreciation of the nominal exchange rate, the catching-up process may result in positive inflation differentials vis-à-vis the euro area. GDP per capita and price levels are still lower than the euro area average in the Czech Republic, despite being relatively high compared with those in the other central and eastern European countries under review. In order to prevent the build-up of excessive price pressures and macroeconomic imbalances, the catching-up process must be supported by appropriate policies.

Achieving an environment that is conducive to sustainable convergence in the Czech Republic requires targeted economic policies, including structural reforms, that are geared to ensuring macroeconomic stability. The Czech Republic is facing the challenge of boosting its economic growth potential by enhancing productivity. Persisting inefficiencies in the business environment and growing labour shortages are weighing on potential growth. Additional efforts are needed to remove unnecessary restrictions on conducting business and firms' market entry, and to support research and development, and innovation. Moreover, skill mismatches in the labour market need to be addressed by improving vocational education and training, and by removing impediments to flexible working arrangements. Owing to adverse demographic trends, employment creation will also

require larger labour market participation of under-represented groups, especially young people, which is lagging significantly behind the EU average. Against this background, it will be important to ensure an efficient and effective absorption of the EU funds allocated to the country. With regard to macroeconomic imbalances, the European Commission did not select the Czech Republic for an in-depth review in its Alert Mechanism Report 2024.

Financial sector policies should be aimed at safeguarding financial stability and ensuring that the financial sector can contribute to sustainable economic growth. The Czech Republic's banking sector remains broadly resilient to adverse shocks given the relatively large capital and liquidity buffers held by banks. Moreover, banks have remained profitable and levels of non-performing loans contained. Risks in the financial sector relate mainly to exchange rate risk stemming from the higher degree of euroisation in the corporate lending market on the back of the recent widening of interest rate differentials vis-à-vis the euro area. The potential impact of such risks depends largely on firms' degree of hedging against exchange rate movements. Risks in the housing market have declined, as households' average gross disposable income has recovered, meaning that they are in a better position to absorb any repricing of mortgages. However, given the high level of interest rates, liquidity-constrained households may still face a greater risk of default on mortgages even for average-priced property. In order to bolster confidence in the financial system, the national competent authorities should continue to improve their supervisory practices by, among other things, following the applicable recommendations from the relevant international and European bodies, and by collaborating closely with other national supervisors of EU Member States within the supervisory colleges.

5.2.2 Fiscal developments

The Czech Republic's general government budget deficit was above the 3% reference value in 2023, while its debt remained below the 60% reference value. In the reference year 2023, the general government budget balance recorded a deficit of 3.7% of GDP, thus above the 3% deficit reference value. The general government gross debt-to-GDP ratio was 44%, i.e. below the 60% reference value (Table 5.2.2). Compared with the previous year, the government deficit-to-GDP ratio increased by 0.5 percentage points, while the debt-to-GDP ratio decreased moderately by 0.2 percentage points. With regard to other fiscal factors, the deficit ratio was below the ratio of public investment to GDP in 2023. The budget deficits in 2022 and 2023 were also affected by the economic impact of Russia's war against Ukraine and the discretionary fiscal policy measures taken in response to the related high energy prices.

The Czech Republic is currently not subject to a Council Decision on the existence of an excessive deficit. The Czech Republic has been subject to the preventive arm of the Stability and Growth Pact since 2014. On 19 June 2024, the European Commission published a report prepared in accordance with Article 126(3) of the Treaty for 12 Member States, including the Czech Republic, which found that

the Czech Republic had exceeded the deficit reference value in 2023. This deficit level was above, and not close to, the reference value and the excess was not assessed to be exceptional. However, the deficit in excess of the reference value was assessed to be temporary, as the European Commission had not projected the deficit to exceed 3% of GDP in 2024 and 2025. Overall, taking into account mitigating relevant factors, the Commission concluded that the Czech Republic fulfilled the deficit criterion of the Stability and Growth Pact. During the period in which the general escape clause under the Stability and Growth Pact applied (due to the pandemic and the invasion of Ukraine by Russia), the European Commission found, in June 2021, May 2022 and May 2023, that the general government deficits in 2020, 2021 and 2022, respectively, had been above and not close to the reference value of 3% of GDP. In all three cases, the Commission's analysis suggested that the deficit criterion had not been fulfilled. However, given the high uncertainty surrounding the macroeconomic outlook, the Commission considered that at that juncture a decision on whether to place Member States under the excessive deficit procedure should not be taken. Previously, the Czech Republic had been subject to an excessive deficit procedure between December 2009 and June 2014. However, in the subsequent period to 2019, the Czech Republic comfortably met its medium-term objective of a structural deficit of no more than 1% of GDP.

Following the pandemic, the structural deficit has remained large, historically speaking, and cyclical factors are still contributing negatively to the government balance. Prior to the pandemic, the budget balance had improved, from a deficit of 2.1% of GDP in 2014 to a surplus of 0.3% of GDP in 2019 (Chart 5.2.2). With the pandemic shock, the deficit widened to 5.8% of GDP on account of both fiscal measures in response to the pandemic and cyclical factors reflecting the deterioration in the general economic situation. The budget balance improved in the period 2020-22 by 2.6 percentage points as a result of cyclical factors reflecting the economic recovery in 2021 and consolidation efforts implemented in 2022. The deterioration in public finances in 2023 was partly attributable to the large increase in pension spending due to the automatic indexation to inflation and a further deterioration in the economic situation, which led to a deficit in 2023 of 3.7% of GDP, 4 percentage points higher than the level seen in 2019, the year before the outbreak of the pandemic.

The debt-to-GDP ratio decreased slightly in 2023 and remained below the 60% reference value. Prior to the pandemic, the debt ratio had decreased by 11.9 percentage points, from 41.9% of GDP in 2014 to 30.0% of GDP in 2019. This reduction was mostly driven by primary surpluses and favourable interest-growth differentials. Between 2019 and 2021, the pandemic triggered an increase in the debt ratio by almost the same magnitude as the decrease prior to the pandemic, i.e. 12 percentage points. This was mainly on account of large primary deficits, as expenditure increased strongly to finance measures to mitigate the adverse impact of external shocks on households and firms. Since 2021, the debt ratio continued to increase, reaching a new peak of 44.2% of GDP in 2022 before decreasing slightly to 44% of GDP in 2023, 14 percentage points higher than the debt-to-GDP ratio recorded in 2019.

The level and structure of government debt protect the Czech Republic from any sudden changes in market conditions, with the bulk of debt at long-term maturities and most of the debt denominated in local currency. The share of government debt with a short-term maturity is low (2.3% in 2023 – Table 5.2.2). Taking into account also the share of debt with a variable interest rate and the overall level of the debt ratio, fiscal balances are relatively insensitive to changes in interest rates. The proportion of foreign currency-denominated government debt is low (7% in 2023) and since 2019, it has remained below the 2014-18 average (16.3%); it is predominantly denominated in euro (96% of foreign-denominated debt). Considering the size of the debt ratio, fiscal balances are also relatively insensitive to changes in exchange rates.

The European Commission's Spring 2024 Economic Forecast predicts an improvement in the budget balance but still a slight increase in the public debt ratio. According to the European Commission's Spring 2024 Economic Forecast, the headline balance is expected to improve, with a deficit of 2.4% of GDP in 2024, and therefore fall below the 3% deficit reference value. The foreseen improvement in the general government balance stems from the phasing-out of energy-related measures and the implementation of a consolidation package. This consolidation package is based mainly on cuts in subsidies, coupled with cuts in operational spending and public wages, increases in tax rates and the streamlining of the VAT structure. The budget balance is projected to improve further in 2025 and reach a deficit of 1.9% of GDP supported by growing momentum in economic activity, while the fiscal stance is expected to remain neutral. The debt ratio is projected to increase slightly to 45.2% of GDP in 2024 and 45.5% of GDP in 2025.

The Czech Republic's fiscal governance framework is applied effectively, but further progress remains warranted. The national legislation implementing the EU Directive on requirements for budgetary frameworks was adopted in 2017. Since then, the Fiscal Council has become operational and issued reports on long-term sustainability and on compliance with the budgetary rules. Nevertheless, coordination among the various levels of general government remains low and should be further enhanced. Tax compliance has improved over recent years, but there is still room for improvement. For instance, the VAT gap (at 7% in 2021) remains above the EU average. The streamlining of the VAT structure planned for 2024 is a step in the right direction, as opposed to the abolition of the electronic registration of sales, which was only introduced in 2016 but discontinued in 2023.

The Czech Republic faces medium risks to fiscal sustainability over the medium term and long term. The European Commission's 2023 Debt Sustainability Monitor shows that the Czech Republic faces medium fiscal sustainability risks over the medium term, mainly on account of rising ageing costs.¹⁵⁴ With regard to long-term risks, the Czech Republic was found to face medium fiscal sustainability risks mainly on account of projected increases in ageing costs that will only partially be mitigated by a favourable initial budgetary position. Budgetary pressures stemming

¹⁵⁴ This assessment was confirmed by the updated debt sustainability analysis that was published as part of the European Commission's Country Report for the Czech Republic on 19 June 2024.

from population ageing remain elevated. According to the 2024 Ageing Report prepared by the Ageing Working Group (AWG) of the EU's Economic Policy Committee,¹⁵⁵ the Czech Republic would record a notable rise in age-related public expenditure (3.7 percentage points of GDP by 2070) under the baseline, from a level of 20.6% of GDP in 2022. Under the AWG's risk scenario, the increase was projected to be 6.2 percentage points of GDP. In spite of the favourable budgetary impact of the legislated reform to improve accessibility to healthcare services, which reduced healthcare spending compared with the 2021 Ageing Report, the increase in total age-related expenditure remains significantly above the EU average. This suggests that reforms to the pension, health and long-term care systems are necessary to improve the long-term sustainability of public finances.

Looking ahead, a prudent fiscal policy will be needed to safeguard the sustainability of public finances and compliance with the requirements of the Stability and Growth Pact. Notwithstanding the current low level of the debt-to-GDP ratio, a consistent and prudent fiscal policy is required to build a sufficient fiscal buffer to alleviate adverse shocks while ensuring compliance with the reformed EU governance framework. The envisaged consolidation plans fall short of reducing the structural deficit beyond 2024. The revenue-to-GDP ratio remains below the EU average, also on account of the 2021 tax reforms which led to a permanent deterioration in the structural balance. Moreover, the Next Generation EU programme needs to be implemented efficiently and effectively in order to support potential growth and to adjust to the structural changes that are under way.

5.2.3 Exchange rate developments

In the two-year reference period from 20 June 2022 to 19 June 2024, the Czech koruna did not participate in ERM II, but traded under a flexible exchange rate regime. Česká národní banka intervened in foreign exchange markets from May to October 2022 to prevent a longer-term weakening of the koruna in an episode of high inflation. Over the reference period the Czech currency was mostly stronger – but often close to – its June 2022 average exchange rate against the euro of 24.7194 korunas per euro, which is used as a benchmark for illustrative purposes in the absence of an ERM II central rate (Chart 5.2.3). The maximum upward deviation from this benchmark was 5.9%, whereas the maximum downward deviation amounted to 3.0%. On 19 June 2024 the exchange rate stood at 24.9100 korunas per euro, i.e. the koruna was 0.8% weaker than its average level in June 2022. Over the past ten years the Czech koruna has appreciated by 9.3% against the euro.

The Czech koruna exhibited, on average, a relatively high degree of volatility against the euro over the two-year reference period. From June 2022 to April 2023 the koruna steadily strengthened against the euro, reflecting action by Česká národní banka, including interventions in foreign exchange markets that ended in October

¹⁵⁵ European Commission and Economic Policy Committee, "The 2024 Ageing Report: Economic and Budgetary Projections for the EU Member States (2022-2070)", *European Economy Institutional Paper*, No 279, European Commission, 2024.

2022. The koruna began to weaken against the euro in May 2023 and this depreciation continued following the ECB's monetary policy decisions as well as Česká národní banka's official announcement in August 2023 that it was ending its foreign exchange interventions. From February 2024 the koruna remained broadly stable before appreciating in May that year to levels close to those at the beginning of the reference period, owing mainly to the release of higher than expected inflation data for April. Short-term interest rate differentials against the three-month EURIBOR were high until the middle of 2023. Although declining, they remained sizeable and reached 2.3 percentage points in the three-month period ending in March 2024.

Over the past ten years the Czech koruna has appreciated in HICP-based real effective terms (Chart 5.2.4). Overall, this appreciation in real terms mainly reflected developments in the nominal effective exchange rate. However, the relatively high level of inflation following the sharp rise in energy prices in 2021, which was exacerbated in the wake of Russia's invasion of Ukraine in February 2022, put upward pressure on the real effective exchange rate. Looking ahead, this indicator should be interpreted with caution, as the Czech Republic has been subject to a process of economic convergence in terms of GDP per capita and price levels over the past few decades, which complicates any long-term assessment of real exchange rate developments.

The combined current and capital account balance has recorded a modest surplus over the past ten years, while the country's net foreign liabilities have declined (Table 5.2.3). The combined current and capital account deficit increased from 1.1% of GDP in 2021 to 4.2% of GDP in 2022, reflecting both a decline in the trade balance and a reduction in the capital account surplus. In 2023, however, it returned to positive territory, mainly reflecting a notable rebound in the goods balance. At the same time, the primary income deficit shrank significantly, albeit remaining large at 4.3% of GDP. On the financing side, the Czech Republic recorded positive net outflows of portfolio investment and other investment on average from 2019 to 2023. However, these net outflows were offset by net inflows of direct investment. The country's gross external debt continued to decline, falling from 75.7% in 2019 to 62.9% in 2023. At the same time, the country's net international investment position improved, rising from -29.1% of GDP on average in the period 2014-18 to -16.56% in the period 2019-23. Fiscal and structural policies continue to be important for supporting external sustainability and the competitiveness of the economy, especially in a more volatile environment characterised by geopolitical and commodity price shocks.

The Czech economy is well integrated with the euro area through trade and investment linkages. In 2023 exports of goods and services to the euro area constituted 62.4% of total Czech exports, whereas imports of goods and services from the euro area amounted to 49% of the country's total imports. In the same year the share of the euro area in the Czech Republic's stock of inward direct investment stood at 76% and its share in the country's stock of portfolio investment liabilities was 63.8%. The share of the Czech Republic's stock of foreign assets invested in the euro area amounted to 65.6% in the case of direct investment and 68.9% for portfolio investment in 2023.

5.2.4 Long-term interest rate developments

Over the reference period from June 2023 to May 2024, long-term interest rates in the Czech Republic stood at 4.2% on average and were thus below the 4.8% reference value for the interest rate convergence criterion (Chart 5.2.5).

Long-term interest rates in the Czech Republic stood at 4.2% at the end of the reference period, about 180 basis points above the level seen at the start of 2014. In the period 2014-16 long-term interest rates in the Czech Republic declined amid a gradual economic recovery, moderate inflation and Česká národní banka's highly accommodative monetary policy. In the light of rising inflationary pressures – which reflected global developments and an acceleration of economic growth that led to overheating in the domestic labour market – Česká národní banka began to gradually tighten monetary policy in mid-2017. Against this background, long-term interest rates also increased until late 2018. In 2019 the economic environment changed as signs of weakness in the global economic outlook emerged alongside geopolitical tensions such as the trade dispute between the United States and China and the perceived risks of a disorderly Brexit. The outbreak of the pandemic further fuelled the decline in long-term interest rates, which reached their lowest point in the summer of 2020. Furthermore, Česká národní banka implemented decisive interest rate cuts over the period from March to May 2020 that brought the two-week repo rate – the main policy rate – to its lowest level since August 2017. Between the last quarter of 2020 and October 2022, long-term interest rates increased steadily, owing to rising and persistent inflationary pressures driven by domestic demand, the increase in energy prices, the disruption to global supply chains and the risk that Russia's invasion of Ukraine would lead to higher and more persistent inflation than previously expected. During this period, Česká národní banka gradually and steadily tightened its monetary policy. Since December 2023 the central bank has cut the two-week repo rate four times, bringing it down from 7.0% in November 2023 to 5.25% in May 2024. Since the end of 2022 the moderation in domestic and global inflationary pressures was an important driver of the decline in long-term interest rates from 5.5% in October 2022 to 4.2% at the end of the reference period. The credit quality of Czech government debt remained rather favourable. Over the review period, credit default swap spreads for Czech government debt were stable at less than 50 basis points, remaining the lowest among the group of peer countries. The Czech Republic's government debt is rated high investment grade by all three main rating agencies (Moody's: Aa3; S&P: AA-; Fitch: AA-).

The Czech Republic's long-term interest rate differential vis-à-vis the euro area average has declined from its historical peak of June 2022. The long-term interest rate differential gradually increased from 2014 to reach a historical high in June 2022 (Chart 5.2.6). This was due to both the continuing decrease in the average long-term interest rate on euro area sovereign debt and the increase in the long-term interest rate on Czech debt, which was fuelled by a persistent and rising inflation differential between Czech and euro area HICP inflation. Since June 2022, when the interest rate differential stood at its peak of 2.9 percentage points (3.6 percentage points vis-à-vis the euro area AAA yield), an increase in euro area government debt yields has led to a

gradual decline of the interest rate differential, which stood at 1.1 percentage points in May 2024 (1.5 percentage points vis-à-vis the euro area AAA yield).

Capital markets in the Czech Republic are smaller and much less developed than those in the euro area (Table 5.2.4). Stock market capitalisation in the Czech Republic stood at 10.4% of GDP in 2023, which is below the average value recorded over the period 2014-23. Outstanding debt securities issued by non-financial institutions, a measure of market-based indebtedness, have continued to decrease in recent years and stood at 3.6% of GDP in 2023, after averaging over 7.0% in the period 2014-18. Meanwhile, debt securities issued by financial institutions have increased over the past decade to stand at 16.3% of GDP in 2023, which is higher than the average value observed during the period 2014-18. Financial intermediation, as measured by MFI credit to the non-government sector, remained in line with its average value for the period 2014-18 and stood at 54.2% of GDP in 2023, slightly over half the euro area average. In 2023 the Czech Republic's banking sector reduced the funding it obtains from euro area banks compared with previous years, with claims of euro area MFIs on resident MFIs standing at 13.1% of total liabilities of domestic MFIs. The development of the Czech Republic's capital markets in terms of size and intermediation capacity remains limited but is comparable with that of other non-euro area EU Member States in central and eastern Europe.

5.2.5 Statistical tables and charts

Czech Republic

5.3 Hungary

5.3.1 Price developments

In May 2024 the 12-month average rate of HICP inflation in Hungary was 8.4%, i.e. considerably above the reference value of 3.3% for the criterion on price stability (Chart 5.3.1). This rate is expected to decrease gradually over the coming months, driven by the past monetary policy tightening and the ongoing easing of pipeline pressures and supply bottlenecks.

Over the past ten years the 12-month average rate of HICP inflation has fluctuated within a very wide range, from -0.3% to 22.5%. In 2014 and 2015 the average annual rate of HICP inflation was very subdued, owing to utility price cuts, relatively muted wage growth and limited external price pressures. However, from 2016 it accelerated, to reach 3.4% – within the central bank’s tolerance band – in 2019. This increase mainly reflected robust domestic demand and a tighter labour market that fuelled strong wage growth, as well as changes to indirect taxes, most notably excise duties on tobacco products. These factors were only partially offset by a reduction in social security contributions and VAT rates on some food items and services. In 2020 the authorities took strong fiscal, macroprudential and monetary policy measures to mitigate the economic impact of the COVID-19 pandemic. In particular, the Magyar Nemzeti Bank cut its key policy rate to a historical low of 0.6% and purchased government securities in the secondary market. Inflation remained elevated, albeit within the central bank’s tolerance band, at 3.4% in 2020, but rose to 5.2% in 2021 on account of a strong rebound in activity, rising energy prices and the supply bottlenecks triggered by the pandemic. This led the central bank to start a cycle of interest rate hikes in June that year and to gradually phase out its quantitative easing schemes. In 2022 HICP inflation continued to rise, to reach 15.3% on average, largely owing to soaring energy and commodity prices in the wake of Russia’s invasion of Ukraine in late February, drought-related increases in agricultural prices, significant fiscal loosening in the run-up to the elections, the depreciation of the exchange rate and robust wage growth mainly on the back of administrative wage increases alongside additional salary and pension benefits (Table 5.3.1). As with the other central and eastern European countries under review, Hungary has been particularly vulnerable to recent global shocks, owing mainly to certain structural features of its economy and its exposure to Russia (see Chapter 3). In order to further mitigate the effects of the energy crisis, the government also placed temporary price caps on motor fuels and selected basic food items. As inflation accelerated throughout 2022, the Magyar Nemzeti Bank tightened minimum reserve requirements, introduced new liquidity-absorbing facilities and continued its rate hiking cycle, bringing the central bank base rate to a peak of 13% in September that year. In October, following a rapid depreciation of the exchange rate, the central bank introduced one-day deposit quick tenders on a daily basis at an interest rate of 18.0%, which became its key rate for monetary policy. After peaking in February 2023, inflationary pressures abated gradually as energy prices started to decline. The Magyar Nemzeti Bank responded

by steadily reducing its central bank base rate, down to 10.75% by the end of 2023, and reinstating it as its key policy rate. HICP inflation averaged 17.0% in 2023.

In May 2024 the annual rate of HICP inflation reached 3.9%. Continuing on a downward trend that had started in 2023, HICP inflation fell further at the beginning of 2024. This decrease was largely due to lower energy and commodity prices, the past monetary policy tightening, the gradual withdrawal of fiscal support measures and the weakness in private consumption resulting from the erosion of households' purchasing power. Against this background, the Magyar Nemzeti Bank lowered its key policy rate on five occasions by a total of 350 basis points, down to 7.25%, in the first five months of 2024.

Policy choices have played an important role in shaping inflation dynamics in Hungary over the past decade, most notably the orientation of monetary policy towards price stability. Since 2015 the Magyar Nemzeti Bank has defined its inflation target as an annual rate of consumer price inflation of 3% with an ex ante tolerance band of ± 1 percentage point. Under this inflation-targeting framework, the central bank has continuously adjusted its monetary policy toolkit to evolving macroeconomic challenges, which at times have been complicated by economic and fiscal policies. Economic policy measures that have had implications for the transmission of monetary policy include, for example, a cap on bank interest rates and on consumer prices for energy and food, and legal provisions restricting the purchase of debt instruments issued by the central bank and therefore its ability to absorb liquidity.

Inflation is expected to decline gradually in the coming years, but over the longer term there are concerns about the sustainability of inflation convergence in Hungary. According to the European Commission's Spring 2024 Economic Forecast, HICP inflation is projected to decelerate in 2024, to a high level of 4.1%, before falling further to 3.7% in 2025. This outlook is based on the expectation that energy prices will moderate as the economic recovery continues, with unemployment remaining at a historically low level and private consumption returning to being the main driver of growth. However, these forecasts are subject to considerable uncertainty about the evolution of energy prices and the geopolitical situation. Risks to the inflation outlook are tilted to the upside, as tensions in energy markets may continue to exacerbate inflationary pressures, and still loose fiscal policies and unfavourable exchange rate developments may add further to inflation. In addition, labour market conditions remain tight, with unit labour costs having grown by 34.0% over the period from 2020 to 2023 – well above the euro area rate of 9.5% – challenging the competitiveness of the Hungarian economy (Table 3.2). Looking further ahead, unless counteracted by an appreciation of the nominal exchange rate, the catching-up process is likely to result in positive inflation differentials vis-à-vis the euro area, since GDP per capita and price levels are still lower in Hungary than in the euro area. In order to prevent the build-up of excessive price pressures and macroeconomic imbalances, the catching-up process must be supported by appropriate policies.

Achieving an environment that is conducive to sustainable convergence in Hungary requires stability-oriented economic policies and wide-ranging

structural reforms. Further improving the quality of public institutions and ensuring that they are free from undue political interference, implementing adequate product market policies and safeguarding the rule of law, are prerequisites for private sector-led economic growth. Enhanced governance, stronger institutions and a better functioning administration at the national level should, among other things, help to improve the absorption of EU funds. In this respect, it is still of utmost importance that the authorities address the concerns over the rule of law expressed by the European Commission under the general regime of conditionality for the protection of the Union budget, to facilitate the full disbursement of EU funds. With regard to macroeconomic imbalances, the European Commission selected Hungary for an in-depth review in its Alert Mechanism Report 2024 based on concerns related to significant price and cost pressures, both government and external financing needs, and house price developments.

Financial sector policies should be aimed at safeguarding financial stability – and ultimately the functioning of monetary policy transmission – as well as ensuring that the financial sector makes a sound contribution to sustainable economic growth. Efforts to strengthen banks' balance sheets over the past years have borne fruit, and the banking sector overall has relatively large capital and liquidity buffers. Banks' profitability has improved and non-performing loan ratios have declined further. Looking ahead, tighter financial conditions, in combination with previously strong private sector credit growth, may nevertheless pose a number of risks. For example, the decline in households' real disposable incomes, together with the higher level of interest rates, may dampen demand for new loans and thus weigh on banks' profitability. At the same time, as house prices continue to rise, the risk of overvaluation in the real estate market, particularly in Hungary's capital region, alongside declining real incomes of borrowers and higher interest rates, may result in increasing debt servicing difficulties. Interest rate caps and mortgage rate freezes distort borrowers' incentives, squeeze banks' profitability further and complicate the transmission of monetary policy. Moreover, lending to corporates in foreign currency may lead to significant currency mismatches and heighten banks' credit risk. In turn, the deterioration in the quality of loan portfolios could put additional pressure on banks' profitability, which is also being hampered by the slow improvement in the low cost efficiency of the Hungarian banking sector. Boosting the profitability of the banking sector in the long term will also require consolidation in the sector and more financial deepening. In this respect, it remains important to closely monitor macro-financial developments. In order to bolster confidence in the financial system, the national competent authorities should continue to improve their supervisory practices, among other things, by following the applicable recommendations from the relevant international and European bodies, and by collaborating closely with other national supervisors of EU Member States within the supervisory colleges.

5.3.2 Fiscal developments

Hungary's general government budget deficit was significantly above the 3% reference value in 2023 and its debt was above the 60% reference value. In the reference year 2023, the general government budget balance recorded a deficit of

6.7% of GDP, i.e. significantly above the 3% reference value. The general government gross debt-to-GDP ratio was 73.5%, i.e. above the 60% reference value (Table 5.3.2). Compared with the previous year, the deficit ratio increased by 0.5 percentage points of GDP and the debt ratio declined moderately by 0.6 percentage points. With regard to other fiscal factors, the deficit ratio exceeded the ratio of public investment to GDP in 2023 by 1.6 percentage points. The budget deficits in 2022 and 2023 were affected by the economic impact of Russia's war against Ukraine and the discretionary fiscal policy measures taken in response to the related high energy prices.

In June 2024, the European Commission found that Hungary did not fulfil the deficit criterion of the Stability and Growth Pact. On 19 June 2024, the European Commission published a report prepared in accordance with Article 126(3) of the Treaty for 12 Member States, including Hungary, which found that Hungary had exceeded the deficit reference value in 2023 and was planning for its deficit in 2024 to be above 3% of GDP. These deficits levels were above, and not close, to the reference value and the excess was not assessed to be either temporary or exceptional. The report's analysis suggested that Hungary did not fulfil the deficit criterion of the Stability and Growth Pact. Based on the conclusions of its report, the Commission announced its intention to propose to the Council, in July, that a decision be adopted under Article 126(6) establishing the existence of an excessive deficit situation in Hungary. During the period in which the general escape clause under the Stability and Growth Pact applied (due to the pandemic and the invasion of Ukraine by Russia), the European Commission found, in May 2023, May 2022 and June 2021, that the general government deficit-to-GDP ratio in 2022, 2021 and 2020, respectively, had been above and not close to the reference value of 3%. In all three cases, the Commission's analysis suggested that the deficit criterion had not been fulfilled. Moreover, the European Commission found, in May 2023 and May 2022, that the debt reduction benchmark had not been respected in 2022 and 2021, respectively, and therefore the Commission's analysis suggested that, in both cases, the debt criterion had not been fulfilled. However, given the high uncertainty surrounding the macroeconomic outlook, the Commission considered that at that juncture a decision on whether to place Member States under the excessive deficit procedure should not be taken. Hungary was once subject to an excessive deficit procedure, which was opened in 2004 based on the deficit in 2003, but which was closed in 2013.

Both cyclical and non-cyclical factors relating to the pandemic contributed to a deterioration in the budget balance over the period 2019-21, which was only partly reversed by 2023. Since 2012 and up until the outbreak of the pandemic, the budget deficit had stood at relatively stable levels of between 1.5% and 3% of GDP, and at 2.0% of GDP in 2019, equating to a structural deficit of 3.9%. As a result of the pandemic, the budget balance declined in 2020 by 5.6 percentage points, to reach a deficit of 7.6% of GDP. This was due to cyclical factors, as well as the deterioration in the structural deficit which rose by 3.2 percentage points between 2019 and 2021, reflecting a sharp increase in expenditure to address the impact of the pandemic. Between 2021 and 2023, the budget deficit decreased by 0.5 percentage points on account of an improving structural balance, whereas cyclical factors contributed negatively. The budget balance in 2023 was 4.7% of GDP higher than in 2019, i.e. the

year before the outbreak of the pandemic. This was due to a deterioration in the cyclical component, as well as a 2.1 percentage point higher structural deficit.

The government debt-to-GDP ratio has remained above 60% of GDP since 2005.

In the lead-up to the pandemic, the debt ratio followed a downward path, underpinned largely by a favourable interest-growth differential and a primary surplus. Having declined by 11.2 percentage points since 2014, the debt ratio reached a trough of 65.3% of GDP in 2019. It then increased markedly on account of the impact of the pandemic, rising by 14 percentage points to reach 79.3% in 2020. Since then, it has declined by 5.8 percentage points on account of economic growth and high inflation, both of which have counterbalanced the primary deficits and the unfavourable deficit-debt adjustments. The debt ratio in 2023 was 8.2 percentage points higher than in 2019.

The level and structure of government debt indicate that fiscal balances are sensitive to interest rate fluctuations and to exchange rate movements.

In 2023, the share of debt with a short-term maturity amounted to 7.4%, with an average residual maturity of 5.9 years. However, the share of debt with variable interest rates increased substantially, from 10.6% of the total debt in 2021 to 21.3% in 2023. Therefore, fiscal balances remain sensitive to interest rates changes. Moreover, Hungary increased its proportion of foreign currency-denominated government debt from 20.5% in 2019 to 29.7% in 2023, which is exclusively denominated in euro. Consequently, fiscal balances remain sensitive to changes in the exchange rate vis-à-vis the euro.

The European Commission's Spring 2024 Economic Forecast foresees an improvement in the budget balance and a slight increase in the debt ratio.

According to the European Commission's latest forecast under a no policy change assumption, the headline deficit is expected to decrease, reaching a deficit of 5.4% of GDP in 2024 and 4.5% of GDP in 2025, therefore remaining above 3%. The debt ratio is projected to increase slightly to 74.3% of GDP in 2024 and to stand at 73.8% of GDP in 2025, therefore remaining above the 60% reference value.

Despite some progress in reforming the fiscal framework, there is scope for further improvement.

The latest changes to the national fiscal rules were made in December 2019 when the Hungarian Parliament adopted amendments aimed at increasing their transparency and enhancing their implementation. According to the debt ratio rule, if the general government debt ratio exceeds 50% of GDP, the Parliament may only adopt an act on the central budget which leads to a reduction in the debt level of at least 0.1% of GDP during normal economic times. In spite of this, Hungary's national fiscal rules and medium-term budgetary framework are among the weakest according to the EU fiscal governance indicator. Stronger emphasis should still be placed on the multi-annual dimension of the budget process. In particular, the incentives to systematically spend budget reserves before the end of the calendar year should be removed, as they can lower the quality of public spending. Furthermore, neither are there any constraints on possible deviations from medium-term plans nor well-defined corrective actions in place in this respect.

Hungary faces medium sustainability risks over the medium term and the long term, mainly due to the debt level being projected to remain above but close to the 60% reference value, but also due to the ageing population. The European Commission's 2023 Debt Sustainability Monitor points to medium risks both in the medium term and the long term with a projected decline in the debt ratio over the forecast period. This lower medium-term risk compared with the 2021 assessment is driven by the notable decrease in the debt-to-GDP ratio. The debt ratio was expected to stand at 75.2% of GDP in 2023 under the baseline scenario in the 2021 Fiscal Sustainability Report, but in the most recent Debt Sustainability report, it was expected to stand at 69.9% of GDP (i.e. below the actual outcome of 73.5% of GDP in 2023). Looking at the longer term, according to the 2024 Ageing Report prepared by the Ageing Working Group (AWG) of the EU's Economic Policy Committee,¹⁵⁶ Hungary would experience a significant rise in age-related expenditure of 5.2 percentage points by 2070 under the baseline from a level of 19.0% of GDP in 2022 to a level of 21.3% of GDP in 2070, which is 1.2 percentage points lower than in the previous report. Under the AWG's risk scenario, this increase is projected to be 4.0 percentage points higher than under the baseline (arising mainly from increases of 3.1% and 1.0% of GDP in long-term care and healthcare respectively), which is significantly above the EU average. All these factors suggest that reforms are needed to improve the long-term sustainability of public finances.

Looking ahead, a prudent and credible fiscal policy, as well as further structural reforms, are needed to ensure a downward debt path and compliance with the Stability and Growth Pact. A prudent fiscal policy is needed to safeguard the sustainability of public finances. A consistent and prudent fiscal policy will also ensure that Hungary complies with the Stability and Growth Pact, reduces its public debt level and maintains buffers to alleviate adverse shocks. Policies aimed at improving tax collection and reducing the informal economy should continue to be pursued. Distortive tax measures should be avoided. Reinforcing multi-annual fiscal planning could mitigate the procyclicality of fiscal policy and increase the effectiveness of public spending. Structural reforms to the pension system, as well as the health and long-term care systems, are also necessary to address longer-term risks to fiscal sustainability. In addition, the Next Generation EU programme needs to be implemented efficiently and effectively in order to support the potential for growth and to adjust to the structural changes that are under way. Finally, growth-friendly fiscal adjustments are important, based on reversing the downward trend in government investment.

5.3.3 Exchange rate developments

Over the reference period from 20 June 2022 to 19 June 2024, the Hungarian forint did not participate in ERM II, but traded under a flexible exchange rate regime. In the two-year reference period the Hungarian forint was often significantly

¹⁵⁶ European Commission and Economic Policy Committee, "The 2024 Ageing Report: Economic & Budgetary Projections for the 28 EU Member States (2019-2070)", *European Economy Institutional Paper*, No 279, European Commission, 2024.

weaker than its June 2022 average exchange rate against the euro of 396.66 forints per euro, which is used as a benchmark for illustrative purposes in the absence of an ERM II central rate (Chart 5.3.3). The maximum upward deviation from this benchmark was 7.2%, while the maximum downward deviation amounted to 8.6%. On 19 June 2024 the exchange rate stood at 396.3400 forints per euro, i.e. the forint was trading almost at the same level (0.1%) as its average level in June 2022. The Magyar Nemzeti Bank entered a repo line arrangement with the ECB in June 2020, under which it could borrow up to €4 billion against high-quality euro-denominated collateral to provide euro liquidity to Hungarian financial institutions in order to address possible needs owing to the pandemic. This agreement remained in place over the reference period as it was extended again in January 2024. As this arrangement helped to reduce the potential risk of financial vulnerabilities, it may also have had an impact on exchange rate developments over the reference period. Over the past ten years the exchange rate of the Hungarian forint against the euro has depreciated by 29.6%.

The exchange rate of the Hungarian forint against the euro exhibited, on average, a very high degree of volatility over the reference period. Between June and October 2022 the Hungarian forint continued to weaken – a trend that had started with Russia’s invasion of Ukraine – against the background of rapidly rising energy prices, a deteriorating external balance, ensuing inflationary pressures, the worsening economic outlook, and deteriorating international investor sentiment towards the region. The Magyar Nemzeti Bank responded by continuing the rate-hiking cycle it had started in mid-2021, raising its key policy rate on five occasions, by a total of 710 basis points, to stand at 13% at the end of September 2022. In the last quarter of 2022 the forint recovered some of its losses as energy prices receded somewhat from their record highs, while the Magyar Nemzeti Bank maintained its restrictive monetary policy stance and conducted daily overnight deposit tenders at a rate of 18%, and short-term interest rate differentials against the three-month EURIBOR peaked at 14.5 percentage points. The exchange rate of the forint continued to display a very high degree of volatility throughout most of 2023, reflecting the continued uncertainty in financial markets about the evolution of the energy crisis and regarding macroeconomic vulnerabilities in Hungary. The forint started to stabilise towards the end of 2023 as exchange rate volatility declined. In May that year, the Magyar Nemzeti Bank started to cut interest rates. This led to a decline in short-term interest rate differentials, down to 4.0%, and prompted the Magyar Nemzeti Bank to reinstate its central bank base rate as its key policy rate, which it gradually reduced from 13% in September 2023 to 7.0% at the end of June 2024.

The HICP-based real effective exchange rate of the Hungarian forint has appreciated slightly over the past ten years (Chart 5.3.4). While the real effective exchange rate depreciated between 2014 and 2021, mainly reflecting the depreciation of the nominal exchange rate in effective terms, it began to appreciate sharply from 2022. This was because the very high level of inflation following the sharp rise in energy prices in 2021, which was exacerbated in the wake of Russia’s invasion of Ukraine in February 2022, put upward pressure on the real effective exchange rate. Looking ahead, this indicator should be interpreted with caution, as Hungary is subject to a process of economic convergence, which complicates any long-term assessment of real exchange rate developments.

Over the past ten years Hungary's combined current and capital account balance has remained in surplus and contributed to a reduction in the country's net foreign liabilities, which, however, remain high (Table 5.3.3). Between 2014 and 2018 Hungary recorded robust combined current and capital account surpluses, averaging 4.3% of GDP over the period. This reflected both a large trade surplus – which more than offset the deficit on income payments – as well as a sizeable capital account surplus which was due to large transfers from the EU budget. In 2019 and 2020 the combined current and capital account balance narrowed to about 1% of GDP, owing to very robust domestic demand which caused the balance of the current account to turn negative. In 2021 the current account deficit widened further, to 4.1% of GDP, as exports declined more than imports during the pandemic, pushing the combined current and capital account into a deficit of 1.6% of GDP. Primarily as a result of the large increases in energy prices following Russia's invasion of Ukraine, Hungary's current account deficit increased further in 2022, to 8.3% of GDP. However, it moved into slightly positive territory in 2023, standing at 0.3% of GDP, as a result of energy prices receding from their peak levels and adjustments in energy consumption and domestic investment and consumption expenditure. Until 2019 Hungary's current and capital account surplus had been mirrored in net financial outflows. Since 2019 the country's current account deficit has been financed by net inflows of portfolio and direct investment as well as other investment. Against this background, gross external debt gradually decreased from an average of 119.6% of GDP over the period 2014-18 to stand at 98.9% of GDP in 2019. In 2020 gross external debt increased sharply to 156.6% of GDP, largely owing to transactions by a major special-purpose entity – which also led to an approximately equal increase in the country's gross external assets – and in 2023 it stood at 129.3% of GDP on account of fast nominal GDP growth in the high inflation environment. As a result, Hungary's net foreign liabilities declined from an average of above 60% of GDP in the period 2014-18 to around 50% in the period since 2019. The international investment position reached -46.6% of GDP in 2023. The country's net foreign liabilities remain high. Fiscal and structural policies therefore continue to be important for supporting external sustainability and the competitiveness of the economy, especially in a more volatile environment characterised by geopolitical tensions and commodity price shocks.

The Hungarian economy is well integrated with the euro area through trade and investment linkages. In 2023 exports of goods and services to the euro area constituted 58.8% of total exports, while the corresponding figure for imports was marginally lower, at 55.1%. In the same year the share of the euro area in Hungary's stock of inward direct investment stood at 47.9% and its share in the country's stock of portfolio investment liabilities was 50.9%. The share of Hungary's stock of foreign assets invested in the euro area amounted to 38.7% in the case of direct investment and 65.4% for portfolio investment in 2023.

5.3.4 Long-term interest rate developments

Over the reference period from June 2023 to May 2024, long-term interest rates in Hungary stood at 6.8% on average and were thus above the 4.8% reference value for the interest rate convergence criterion (Chart 5.3.5).

The downward path in long-term interest rates in Hungary observed since 2014 was interrupted after the pandemic.

Until 2017 domestic factors, such as the improvement in general macroeconomic conditions amid lower global risk aversion, had contributed to the decline in long-term interest rates. During this period, monetary policy contributed to an easing of financing conditions and, therefore, to a decline in long-term rates as the Magyar Nemzeti Bank introduced foreign exchange and long-term interest rate swaps, purchased corporate, mortgage and government bonds, and provided cheap financing for small and medium-sized enterprises through its various Funding for Growth measures. Long-term interest rates in Hungary declined from around 6% in early 2014 to around 2% in December 2017. After increasing temporarily in 2018 owing to the rebound in economic activity and a resurgence of inflationary pressures, long-term interest rates resumed their decline in 2019. This reflected the deterioration in the global economic outlook as well as the decline in global yields that was driven by higher levels of global risk aversion, which favoured global portfolio flows into low-risk assets, including Hungarian fixed income assets. In 2020 long-term interest rates fluctuated around 2%, supported by the quantitative easing measures taken by the Magyar Nemzeti Bank. These sought to improve financing conditions in the economy and, in turn, dampen the high financial market volatility caused by the impact of the pandemic and ensure the proper functioning of the monetary policy transmission mechanism. In addition, to counter the negative impact of the pandemic on the economic outlook, the central bank reduced its main policy rate from 0.9% to 0.6% in July 2020. From mid-2021 – following a robust recovery of the economy and, more recently, the acceleration in inflation dynamics, which was also related to Russia’s invasion of Ukraine in February 2022 – the Magyar Nemzeti Bank tightened monetary policy by increasing the policy rate and scaling back its quantitative easing measures. Domestic and global disinflationary pressures from September 2023 led the Magyar Nemzeti Bank to start cutting the key policy rate in October 2023. It stood at 7.0% in June 2024. Long-term interest rates in Hungary peaked at 10% in October 2022 before falling to 6.8% in May 2024. Ten-year credit default swap spreads on Hungarian government debt have increased significantly over the past two years but, after hitting 300 basis points in November 2022, they declined to less than 170 basis points in May 2024, 15 basis points higher than their level in May 2022. Hungary’s government debt is rated investment grade by all three main rating agencies (Moody’s: Baa2; S&P: BBB; Fitch: BBB).

Hungary’s long-term interest rate differential vis-à-vis the euro area declined recently after a long period of stabilisation (Chart 5.3.6).

Hungary’s long-term interest rate differential declined from around 3 percentage points in 2014 to around 2 percentage points in 2015, where it stayed for the following five years. From May 2020 the long-term interest rate differential increased steadily, initially owing to the relatively sharper decline in euro area interest rates and then, from 2021, to the positive and increasing inflation differential and the relatively larger increase in policy rates in Hungary. Over the period from May 2022 to May 2024 the long-term interest rate differential declined from 5.5 percentage points to 3.7 percentage points, having peaked at more than 7.0 percentage points in October 2022.

Capital markets in Hungary are smaller and much less developed than those in the euro area (Table 5.3.4).

Stock market capitalisation, which stood at 17.6% of

GDP in 2023, was slightly higher than the annual average during the period 2014-23. In 2023 outstanding debt securities issued by non-financial corporations remained at low levels, standing at 4.7% of GDP, but were higher than the ten-year average of 2.8% over the period 2014-23. Debt securities issued by financial institutions in 2023 amounted to 12.7% of GDP, which is considerably above the average value recorded over the period 2014-23. Hungarian banks' borrowing from euro area banks – a measure of banking system integration – increased significantly in 2023, with claims by euro area banks on Hungarian banks standing at 7.3% of GDP, compared with 4.9% over the period 2014-23. The degree of financial intermediation is lower than the euro area average and is among the lowest in the region. MFI credit to non-government residents stood at 35.1% of GDP in 2023, slightly below the average level recorded over the period 2014-23.

5.3.5 Statistical tables and charts

[Hungary](#)

5.4 Poland

5.4.1 Price developments

In May 2024 the 12-month average rate of HICP inflation in Poland was 6.1%, i.e. well above the reference value of 3.3% for the criterion on price stability (Chart 5.4.1). This rate is expected to decrease gradually over the coming months, driven by the past monetary policy tightening and the ongoing easing of pipeline pressures and supply bottlenecks.

Over the past ten years the 12-month average rate of HICP inflation has fluctuated within a very wide range, from -0.7% to 15.2%. HICP inflation was notably subdued in 2014 and 2015, reflecting the weakening of domestic economic activity in the preceding years and the significant fall in global commodity prices. In response to the decline in inflation, Narodowy Bank Polski cut its main policy rate to 1.5% in March 2015. From mid-2016 HICP inflation rose gradually on the back of relatively robust economic activity. In line with forecasts of an economic slowdown and a faster than anticipated fall in inflation in 2020 as a result of the COVID-19 pandemic, from mid-March that year Narodowy Bank Polski lowered its main policy rate on several occasions, bringing it down to a historical low of 0.1% in May. In 2021 inflation rose sharply, to 5.2%, on account of surging energy prices, supply bottlenecks triggered by the pandemic, and strong increases in global demand for goods amid a robust rebound in economic activity. Russia's invasion of Ukraine in late February 2022 exacerbated the increase in global commodity prices and supply bottlenecks, which led to a strong acceleration of HICP inflation to 13.2% that year (Table 5.4.1). As with the other central and eastern European countries under review, Poland has been particularly vulnerable to recent global shocks, owing mainly to certain structural features of its economy and its exposure to Russia (see Chapter 3). To counteract the risk of inflation expectations becoming unanchored from the target, Narodowy Bank Polski implemented a number of decisive policy rate hikes in 2021 and 2022, up to 6.75%. The government also introduced discretionary fiscal support measures, predominantly in 2022 and 2023, to alleviate the high inflation burden on the economy. These measures were mainly in the form of caps on electricity and gas prices and reductions in indirect taxes. After peaking at 17.2% in February 2023, HICP inflation started to decrease notably, owing to the fall in food and energy prices, weaker domestic demand resulting, in part, from earlier monetary policy tightening, subdued economic activity abroad and an appreciation of the Polish zloty. In this context, Narodowy Bank Polski decided to cut its main policy rate in September and October, bringing it down to 5.75%.

In May 2024 the annual rate of HICP inflation reached 2.8%. The strong decline in headline inflation in 2023 moderated in early 2024. This can be attributed to the fading impact of the unwinding of the sharp increases in energy prices a year before and the return of the VAT rate on staple food products to 5% from April 2024. At the same time, inflation excluding food and energy has remained higher than headline HICP inflation amid robust wage growth, labour market bottlenecks and a gradual improvement in economic activity.

Policy choices have played an important role in anchoring inflation expectations in Poland over the past decade, most notably the orientation of monetary policy towards price stability. Narodowy Bank Polski operates a floating exchange rate system and has had an inflation-targeting monetary policy framework in place since 1998. The medium-term consumer price inflation target has been 2.5% (± 1 percentage point) since 2004. Despite the high level of inflation recorded since 2021, inflation expectations have remained broadly consistent with the inflation target range over the medium term, supported by the past monetary policy tightening, greater labour market flexibility and increased product market competition, as well as the discretionary fiscal measures implemented in 2022 and 2023 to help to contain inflationary pressures.

While remaining elevated, inflation is projected to decline in 2024-25, but over the longer term there are concerns about the sustainability of inflation convergence in Poland. According to the European Commission's Spring 2024 Economic Forecast, HICP inflation is projected to fall from 10.9% in 2023 to 4.3% in 2024 and 4.2% in 2025. The removal of the measures to contain price pressures could have a significant temporary upward impact on inflation, particularly from mid-2024. However, these forecasts are subject to considerable uncertainty about the evolution of energy prices and the geopolitical situation. Risks to the inflation outlook are tilted to the upside, as renewed global supply bottlenecks could push up prices further in certain product segments, and tensions in energy markets may continue to exacerbate inflationary pressures. In addition, labour market conditions remain tight, with unit labour costs having grown by 22.0% over the period from 2020 to 2023 – well above the euro area rate of 9.5% – challenging the competitiveness of the Polish economy (Table 3.2). Looking further ahead, the catching-up process is likely to result in positive inflation differentials vis-à-vis the euro area, given that GDP per capita and price levels are still lower in Poland than in the euro area, unless this is counteracted by an appreciation of the nominal exchange rate. In order to prevent the build-up of excessive price pressures and macroeconomic imbalances, the catching-up process must be supported by appropriate policies.

Achieving an environment that is conducive to sustainable convergence in Poland requires stability-oriented economic policies and targeted structural reforms. Although the Polish economy managed to weather the global energy price shock and the decline in global activity comparatively well, a number of structural issues still need to be addressed. It is important that fiscal and structural policies continue to support external sustainability, enhance competitiveness and ensure investor confidence. In order to foster potential growth and resource allocation, efforts are required to boost competition in product markets, and to speed up innovation and infrastructure modernisation. In the labour market, in view of the ageing population, it is essential to increase the labour force participation rate by removing disincentives to work and by pursuing policies to support a better integration of refugees. In the medium term, there is a pressing need for Poland to reduce both its reliance on fossil fuel energy production and its greenhouse gas emissions. Against this background, it will be important to ensure an efficient and effective absorption of the EU funds allocated to the country. With regard to macroeconomic imbalances, the European

Commission did not select Poland for an in-depth review in its Alert Mechanism Report 2024.

Financial sector policies should be aimed at safeguarding financial stability and ensuring that the financial sector makes a sound contribution to economic growth. The banking sector remains resilient and banks' capital positions have improved. Growth in lending to the non-financial sector began to recover in late 2023, partly as a result of the government's new mortgage subsidy scheme, but could remain relatively subdued in the coming years, owing largely to factors affecting demand. However, long-term loans to non-financial corporations are expected to pick up, among other things, to co-finance investment projects under Poland's Recovery and Resilience Plan. Credit risk remains at a moderate level owing to the favourable labour market situation and to banks' still relatively solid capacity to service their liabilities, as well as to their prudential lending policies. Legal risks associated with banks' exposure to foreign exchange-denominated mortgage loans remain the main challenge facing the banking sector. Banks have actively managed this risk by offering settlements to their customers and by creating loan loss provisions, although the associated costs are squeezing their profitability. In this respect, regulatory changes and any related uncertainty may impair the stability of banking activity and adversely affect long-term business decisions. Untargeted mortgage credit holidays could undermine incentives to service debt and weaken the banking system's ability to provide credit. In order to further strengthen the financial system, the national competent authorities should continue to improve their supervisory practices, among other things, by following the applicable recommendations from the relevant international and European bodies, and by collaborating closely with other national supervisors of EU Member States within the supervisory colleges.

5.4.2 Fiscal developments

Poland's general government budget balance was well above the 3% deficit reference value in 2023, while its government debt remained below the 60% reference threshold. In the reference year 2023, the general government budget balance recorded a deficit of 5.1% of GDP, well above the 3% reference value. The general government gross debt-to-GDP ratio stood at 49.6%, therefore remaining below the 60% reference value (Table 5.4.2). Compared with the previous year, the deficit saw an increase of 1.7 percentage points of GDP, with a slight rise of 0.4 percentage points in the debt ratio. The budget deficits in 2022 and 2023 were significantly influenced by the economic impact of Russia's war against Ukraine and the discretionary fiscal policy measures taken in response to the related high energy prices.

The European Commission found, in June 2024, that Poland did not fulfil the deficit criterion of the Stability and Growth Pact. On 19 June 2024, the European Commission published a report prepared in accordance with Article 126(3) of the Treaty for 12 Member States, including Poland, which found that Poland had exceeded the deficit reference value in 2023 and was planning for its deficit in 2024 to be above 3% of GDP. These deficits were above, and not close to, the reference value

and the excess was not assessed to be either temporary or exceptional. Overall, taking into account relevant factors, as appropriate, the report's analysis suggested that Poland did not fulfil the deficit criterion of the Stability and Growth Pact. Based on the conclusions of its report, the Commission announced its intention to propose to the Council, in July, that a decision be adopted under Article 126(6) establishing the existence of an excessive deficit situation in Poland. During the period in which the general escape clause under the Stability and Growth Pact applied (due to the pandemic and the invasion of Ukraine by Russia), the European Commission found, in June 2021 and May 2023, that the general government deficit-to-GDP ratio in 2020 and 2022, respectively, had been above and not close to the reference value of 3%. Moreover, in May 2022, the Commission found that the planned deficit in 2022 was also above and not close to 3% of GDP. In all three cases, the Commission's analysis suggested that the deficit criterion had not been fulfilled. However, given the high uncertainty surrounding the macroeconomic outlook, the Commission considered that at that juncture a decision on whether to place Member States under the excessive deficit procedure should not be taken. From 2009 Poland had been subject to an excessive deficit procedure, which was subsequently abrogated by the ECOFIN Council in June 2015, one year earlier than the extended deadline, on account of a systemic pension reform. In the subsequent period to 2019, there were some deviations from the requirements of the preventive arm of the Stability and Growth Pact, particularly in respect of the recommended adjustment path towards the country's medium-term objective.

The budget balance deteriorated significantly over the period 2021-23, with the deficit standing at much higher levels than those prior to the pandemic.

Poland's budget balance had shown a marked improvement prior to the pandemic, with a low deficit of 0.7% of GDP in 2019, which was 3 percentage points lower than in 2014. However, during the pandemic in 2020, the deficit ratio surged by 6.2 percentage points, driven by cyclical factors and fiscal measures to protect the economy. Once the pandemic-related support had been phased out and the economy had begun to recover, the deficit improved significantly, dropping to 1.8% of GDP by 2021. This improvement was short-lived, as the deficit rose again to 3.4% of GDP by 2022, mainly due to measures to address the energy crisis. In 2023 the deficit further deteriorated by 1.7 percentage points, which was attributable to cyclical factors, the impact of inflation indexation, a rise in interest payments and new spending initiatives, including for defence. The budget balance in 2023 was 4.4 percentage points of GDP lower than in 2019, i.e. the year before the outbreak of the pandemic.

Aside from the peak during the pandemic in 2020, the debt-to-GDP ratio has remained relatively stable over the past decade, fluctuating around 50%.

Prior to the pandemic, the ratio had been on a downward trajectory, falling from 54.5% in 2016 to 45.7% in 2019, thanks to a very favourable interest-growth differential and modest primary surpluses. The pandemic subsequently led to an increasing primary deficit and negative growth, along with a significant deficit-debt adjustment (5.5% of GDP), resulting in an 11.5 percentage point increase in the debt ratio in 2020, which was above its historical average. Since then, it declined up to 2023 by 7.6 percentage points, reaching 49.6% in 2023, largely on the back of strong nominal GDP growth.

While the debt ratio in 2023 was only slightly above its average level, it remained 3.9 percentage points above the 2019 level.

The composition of Poland's government debt makes it vulnerable to fluctuations in interest rate and exchange rate developments. Since 2023, 23.7% of the government debt has been tied to variable interest rates, while short-term debt has constituted a mere 1.6% of the total debt (Table 5.4.2). Considering these factors, along with the debt-to-GDP ratio, the budget balance is sensitive to shifts in interest rates. Furthermore, a relatively high share of the debt, 24.4%, is denominated in foreign currencies, predominantly in euro, while 66.4% of the debt is held domestically. Given these factors, as well as the debt-to-GDP ratio, Poland's budget balance is also sensitive to changes in exchange rates.

The European Commission's Spring 2024 Economic Forecast anticipates a continuation of the high deficits and a notable increase in the debt ratio. The forecast predicts the general government deficit to reach 5.4% and 4.6% of GDP in 2024 and 2025, respectively, which significantly exceeds the 3% reference value. This development is largely structural, with the structural deficit also remaining excessively high and amounting to 4.3% of GDP in 2025. This sizeable deficit reflects persisting high spending pressures, most notably in areas of public wages, social transfers and defence investments. The government debt ratio is projected to increase during this period, yet to remain below the 60% reference value, reaching 53.7% and 57.7% in 2024 and 2025 respectively. One significant factor which contributes towards the divergence between the budget balance and the debt ratio developments has been attributed to substantial stock-flow adjustments, primarily on account of the timing of payments and deliveries of military-related investments.

The Polish fiscal framework is strong overall, but its effectiveness could be enhanced. The constitutional debt limit of 60% of GDP acts as a constraint against the accumulation of excessive debt and, therefore, helps ensure fiscal sustainability. Medium-term budgetary planning is based on the Multiannual State Financial Plan, as well as a permanent expenditure rule established in 2015. This rule limits spending growth in accordance with predefined debt thresholds. However, recent developments have seen several new expenditure categories being funded through extra-budgetary funds which do not fall under this spending rule. Thus far, Poland is the only EU country that does not have an independent fiscal council, a situation which is at odds with the provisions of the fiscal compact. This is expected to change based on intentions expressed by its government.

Poland faces high risks to fiscal sustainability in the medium run and medium risks in the long run, as the adequacy of the pension system needs to be safeguarded. The European Commission's 2024 Country Report found that Poland faces high fiscal sustainability risks over the medium term.¹⁵⁷ Long-term risks are classified as medium due to an unfavourable initial budgetary position and projected age-related expenditure. In this respect, the 2024 Ageing Report prepared by the

¹⁵⁷ The debt sustainability analysis published as part of the European Commission's Country Report for Poland on 19 June 2024 follows the multidimensional approach of the European Commission's 2023 Debt Sustainability Monitor, updated based on the Commission's Spring 2024 Economic Forecast.

Ageing Working Group of the EU's Economic Policy Committee¹⁵⁸ shows a 1.9 percentage point rise in age-related expenditure by 2070 under the baseline, from 19.1% of GDP in 2022. The expected increase is driven by healthcare and long-term care spending, while pension spending is projected to remain stable. However, amid a marked increase in population ageing and the old-age dependency ratio, only a substantial decline in the benefit ratio can stabilise the pension bill, unless reforms are undertaken to increase contributions or the retirement age.¹⁵⁹ This poses risks of old-age poverty and could trigger additional social payments to support the elderly, thereby weighing on long-term fiscal sustainability.

Looking ahead, Poland's fiscal policy should focus on reducing the budgetary deficit and complying with the Stability and Growth Pact, pushing through structural reforms to ensure the long-term sustainability of public finances. This will help to counter any adverse shocks. The Next Generation EU programme needs to be implemented efficiently and effectively in order to foster the necessary reforms to the Polish economy. Strengthening the role of national institutions that monitor EU fiscal rule compliance is vital. Additionally, efforts to simplify labour taxation, reduce the tax wedge and improve the progressivity of tax and social benefits schemes should continue. Preserving the long-term sustainability of public finances and providing adequate pension payments, as well as healthcare and long-term care services, continues to be of paramount importance.

5.4.3 Exchange rate developments

In the two-year reference period from 20 June 2022 to 19 June 2024, the Polish zloty did not participate in ERM II, but traded under a flexible exchange rate regime. Over the reference period the Polish zloty often traded close to its June 2022 average exchange rate against the euro of 4.6471 zlotys per euro, which is used as a benchmark for illustrative purposes in the absence of an ERM II central rate (Chart 5.4.3). The maximum upward deviation from this benchmark was 8.6%, while the maximum downward deviation amounted to 4.8%. On 19 June 2024 the exchange rate stood at 4.3300 zlotys per euro, i.e. the zloty was 6.8% stronger than its average level in June 2022. Between March 2022 and mid-January 2024 Narodowy Bank Polski had a swap line arrangement with the ECB, under which it could borrow up to €10 billion against zlotys in order to address potential euro liquidity needs in the Polish financial system. As this arrangement helped to reduce the potential risk of financial vulnerabilities, it may also have had an impact on exchange rate developments over the reference period. Over the past ten years the exchange rate of the Polish zloty against the euro has depreciated by 4.7%.

¹⁵⁸ European Commission and Economic Policy Committee, "The 2024 Ageing Report: Economic & Budgetary Projections for the EU Member States (2022-2070)", *European Economy Institutional Paper*, No 279, European Commission, 2021.

¹⁵⁹ The benefit ratio is defined as average pensions in relation to average wages. The old-age dependency ratio is defined as the ratio between the number of persons aged 65 and over (age when they are generally economically inactive) and the number of persons aged between 15 and 64.

The exchange rate of the Polish zloty against the euro exhibited, on average, a relatively high degree of volatility over the reference period. From June 2022 to March 2023 the Polish zloty fluctuated mostly within a narrow range of between 4.7 zlotys and 4.8 zlotys per euro. However, since the beginning of April 2023 the zloty has appreciated somewhat against the euro. Overall, exchange rate volatility tended to increase in autumn 2023, likely reflecting changes in Narodowy Bank Polski's monetary policy rates in September and October 2023. The exchange rate has stabilised since the beginning of 2024 at around 4.3 zlotys per euro. There was a notable decline in short-term interest rate differentials against the three-month EURIBOR, which gradually decreased from around 6.6 percentage points in mid-2022 to around 1.9 percentage points at the end of 2023. They have remained largely stable since then. Changes in these differentials largely reflected the increases in the key ECB interest rates between July 2022 and September 2023.

The HICP-based real effective exchange rate of the Polish zloty has appreciated somewhat over the past ten years (Chart 5.4.4). The real effective exchange rate weakened until 2016 and then remained broadly stable before recording a strong appreciation from early 2022. Relatively high inflation following the sharp rise in energy prices in 2021, which was exacerbated in the wake of Russia's invasion of Ukraine in February 2022, put upward pressure on the real effective exchange rate. Looking ahead, this indicator should be interpreted with caution, as Poland is subject to a process of economic convergence, which complicates any long-term assessment of real exchange rate developments.

Poland's combined current and capital account balance has increased over the past ten years and the country's net foreign liabilities have tended to decline (Table 5.4.3). After standing virtually in balance on average over the period 2014-18, the combined current and capital account subsequently recorded an increasing surplus which reached a peak in 2020 of slightly above 4% of GDP. It then declined to a deficit of close to 2% of GDP in 2022, largely owing to a reduction in the goods trade balance. However, in 2023 a higher goods balance led to an improvement in the combined current and capital account, which turned into a surplus of 1.8% of GDP. On the financing side, Poland has received net inflows in direct investment over the past ten years, which have tended to increase. Gross external debt increased until 2016, but has steadily declined since then and reached 49.3% of GDP in 2023. Over this ten-year period Poland's negative net international investment position has also declined gradually, from close to 70% of GDP in 2014 to 31.4% of GDP in 2023. Net foreign liabilities mostly consist of net direct investment. Fiscal and structural policies continue to be important for supporting external sustainability, maintaining Poland's attractiveness as a target for foreign direct investment and enhancing the competitiveness of the economy, especially in a more volatile environment characterised by geopolitical and commodity price shocks.

The Polish economy is well integrated with the euro area through trade and investment linkages. In 2023 exports of goods and services to the euro area constituted 57.2% of total exports, while the corresponding figure for imports was slightly lower at 55.8%. In the same year the share of the euro area in Poland's stock of inward direct investment stood at 76.7%, and its share in the country's stock of

portfolio investment liabilities was 46.4%. The share of Poland's stock of foreign assets invested in the euro area amounted to 56.1% in the case of direct investment and 48.4% for portfolio investment.

5.4.4 Long-term interest rate developments

Over the reference period from June 2023 to May 2024, long-term interest rates in Poland stood at 5.6% on average and were thus above the reference value of 4.8% for the interest rate convergence criterion (Chart 5.4.5).

Overall, long-term interest rates in Poland have increased since 2014, when they averaged around 3.5%. Over the period 2014-20 long-term interest rates on sovereign bonds fluctuated between 2% and 4% amid a gradual tightening of the fiscal stance by the Polish Government and the diminishing impact of the global and euro area financial crises. From the end of 2014 long-term interest rates in Poland increased for two years as the positive economic cycle led to higher growth and inflation. After peaking at around 4% at the start of 2017, long-term interest rates initially declined only moderately, reflecting falling inflation amid still resilient real economic growth as well as fiscal tightening. The decline accelerated in 2019, with long-term rates being mostly influenced by global trends. They reached around 2% at the beginning of 2020, despite quite robust domestic growth and increasing inflation. In 2020 long-term interest rates declined further and stabilised at historical lows of slightly above 1% in the context of a swift easing of monetary policy. In response to the outbreak of the pandemic, Narodowy Bank Polski cut the monetary policy reference rate to 0.1% in May 2020 and launched quantitative easing measures. The measures were aimed at changing the long-term liquidity structure of the banking sector, ensuring the liquidity of the secondary markets for government securities and government-guaranteed debt securities and enhancing the impact of the Narodowy Bank Polski's interest rate cuts on the economy (i.e. strengthening the functioning of the monetary policy transmission mechanism). Between 2021 and late 2022, long-term interest rates increased, gradually at first and then more decisively from October 2021, owing mostly to the economic recovery, the rise in inflation, the significant upside risks to inflation and the downside risks to the fiscal position posed by Russia's invasion of Ukraine. Narodowy Bank Polski responded to rising inflationary pressures by decisively raising policy rates until September 2022. It subsequently cut policy rates in September and October 2023 as incoming data suggested that the inflation outlook had improved substantially amid weaker than expected growth. As a result, the reference interest rate stood at 5.75% at the end of the review period. Long-term interest rates also increased significantly during the review period, reaching 5.7% in May 2024 after peaking at about 8.0% in October 2022. After increasing significantly at the beginning of the review period, credit default swap spreads declined to around 100 basis points by May 2024, around the same level as in May 2022. The spreads thus remain low by historical standards and among the lowest in the group of peer countries in the region, suggesting a benign market perception of sovereign credit risk. Poland's government debt is currently rated investment grade by all three main rating agencies (Moody's: A2; S&P: A-; Fitch: A-).

Poland's long-term interest rate differential vis-à-vis the euro area declined significantly during the review period, reaching 2.6 percentage points in May 2024 (Chart 5.4.6). This figure is in line with the long-term average differential over the period 2014-21, which fluctuated between around 1 and 2 percentage points, driven by the dynamism of economic activity and inflationary pressures. Owing to the sharp acceleration in inflation in Poland since the summer of 2021, the interest rate differential widened and reached its historical peak of 4.8 percentage points in May 2022 (up from 1.1 percentage points in April 2020). In May 2024, the end of the review period, the interest rate differential vis-à-vis the euro area AAA yield stood at 3.0 percentage points.

Capital markets in Poland are smaller and much less developed than those in the euro area (Table 5.4.4). The markets for financial and non-financial corporate debt were still much smaller than the respective markets in the euro area at the end of 2023. Debt securities issued by financial and non-financial corporations stood at 10.0% and 2.0% of GDP respectively. In 2023 stock market capitalisation was 22% of GDP, lower than the annual average over the period 2014-23 but still one of the highest levels among peer countries. Euro area banks' provision of funds to the Polish banking system is quite limited. The claims of euro area MFIs on Polish banks accounted for 3.8% of Polish banks' liabilities at the end of 2022. The degree of financial intermediation in Poland, as measured by credit extended by MFIs to the private sector, is in line with that of peer countries in the region, amounting to 40.3% of GDP in 2023 (compared with 99.6% in the euro area). Foreign ownership of banks in Poland, while remaining elevated, has declined markedly in recent years on the back of government initiatives. At the end of 2023 the share of foreign banks in total Polish banking sector assets stood at around 40%.

5.4.5 Statistical tables and charts

Poland

5.5 Romania

5.5.1 Price developments

In May 2024 the 12-month average rate of HICP inflation in Romania was 7.6%, i.e. considerably above the reference value of 3.3% for the criterion on price stability (Chart 5.5.1). This rate is expected to decrease gradually over the coming months, driven by past monetary policy tightening and the ongoing easing of pipeline pressures and supply bottlenecks.

Over the past ten years the 12-month average rate of HICP inflation has fluctuated within a very wide range, from -1.7% to 13.2%. Starting from a moderate level, HICP inflation slipped into negative territory in June 2015 owing to a series of tax cuts. It remained negative throughout 2016, before turning positive again at the beginning of 2017, partly on account of favourable base effects. In 2018 it continued on an upward trend on the back of strong fiscal stimulus and increases in minimum wages, averaging 4.1% over the year and remaining around that level also in 2019 (Table 5.5.1). HICP inflation then fell significantly in 2020, reflecting the downturn in economic activity as a result of the COVID-19 pandemic. Supply-side shocks, particularly in relation to prices for electricity, natural gas and fuel, and then food price increases, contributed to inflation rising considerably during the second half of 2021 and exceeding the upper bound of the variation band around the target. In response, Banca Națională a României started a monetary policy tightening cycle in October 2021. Inflation accelerated further following Russia's invasion of Ukraine in late February 2022, peaking at 14.6% in November that year. This increase was largely due to higher food and energy prices, together with severe bottlenecks in global supply chains. As with the other central and eastern European countries under review, Romania has been particularly vulnerable to recent global shocks, owing mainly to certain structural features of its economy (see Chapter 3). Since the end of 2022 HICP inflation has been falling, down from 12% on average that year to 9.7% in 2023. This decrease was driven by the ongoing easing of pipeline pressures and supply bottlenecks, the monetary policy tightening and government measures to mitigate the impact of the energy price rises (mainly in the form of transfers to households and firms). This notwithstanding, HICP inflation remained at elevated levels owing to domestic price pressures stemming from wage and pension increases. Between October 2021 and January 2023 Banca Națională a României raised its policy rate on 11 occasions, from 1.25% up to the current level of 7%.

In May 2024 the annual rate of HICP inflation reached 5.8%. After rising in January on the back of hikes in indirect taxes, HICP inflation decreased gradually over the following months, owing to declining food prices alongside falling electricity and natural gas prices in April after the government changed its energy price-related measures. At the same time, core inflation remained sticky, reflecting strong wage developments in the context of a tight labour market and minimum wage increases, as well as higher short-term inflation expectations. Banca Națională a României has kept its main policy rates unchanged since January 2023 in an attempt to durably reduce inflation.

The orientation of monetary policy towards price stability has played an important role in shaping inflation dynamics in Romania over the past decade.

In 2005 Banca Națională a României shifted to an inflation-targeting framework combined with a managed floating exchange rate regime. In 2005 the annual CPI inflation target was set at 7.5% and was reduced gradually until 2012. In 2013 the central bank adopted a flat target of 2.5%, with a variation band of ± 1 percentage point. Despite the significant increases in monetary policy rates from October 2021 in order to bring inflation back to the target, the prolonged period of loose fiscal policy (see Section 5.5.2) has continued to fuel inflationary pressures, especially since 2022.

While remaining elevated, inflation is expected to continue on a downward trend over the forecast horizon, but over the longer term there are concerns about the sustainability of inflation convergence in Romania.

According to the European Commission's Spring 2024 Economic Forecast, HICP inflation is expected to decrease to 5.9% in 2024 and 4.0% in 2025. However, these forecasts are subject to considerable uncertainty about the evolution of energy prices and the geopolitical situation, as renewed global supply bottlenecks and tensions in energy markets could push up inflation further. Risks to the inflation outlook are tilted to the upside, owing mainly to fiscal policy, as well as labour market conditions and wage dynamics. Labour shortages and related wage pressures are expected to persist in the medium term. Looking further ahead, there are concerns about the sustainability of inflation convergence in Romania over the longer term, also taking into account the marked increase in unit labour costs. Unit labour costs grew by 26.7% over the period from 2020 to 2023 – well above the euro area rate of 9.5% – challenging the competitiveness of the Romanian economy, as this differential was not offset by nominal exchange rate developments (Table 3.2). The catching-up process is also likely to result in positive inflation differentials vis-à-vis the euro area, given that GDP per capita and price levels are still lower in Romania than in the euro area, unless this is counteracted by an appreciation of the domestic currency against the euro. In order to prevent the build-up of excessive price pressures and reduce macroeconomic imbalances, the catching-up process must be supported by appropriate policies. In particular, wage growth needs to be consistent with productivity growth, among other things in order to safeguard price competitiveness and the attractiveness of Romania to foreign investors.

Achieving an environment that is conducive to sustainable convergence in Romania requires stability-oriented economic policies and wide-ranging structural reforms.

With regard to macroeconomic imbalances, the European Commission selected Romania for an in-depth review in its Alert Mechanism Report 2024, highlighting significant concerns related to cost competitiveness, external sustainability and the government deficit. The relative inefficiency of the country's institutions and governance, as well as its weak business environment, continue to hamper its growth potential in an environment of low productivity. As headwinds related to Romania's demographic profile and labour market (i.e. its ageing population coupled with high migration outflows) are likely to persist, Romania's current growth strategy, based on extensive labour utilisation, should be complemented by a growth model that is more focused on fostering innovation, as well as knowledge-based and high-value-added industries (e.g. ICT). Continued reform efforts aimed at fighting

corruption, improving competition and enhancing the predictability of the country's tax, judicial, regulatory and administrative systems are needed, as they would also boost the country's attractiveness to foreign creditors by increasing trust in domestic institutions. Measures should include upgrading skill levels by improving access to education for the minorities and the under-represented, strengthening the insolvency regime and combating regional disparities in living standards to spur a more inclusive growth. Finally, an efficient and effective absorption of EU funds remains key to fostering economic convergence in the medium term and to guiding the economy in the upcoming green and digital transition.

Financial sector policies should be aimed at safeguarding financial stability and ensuring that the financial sector makes a sound contribution to economic growth. After several profitable years, there appears to be limited vulnerabilities in the banking sector, with banks having built up relatively large capital and liquidity buffers, and non-performing loan ratios having come closer to EU levels. The rise in foreign currency lending to non-financial corporations since 2022 warrants close monitoring. To further strengthen the resilience of the financial system in the light of the high global uncertainty, the Romanian authorities decided to increase the countercyclical capital buffer from 0.5% to 1% from October 2023. In order to bolster confidence in the financial system, the national competent authorities should continue to improve their supervisory practices, among other things, by following the applicable recommendations from the relevant international and European bodies, and by collaborating closely with other national supervisors of EU Member States within the supervisory colleges.

5.5.2 Fiscal developments

Romania's general government budget deficit was significantly above the 3% reference value in 2023, while its debt level was below the 60% reference value. In the reference year 2023, the general government budget balance recorded a deficit of 6.6% of GDP, i.e. significantly above the 3% reference value. The general government debt ratio was 48.8% of GDP, i.e. below the 60% reference value (Table 5.5.2). Compared with the previous year, the general government deficit increased by 0.3 percentage points of GDP and the debt ratio increased moderately by 1.3 percentage points of GDP. With regard to other fiscal factors, the deficit ratio exceeded the ratio of public investment to GDP in 2023. The budget deficits in 2022 and 2023 were affected by the economic impact of Russia's war against Ukraine and the discretionary fiscal policy measures taken in response to the related high energy prices.

Romania is currently subject to an excessive deficit procedure and the European Commission found, in June 2024, that it had not taken effective action to put an end to its excessive deficit situation. Following a recommendation from the European Commission of 4 March 2020 on the basis of a projected excessive deficit in 2019, the Council decided on 3 April 2020, in accordance with Article 126(6) of the Treaty, that an excessive deficit existed in Romania and issued a recommendation to correct the excessive deficit by 2022 at the

latest. In 2021, a Council recommendation revised the date for correcting this excessive deficit to 2024, with the argument being that the economic recovery following the pandemic should not be compromised. On 19 June 2024, the European Commission assessed that Romania had not reached the headline deficit target of 4.4% in 2023 and was not forecast to put an end to its excessive deficit by 2024 either.¹⁶⁰ Moreover, it found that Romania's fiscal effort had fallen significantly short of what had been recommended and that net primary expenditure had grown much faster than recommended. On that basis, the Commission recommended to the Council that a decision be adopted establishing that Romania had not taken effective action in response to the Council recommendation to put an end to the excessive deficit situation by 2024, at the latest.

Both cyclical and non-cyclical factors contributed to the deterioration in the budget balance over the period 2019-23, with the budget deficit in 2023 remaining above the pre-pandemic level in 2019. Romania's fiscal position appeared highly vulnerable even before the outbreak of the pandemic and the energy crisis, with the deficit having reached 4.3% of GDP by 2019, following a steady deterioration which had begun in 2016. In 2020 the deficit ratio deteriorated by 5 percentage points and the structural balance by 2.9 percentage points. This was mainly the result of pre-existing expansionary policies (including significant increases in pension payments), as well as temporary measures taken in the face of the pandemic (albeit these were smaller in size than those implemented in other countries) and cyclical factors. The budget deficit recorded a net improvement of 2.7 percentage points between 2021 and 2023, driven by a rise in the structural balance by 1.5 percentage points. This was on account of strong energy-related taxes and current expenditure that had grown less than nominal GDP, as well as cyclical conditions. The 2023 budget deficit nonetheless stands 2.3 percentage points above the pre-pandemic deficit level seen in 2019, with the structural deficit being higher than in 2019 by 1.4 percentage points.

The debt-to-GDP ratio, while remaining below the 60% reference value, has been predominantly increasing since 2019. Prior to the pandemic, the debt ratio had decreased from 39.1% of GDP in 2014 to 34.4% of GDP in 2018 owing to a favourable interest-growth differential and, to a lesser extent, some favourable deficit-debt adjustments, but in 2019, it had increased slightly. The debt ratio subsequently increased strongly by 13.4 percentage points over the period 2020-21, when it reached 48.5% of GDP. Since then, it increased slightly, reaching 48.8% of GDP in 2023, thus remaining 13.7 percentage points above its pre-pandemic level. The increases over the period 2019-23 were largely the result of primary deficits, with the favourable interest-growth differential helping to contain the debt increase over the period of 2021-23 (Table 5.5.2).

The level and structure of government debt indicate that Romania's fiscal balances are protected from sudden changes in interest rates, however, those balances are sensitive to exchange rate fluctuations. The share of government

¹⁶⁰ Recommendation for a Council decision establishing that Romania has taken no effective action in response to the Council Recommendation of 18 June 2021, (COM(2024) 597), Brussels, 19 June 2024.

debt with a short-term maturity is low (6.5% of overall debt in 2023 – Table 5.5.2). Taking into account medium and long-term debt with a variable interest rate as a percentage of GDP, fiscal balances appear relatively insensitive to interest rate changes. The proportion of foreign currency-denominated government debt is high (51.8% in 2023). Taking the size of the debt in relation to GDP into consideration, it can therefore be concluded that the fiscal balances are sensitive to exchange rate movements, mainly the euro/leu exchange rate, as a large part of the debt is denominated in euro (83.0% of foreign-denominated debt in 2023).

The European Commission’s Spring 2024 Economic Forecast foresees a moderate deterioration in the budget balance by 2025 and a significant increase in the debt ratio, with significant further consolidation required for Romania to correct its excessive deficit situation. According to the European Commission’s Spring 2024 Economic Forecast, the deficit is projected to increase to 6.9% of GDP in 2024 and to 7.0% of GDP in 2025. This forecast includes the short-term cost of the pension reform that was adopted in November 2023 and will come into force in September 2024. Romania is therefore not expected to correct its excessive deficit by 2024, as required by the Council of the European Union. Over the period 2024-25, the structural deficit is projected to increase to 6.4% of GDP in 2024 and 6.7% of GDP in 2025. With regard to the debt ratio, the European Commission forecasts an increase of 2.1 percentage points of GDP in 2024, followed by a further increase of 3.0 percentage points in 2025. The debt ratio is projected to remain below the 60% reference value, reaching 53.9% of GDP in 2025, but this would be its highest level since 1995. On the basis of the European Commission’s Spring 2024 Economic Forecast, significant further consolidation will be required to correct its excessive deficit.

Romania has strengthened its national fiscal governance framework significantly, but the framework has not been respected or applied effectively, particularly in the context of policy decisions taken from 2015 onwards.

Romania’s fiscal governance framework was strengthened following the adoption of the fiscal compact (through the implementation of a structural budget balance rule, a debt rule and a correction mechanism), the creation of an independent fiscal council in 2010 and a reform of the tax collection agency. However, Romania has systematically and repeatedly derogated from its national fiscal rules and the timeline for the adoption of the medium-term fiscal strategy, as enshrined in the national fiscal framework, thereby rendering these rules largely ineffective. In particular, the Romanian authorities should fully support the Fiscal Council by submitting the budget in a timely manner and by increasing the transparency of the macroeconomic and fiscal forecasts as well as the budget documentation. The government should also increase efforts to reform the public administration and make tax policy and administration more efficient. Some progress has been made with public finance management, including through the new law tasking the Fiscal Council with a regular impact assessment of spending reviews. Limited progress has been made in public investment project preparation and prioritisation. However, progress in improving the governance and performance of state-owned enterprises has been made, yet significant shortcomings in terms of implementation persist. Romania’s budgetary adjustment would be well supported by the full application of the national fiscal framework.

Romania faces high sustainability risks in the medium and in the long term, with only slight increases in age-related public expenditure projected over the period 2022-70. Over the medium term, the European Commission's 2024 Country Report risk classification remains unchanged compared with the 2021 Fiscal Sustainability Report, with ageing costs weighing on the results.¹⁶¹ Over the long term, the increase from the medium to high-risk classification, compared with the 2021 Fiscal Sustainability Report, is attributable to the unfavourable initial budgetary position. The European Commission's 2024 Ageing Report prepared by the Ageing Working Group (AWG) of the EU's Economic Policy Committee¹⁶², which incorporates the pension reforms adopted in November 2023, points to a slight increase of 0.2 percentage points of GDP in age-related public expenditure over the period 2022-70 under its baseline, from a level of 15.8% of GDP in 2022. The projected decrease in pension expenditure by 0.9 percentage points of GDP over the period 2022-70 largely compensates for the projected increase in health and long-term care expenditure. While over the full projection horizon of the Ageing Report, pension spending is projected to fall, a notable increase is expected during the first period of the projection horizon (2022-45). Under the AWG's risk scenario, the increase in the cost of ageing amounted to 4.3 percentage points of GDP.

Looking ahead, additional reforms and significant consolidation in line with the requirements of the Stability and Growth Pact are needed to safeguard the sustainability of public finances over the medium term. Romania must ensure compliance with the requirements of the excessive deficit procedure through significant further consolidation. This needs to be supported by efforts geared towards enhancing the quality of public finances and reinforcing the growth potential of the economy. Moreover, the Next Generation EU programme needs to be implemented efficiently and effectively. The Romanian government should make further efforts to improve the tax collection system, fight tax evasion, increase spending efficiency, advance structural fiscal reforms (including in the corporate governance of state-owned enterprises) and complete tax system reforms.

5.5.3 Exchange rate developments

Over the reference period from 20 June 2022 to 19 June 2024, the Romanian leu did not participate in ERM II, but traded under a flexible exchange rate regime involving a managed float of the currency's exchange rate. Over the two-year reference period the Romanian leu mostly traded close to its June 2022 average exchange rate against the euro of 4.9444 lei per euro, which is used as a benchmark for illustrative purposes in the absence of an ERM II central rate (Chart 5.5.3). The maximum upward deviation from this benchmark was 2.5%, while the maximum

¹⁶¹ The debt sustainability analysis published as part of the European Commission's Country Report for Romania on 19 June 2024 follows the multidimensional approach of the European Commission's 2023 Debt Sustainability Monitor, updated based on the European Commission's Spring 2024 Economic Forecast.

¹⁶² European Commission and Economic Policy Committee, "The 2024 Ageing Report: Economic & Budgetary Projections for the EU Member States (2022-2070)", *European Economy Institutional Paper*, No279, European Commission, 2024.

downward deviation amounted to 0.7%. On 19 June 2024 the exchange rate stood at 4.9768 lei per euro, i.e. the leu was 0.7% weaker than its average level in June 2022. Between June 2020 and mid-January 2024 Banca Națională a României had a repo line arrangement with the ECB, under which it could borrow up to €4.5 billion against high-quality euro-denominated collateral to provide euro liquidity to Romanian financial institutions in order to address possible liquidity needs. As this arrangement helped to reduce the potential risk of financial vulnerabilities, it may also have had an impact on exchange rate developments over the reference period. Over the past ten years the Romanian leu has depreciated against the euro by 13.3%.

The exchange rate of the Romanian leu against the euro exhibited, on average, a low degree of volatility over the reference period. From mid-2022 exchange rate volatility increased somewhat, with the leu seeing several episodes of slight appreciation against the euro followed by more pronounced depreciations. This was against the background of the greater relative attractiveness of investments in domestic currency and the downward correction of the current account deficit in 2023, as well as fluctuations in global risk appetite. Throughout the reference period the Romanian leu continued its steady trend depreciation, given the risks stemming from the fiscal position and external imbalance. Since September 2023 the exchange rate has fluctuated between 4.96 lei and 4.98 lei per euro. Over the reference period short-term interest rate differentials against the three-month EURIBOR were wide. After reaching a peak of 7.1 percentage points in the three-month period ending in September 2022, the interest rate differential came down again and stood at 2 percentage points in the three-month period ending in March 2024. The recent narrowing of short-term interest rate differentials largely reflects a moderation in the pace of monetary policy tightening by Banca Națională a României, as well as the increases in the key ECB interest rates which started in July 2022.

The Romanian leu has appreciated over the past ten years in HICP-based real effective terms (Chart 5.5.4). Overall, this appreciation mainly reflected developments in relative prices. The relatively high level of inflation following the sharp rise in energy prices in 2021, which was exacerbated in the wake of Russia's invasion of Ukraine in February 2022, put additional upward pressure on the real effective exchange rate. Looking ahead, this indicator should be interpreted with caution, as Romania is subject to a process of economic convergence, which complicates any long-term assessment of real exchange rate developments.

Romania's current and capital account balance has weakened over the past ten years, while the country's net foreign liabilities have declined gradually but remain high (Table 5.5.3). Following three consecutive EU and IMF financial assistance programmes ending in 2015, the combined current and capital account balance strengthened until 2016, before deteriorating notably in subsequent years. This deterioration reflected a growing trade deficit on the back of a worsening merchandise goods balance in conjunction with a flattening services surplus, as Romania's export performance weakened and strong domestic demand fuelled import growth. This trend continued after the pandemic, which further worsened the trade balance owing to the emergence of global supply chain disruptions. In 2023 the current account deficit declined as domestic demand growth slowed, import prices of

energy declined and services exports continued their upward trend. On the financing side, from 2014 to 2018 net inflows in direct and portfolio investment were more than offset by net outflows in other investment, and gross external debt declined simultaneously. Portfolio investment inflows in the form of debt securities subsequently gained in importance. Given the Romanian government's fiscal support measures (financed in part by the issuance of international bonds) and the contraction of the country's economy induced by the pandemic, the gross external debt ratio increased to 57.9% in 2020. After declining over the following two years on the back of high nominal GDP growth, it edged up again to 52.7% in 2023. While the country's net international investment position has improved steadily over the past ten years, net foreign liabilities remained relatively high at -39.8% in 2023. Hence, fiscal and structural policies continue to be important for supporting external sustainability, maintaining Romania's attractiveness to foreign direct investors and enhancing the competitiveness of the economy, especially in a more volatile environment characterised by geopolitical and commodity price shocks.

The Romanian economy is well integrated with the euro area through trade and investment linkages. In 2023 exports of goods and services to the euro area constituted 55.5% of total exports, while the corresponding figure for imports amounted to 54.4%. In the same year the share of the euro area in Romania's stock of inward direct investment stood at 79.6% and its share in the country's stock of portfolio investment liabilities was 53.4%. The share of Romania's stock of foreign assets invested in the euro area amounted to 66.1% in the case of direct investment and 70.6% for portfolio investment in 2023.

5.5.4 Long-term interest rate developments

Over the reference period from June 2023 to May 2024, long-term interest rates in Romania stood at 6.4% on average, above the 4.8% reference value for the interest rate convergence criterion (Chart 5.5.5).

Long-term interest rates in Romania stood at 6.3% in May 2024, having reached more than 9% in October 2022, the highest level during the review period. In 2014 and early 2015 long-term interest rates in Romania declined steadily from more than 5% to a historical low of 2.8% in February 2015. This was driven by both domestic factors, such as a decrease in inflation outturns and expectations, and external factors, in particular developments in the euro area, where sovereign bonds gradually priced in the lower risk of euro area member government bonds. For the following five years, long-term interest rates were affected by imbalances in the Romanian economy, which materialised in positive inflation dynamics, sizeable current account deficits and uncertainty regarding the sustainability of the Government's fiscal policy. The long-term interest rate in Romania increased steadily and fluctuated between 3% and 4% over the period 2015-17 and between 4% and 5% from 2018 until the outbreak of the pandemic in spring 2020. To counter the negative impact of the pandemic on inflation and economic growth, Banca Națională a României acted quickly to ease monetary policy. In March 2020 it cut policy rates and decided to conduct government bond purchases in the secondary market. After cumulative rate cuts of 125 basis

points between March 2020 and January 2021, policy rates stood at 1.25% until October 2021. From then, in a context of rising inflation and supply-side shocks posing upside risks to medium-term inflation expectations – which were then further exacerbated by the impact on food and energy prices of Russia’s invasion of Ukraine in February 2022 – Banca Națională a României reversed the course of monetary policy and, over time, brought the policy rate up to 7%, where it currently stands. Over the review period, long-term interest rates in Romania declined from a peak of more than 9% in October 2022 to 6.3% in May 2024. This came on the back of declining inflation from the end of 2022 and evidence of a slowdown in economic activity in 2023. During the review period, credit default swap spreads for Romanian government bonds increased to more than 400 basis points in October 2022 before falling to 200 basis points in May 2024. This is one of the highest levels among the group of peer countries in the region and is mainly related to market concerns about the structural sustainability of domestic government finances. Romania’s government debt is rated the lowest investment-grade notch by all three main rating agencies (Moody’s: Baa3; S&P: BBB-; Fitch: BBB-).

After standing at close to 2.5 percentage points over the period 2014-16, the long-term interest rate differential of Romanian bonds vis-à-vis the euro area has since increased (Chart 5.5.6). The increase was driven by persistent macroeconomic imbalances in the Romanian economy. It showed a spike in 2022 before completely reversing. The differential stood at 3.2 percentage points at the end of the review period, having reached 7.3 percentage points in July 2022.

Capital markets in Romania are much smaller than those in the euro area and are still underdeveloped (Table 5.5.4). At the end of 2023 the Romanian corporate debt market was almost non-existent, with outstanding debt securities issued by financial and non-financial corporations amounting to only 1.8% and 0.3% of GDP respectively. Romania’s equity market also remains quite small, with a stock market capitalisation of 13.5% of GDP in 2023, which ranks among the lowest in the region. Foreign-owned banks play a major role in Romania and accounted for around 66% of total banking assets in 2023. The degree of financial intermediation is quite small and the lowest in the region, with MFIs extending the equivalent of 24.1% of GDP in credit to the private sector in 2023. Over the past decade Romanian banks have gradually relied less on euro area banks for their funding needs. The claims of euro area banks on Romanian banks have declined from an annual average of 6.7% of total liabilities of domestic MFIs over the period 2014-23 to 2.9% in 2023. Since 2014 MFI loans denominated in domestic currency as a share of total loans extended to the private sector have increased consistently, from about 44% at the end of 2014 to 69% in April 2024.

5.5.5 Statistical tables and charts

Romania

5.6 Sweden

5.6.1 Price developments

In May 2024 the 12-month average rate of HICP inflation in Sweden was 3.6%, i.e. above the reference value of 3.3% for the criterion on price stability (Chart 5.6.1). This rate is expected to decrease gradually over the coming months, driven by a restrictive monetary policy stance, a fall in energy prices and the ongoing easing of pipeline pressures.

Over the past ten years the 12-month average rate of HICP inflation has fluctuated within a wide range, from 0.2% to 9.2%. Owing to the lagged effects of the krona's depreciation and strong economic growth, HICP inflation picked up in 2015 from the very low levels the year before. This upward trend was also driven by an accommodative monetary policy stance, as that year Sveriges Riksbank had lowered its main policy rate into negative territory and launched a programme of government bond purchases. Between early 2017 and early 2019, HICP inflation hovered between 1.4% and 2.5%, as volatile energy prices contributed to fitful inflation growth. In 2018 and 2019 Sveriges Riksbank raised its repo rate in two steps from -0.50% to 0%, in the light of robust economic growth and accelerating core inflation. With the COVID-19 pandemic-related contraction of the Swedish economy in the first half of 2020, HICP inflation fell significantly, averaging 0.7% over the whole year. In 2021 it rose to 2.7% owing to rising energy prices and a strong rebound in economic activity. Russia's invasion of Ukraine in late February 2022 exacerbated supply shortages and the scarcity of raw materials, pushing up energy and commodity prices significantly. As a result, HICP inflation peaked at 10.8% in December 2022 and remained well above the 2.0% target until November 2023. In April 2022 Sveriges Riksbank launched a series of interest rate hikes, bringing its key policy rate up to 4.0% in September 2023. In addition, the government introduced energy support measures, including fuel tax cuts (combined with a reduction in the biofuel blending requirements) and electricity price subsidies in 2022. Economic activity started to contract in the second half of 2023, as real disposable incomes were hit by tighter financial conditions and high energy prices, leading to falls in spending, particularly in the household and construction sectors (Table 5.6.1). By December inflation had fallen to 1.9% on the back of a decline in non-energy inflation and energy prices.

In May 2024 the annual rate of HICP inflation reached 2.5%. In the first five months of 2024 both headline and core inflation moderated further, in a context of high interest rates and weak economic activity. In addition, energy prices fell sharply, reflecting lower global energy prices, changes in energy taxation and a reduction in the requirements for mixing biofuel into petrol and diesel. With inflation approaching the target and economic activity remaining weak, Sveriges Riksbank reduced its key policy rate by 25 basis points to 3.75% in May 2024.

Policy choices have played an important role in shaping inflation dynamics in Sweden over the past decade, most notably the orientation of monetary policy towards price stability. Since 1995 Sveriges Riksbank has had an inflation target

that is quantified as an annual rise of 2.0% in the consumer price index (CPI). Sweden's institutional framework, which fosters prudent fiscal policy and wage formation, has lent support to the achievement of price stability. In September 2017, while keeping the inflation target at 2.0%, Sveriges Riksbank decided to switch to an inflation target defined in terms of the CPIF (the CPI with a fixed interest rate) as a formal target variable for monetary policy. It also decided to introduce a variation band of ± 1 percentage point to illustrate uncertainty surrounding the development of inflation.

Inflation in Sweden is likely to fall to close to the target over the forecast horizon. According to the European Commission's Spring 2024 Economic Forecast, HICP inflation is projected to stand at 2.0% in 2024 and to fall to 1.8% in 2025. The near-term outlook for economic activity is subdued. Although base effects for energy prices led to a rise in headline inflation at the beginning of 2024, disinflation is set to continue over the forecast horizon, as domestic wage and price pressures are likely to remain contained. However, these forecasts are subject to considerable uncertainty about the evolution of energy prices and the geopolitical situation. Risks to the inflation outlook are balanced, as there are a number of uncertain factors relating to the international environment and the exchange rate that could drive inflation either up or down. Looking further ahead, monetary policy and the stability-oriented institutional framework should continue to support the achievement of price stability in Sweden.

Maintaining an environment that is conducive to sustainable convergence in Sweden requires the continuation of stability-oriented economic policies and targeted structural reforms. High levels of private debt coupled with large numbers of flexible interest rate mortgages mean that Swedish households are particularly vulnerable to interest rate fluctuations and economic downturns, which, in turn, poses risks for the housing market and the stability of the Swedish economy. The European Commission selected Sweden for an in-depth review in its Alert Mechanism Report 2024, in particular because of the macroeconomic imbalances stemming from the housing market.

Financial sector policies should be aimed at continuing to safeguard financial stability and ensuring that the financial sector makes a sound contribution to economic growth. Macro-financial volatility has increased in recent years, owing primarily to instability in property prices, elevated levels of household indebtedness and the banking sector's large exposure to the real estate market. Although the resilience of the banking sector has improved in recent years, as banks have built up liquidity buffers and increased their capital ratios, the Swedish authorities need to address the structural factors behind the volatility in property prices once the business cycle allows, for instance by reforming property taxation and improving the functioning of the rental market. In order to bolster confidence in the financial system, the national competent authorities should continue to improve their supervisory practices, among other things, by following the applicable recommendations from the relevant international and European bodies, and by collaborating closely with other national supervisors of EU Member States within the supervisory colleges.

5.6.2 Fiscal developments

Sweden's general government budget deficit was well below the 3% reference value in 2023 and its debt ratio was well below the 60% reference value. In the reference year 2023, the general government budget recorded a deficit of 0.6% of GDP, i.e. well below the 3% deficit reference value. The general government debt ratio was 31.2% of GDP, i.e. well below the 60% reference value (Table 5.6.2). Compared with the previous year, the budget balance decreased by 1.8 percentage points of GDP, while the debt ratio declined notably by 2.0 percentage points. With regard to other fiscal factors, the deficit ratio did not exceed the ratio of public investment to GDP in 2023. The budget deficits in 2022 and 2023 were affected by the economic impact of Russia's war against Ukraine and the discretionary fiscal policy measures taken in response to the related high energy prices.

Sweden has never been subject to an ECOFIN Council decision on the existence of an excessive deficit. Sweden is currently subject to the preventive arm of the Stability and Growth Pact. The European Commission's Spring 2024 Economic Forecast assessed that the structural balance remained within the medium-term objective in 2023.

The budget balance improved strongly in 2021 and 2022, following the trough during the pandemic, but deteriorated again in 2023. Prior to the pandemic, Sweden had consistently recorded structural surpluses and most of the time also surpluses in the overall fiscal balance, amounting to 0.5% of GDP in 2019. In 2020, at the peak of the pandemic, the budget balance deteriorated by 3.3 percentage points of GDP due to a deterioration in the cyclical conditions, as well as a deterioration in the structural balance by 1.1 percentage points. As the effects of the pandemic dissipated, the exceptional expenditure measures were gradually withdrawn and the structural balance returned to surplus territory, reaching 0.9% of GDP in 2022 and 0.1% in 2023. Over this period, the budget balance was also helped by a strong cyclical recovery, which partly reversed in 2023 when economic activity began to weaken. The budget balance in 2023 was 1.1% of GDP lower than in 2019, i.e. the year before the outbreak of the pandemic.

Despite the pandemic, the government debt-to-GDP ratio has continued its declining trend and remained well below the 60% reference value over the past ten years. Prior to the pandemic, the debt ratio had declined between 2014 and 2019 by 9.4 percentage points to 35.6% of GDP thanks to a combination of primary surpluses and favourable interest-growth differentials. The fallout of the pandemic was an increase in the debt ratio by 4.6 percentage points in 2020, but by 2022, the ratio had fallen back below the pre-pandemic level, driven by an improved interest-growth differential and primary surpluses. In 2023 the ratio fell further, in spite of a deteriorating economic cycle, to reach the historically low rate of 31.2% of GDP, which was 4.4 percentage points below its level in 2019.

Sweden's government debt structure shows that fiscal balances are relatively sensitive to interest rate variations but relatively insensitive to exchange rate fluctuations. The share of government debt with a short-term maturity is high (31.5% in 2023). A further noticeable part of its debt with medium and long-term maturities is

exposed to variable interest rates (12.0% in 2022 – Table 5.6.2). After taking into account the level of the debt ratio, the fiscal balances remain relatively sensitive to interest rate movements. Furthermore, the share of government debt denominated in foreign currency is low (9.9% in 2023), which leaves fiscal balances relatively insensitive to exchange rate movements.

The European Commission’s Spring 2024 Economic Forecast predicts a moderate deterioration in the budget balance, with a moderate deficit projected for both 2024 and 2025. According to the Commission’s latest forecast, the budget balance is expected to deteriorate, with a deficit of 1.4% of GDP in 2024 and 0.9% in 2025, but remaining well below the reference value of 3% in both cases. The expected moderate deterioration in the general government balance in 2024 stems primarily from weak economic activity, increasing unemployment and the lagged impact of price increases on government expenditure, while the contribution from discretionary spending measures is relatively limited. The government debt ratio is projected to increase moderately to 32.0% of GDP in 2024 and then to moderately decrease to 31.3% of GDP in 2025, thus remaining well below the 60% reference value in both years.

Sweden has a strong fiscal governance framework. Following the last revision of the fiscal framework, which entered into force in 2019, the general government surplus target is now ⅓% of GDP over the business cycle. In addition, a debt anchor was introduced into the fiscal framework in 2019, targeting a debt ratio of 35% (Maastricht definition). A deviation from the debt anchor by 5 percentage points or more in either direction requires the government to submit a report to Parliament explaining the causes of the deviation and presenting an action plan to address it. The debt level of 35% leaves a significant safety margin to the Maastricht reference value of 60% of GDP. The Swedish fiscal framework also includes a three-year rolling nominal expenditure ceiling for central government and the pension system, as well as a balanced budget requirement for local governments. Overall, the national fiscal framework is strong and supports the medium-term sustainability of public finances in line with the requirements of the Stability and Growth Pact.

Sweden faces low risks to the sustainability of public finances over the medium and long term. The analysis laid out in the European Commission’s 2023 Debt Sustainability Monitor points to low risks over the medium and long term, which is an assessment that has remained unchanged as compared with the 2021 Fiscal Sustainability Report.¹⁶³ The positive assessment in the 2023 report stemmed from a favourable initial budgetary position that more than fully mitigates the projected increase in ageing-related costs, as well as from low government debt. According to the baseline from the 2024 Ageing Report prepared by the Ageing Working Group (AWG) of the EU’s Economic Policy Committee¹⁶⁴, a moderate increase in age-related public expenditure by 0.9 percentage points of GDP is expected over the period

¹⁶³ This assessment was confirmed by the updated debt sustainability analysis that was published as part of the European Commission’s Country Report for Sweden on 19 June 2024.

¹⁶⁴ European Commission and Economic Policy Committee, “The 2024 Ageing Report: Economic and Budgetary Projections for the EU Member States (2022-2070)”, *European Economy Institutional Paper*, No 279, European Commission, 2024.

2022-70, from a level of 23.6% of GDP in 2022. This rise is mainly driven by long-term care costs. Under the AWG's risk scenario, the increase in the cost of ageing amounted to 2.7 percentage points of GDP, which is in line with the EU average.

Looking ahead, Sweden should build on its strong track record and continue complying with the requirements of the preventive arm of the Stability and Growth Pact. Sweden should continue to anchor sound public finances in its rule-based fiscal framework, which would help to maintain the resilience of public finances to adverse economic shocks, while ensuring fiscal space where needed for both the green and digital transitions in the years to come.

5.6.3 Exchange rate developments

In the two-year reference period from 20 June 2022 to 19 June 2024, the Swedish krona did not participate in ERM II, but traded under a flexible exchange rate regime. Over the reference period the Swedish currency was mostly significantly weaker than its June 2022 average exchange rate against the euro of 10.6005 kronor per euro, which is used as a benchmark for illustrative purposes in the absence of an ERM II central rate (Chart 5.6.3). The maximum upward deviation from this benchmark was 2.3%, while the maximum downward deviation amounted to 13.1%. On 19 June 2024 the exchange rate stood at 11.2140 kronor per euro, i.e. the krona was 5.8% weaker than its average level in June 2022. Over the reference period Sveriges Riksbank maintained a swap agreement with the ECB for borrowing up to €10 billion in exchange for Swedish kronor, which has been in place since 20 December 2007, with the aim of facilitating the functioning of financial markets and providing euro liquidity to them if needed. As this agreement helped to reduce the potential risk of financial vulnerabilities, it might also have had an impact on the exchange rate of the Swedish krona against the euro over the reference period. Over the past ten years the exchange rate of the Swedish krona against the euro has depreciated by 23.4%.

The exchange rate of the Swedish krona against the euro exhibited, on average, a high degree of volatility over the two-year reference period. Overall, the krona weakened steadily against the euro for most of 2022 and 2023, with the exchange rate peaking in September 2023 when the krona traded at historically high levels of just under 12 kronor per euro. Several factors contributed to this weakening, such as global risk sentiment and risk perceptions related specifically to the Swedish economy in connection with the real estate market and the high level of household debt. From late September 2023 the krona began to strengthen against the euro, before depreciating at the turn of the year as the Swedish economy weakened and fluctuating between 11 kronor and 11.7 kronor per euro. During the reference period short-term interest rate differentials against the three-month EURIBOR were overall low and stood at 0.1 percentage points in the three-month period ending in March 2024.

The HICP-based real effective exchange rate of the Swedish krona has depreciated over the past ten years (Chart 5.6.4). This depreciation in real terms mainly reflected developments in the nominal effective exchange rate.

Over the past ten years Sweden has recorded relatively large current account surpluses and has had a large positive net international investment position (Table 5.6.3). In 2023 the surplus in the combined current and capital account of the balance of payments stood at 6.8% of GDP, reflecting surpluses in the goods and primary income balances. The corresponding net capital outflows in the financial account were mainly in direct investment. Gross external debt, which is concentrated in monetary and financial institutions, stood at 166.4% of GDP in 2023. Over the past ten years Sweden has recorded a positive net international investment position on average. In 2018 its net international investment position turned positive and it reached 33.2% of GDP in 2023.

The Swedish economy is well integrated with the euro area through trade and investment linkages. In 2023 exports of goods and services to the euro area constituted 40.7% of total exports, while the corresponding figure for imports was higher, at 50.4%. In the same year the share of the euro area in Sweden's stock of inward direct investment stood at 56.6% and its share in the country's stock of portfolio investment liabilities was 40.8%. The share of Sweden's stock of foreign assets invested in the euro area amounted to 44.1% in the case of direct investment and 33% for portfolio investment.

5.6.4 Long-term interest rate developments

Over the reference period from June 2023 to May 2024, long-term interest rates in Sweden stood at 2.5% on average and thus remained well below the 4.8% reference value for the interest rate convergence criterion (Chart 5.6.5).

Long-term interest rates in Sweden stood at very low levels over most of the review period but rose towards the end to levels last seen in 2014. After falling to almost 0% between 2014 and mid-2015, partly owing to high levels of risk appetite and a gradual shift from safe to riskier assets, long-term interest rates in Sweden continued to be driven by both the domestic economic cycle and global developments. Long-term interest rates increased moderately between 2016 and 2018, owing to a recovery in economic growth and inflation, before falling again in 2019. Following the global downward trend in 2019 and 2020, long-term interest rates in Sweden declined and fluctuated closely around 0% until the end of 2020, with short spells in slightly negative territory. In 2020 Sveriges Riksbank responded to the pandemic by increasing the envelope of its quantitative easing programme until the end of 2021, including purchases of government and corporate bonds and commercial paper. It also cut the repo rate to 0% in August 2020 – close to its historically low level of -50 basis points set in February 2016. Sveriges Riksbank's monetary policy stance remained accommodative from August 2020 to April 2022, at which point, against a backdrop of rising and persistent inflation, the central bank began a tightening cycle with a view to stopping high inflation from becoming entrenched in price and wage-setting. Sveriges Riksbank's last rate increase, at the end of November 2023, brought the repo rate to 4.0%. It remained there until May 2024, when the central bank lowered it to 3.75%. The long-term interest rate has also been increasing since January 2022, standing at 2.4% in May 2024, the end of the review period. Sweden's

government debt is rated the top investment-grade notch by all three main rating agencies (Moody's: Aaa; S&P: AAA; Fitch: AAA).

Historically, Sweden's long-term interest rate differential vis-à-vis the highest-rated euro area countries has been negative, or temporarily positive but very small (Chart 5.6.6). Thanks to its sound fiscal policy and its balanced and healthy economy, Sweden enjoys the same credibility as the highest-rated euro area countries. Vis-à-vis the euro area average, the interest rate differential has been historically negative and declined to almost -1 percentage point by the end of 2022. It has since recovered slightly, reaching -0.7 percentage points at the end of the review period (-0.3 percentage points vis-à-vis the euro area AAA yield).

Capital markets in Sweden are highly developed, with corporate bond issuance and stock market capitalisation accounting for a higher percentage of GDP than in the euro area (Table 5.6.4). Relative to GDP, outstanding amounts of debt securities issued by non-financial corporations in Sweden are more than twice as large as those in the euro area. The size of the Swedish stock market, as a percentage of GDP, is also more than twice that of the euro area. Sweden's banks tend to fund their activities by borrowing from euro area banks only to a limited extent. Claims of euro area MFIs accounted for 8.7% of Swedish banks' total liabilities in 2023. The degree of financial intermediation in Sweden is high. At the end of 2023 bank credit to the private sector amounted to 131.3% of GDP, much higher than the figure for the euro area, which was 99.6%.

5.6.5 Statistical tables and charts

Sweden

6 Statistical methodology of convergence indicators

The examination of the convergence process is highly dependent on the quality and integrity of the underlying statistics; the compilation and reporting of statistics, particularly government finance statistics (GFS), must not be subject to any political or other external interference. Member States are invited to consider the quality and integrity of their statistics as a matter of priority, to ensure that a proper system of checks and balances is in place when compiling these statistics and to apply high standards with respect to governance and quality in the domain of statistics.

National statistical authorities in each Member State and the EU statistical authority within the European Commission (Eurostat) should enjoy professional independence and ensure that European statistics are impartial and of a high quality. This is in line with the principles laid down in Article 338(2) of the Treaty, the Regulation on European statistics¹⁶⁵ and the European Statistics Code of Practice¹⁶⁶. Article 2(1) of the Regulation on European statistics states that the development, production and dissemination of European statistics shall be governed by the following statistical principles: a) professional independence, b) impartiality, c) objectivity, d) reliability, e) statistical confidentiality, and f) cost effectiveness. Pursuant to Article 11 of the Regulation, these statistical principles are elaborated further in the European Statistics Code of Practice.

Against this background, this chapter reviews the quality and integrity of the convergence indicators in terms of the underlying statistics. It provides information on the statistical methodology of the convergence indicators, as well as on the compliance of the underlying statistics with the standards necessary for an appropriate assessment of the convergence process.

6.1 Institutional features relating to the quality of statistics for the assessment of the convergence process

The governance of the European Statistical System (ESS) has been progressively improved, in particular with the adoption of the European

¹⁶⁵ Regulation (EC) No 223/2009 of the European Parliament and of the Council of 11 March 2009 on European statistics and repealing Regulation (EC, Euratom) No 1101/2008 of the European Parliament and of the Council on the transmission of data subject to statistical confidentiality to the Statistical Office of the European Communities, Council Regulation (EC) No 322/97 on Community Statistics, and Council Decision 89/382/EEC, Euratom establishing a Committee on the Statistical Programmes of the European Communities (OJ L 87, 31.3.2009, p. 164).

¹⁶⁶ The European Statistics Code of Practice was endorsed by the European Commission in its Recommendation of 25 May 2005 on the independence, integrity and accountability of the national and Community statistical authorities (COM(2005) 217 final), and revised by the European Statistical System Committee in September 2011 and November 2017.

Statistics Code of Practice in 2005. In the specific context of the EU fiscal surveillance system and of the excessive deficit procedure (EDP), Council Regulation (EU) No 679/2010¹⁶⁷ granted Eurostat new competences for the regular monitoring and verification of public finance data, which it exercises by conducting more in-depth dialogue visits to Member States and by extending such visits to public entities supplying upstream public finance data to the national statistical institutes (NSIs).

Furthermore, the legislative package of six legal texts adopted in 2011 to strengthen the economic governance structure of the euro area and the EU as a whole requires the compilation of high-quality statistical information, which needs to be produced under robust quality management.¹⁶⁸ In this context, the European Statistics Code of Practice was revised in September 2011 in order to distinguish between the principles to be implemented by ESS members and the principles relating to the institutional environment that are to be implemented by Member State governments. In 2017 it was revised again in order to emphasise that the NSIs and Eurostat coordinate all activities involved in the development, production and dissemination of European statistics (produced in accordance with the Regulation on European statistics) at the level of their national statistical systems and the ESS respectively.¹⁶⁹

In 2015 the Regulation on European statistics¹⁷⁰ was amended in order to, among other things, clarify that the principle of professional independence of NSIs applies unconditionally. Statistics must indeed be developed, produced and disseminated in an independent manner, free of any pressures from political or interest groups or from EU or national authorities, and existing institutional frameworks must not be allowed to restrict this principle.

Lastly, it is necessary to assure the independence of other statistical authorities responsible for the compilation of European statistics (e.g. ministries of finance). Other statistical authorities' responsibility for the publication of statistics needs to be clearly identified in order to distinguish statistical releases from political statements. In Poland and Romania, the Ministries of Finance compile EDP debt data. In Bulgaria, the Ministry of Finance compiles quarterly government debt data, while the NSI compiles annual government debt. The institutional responsibilities

¹⁶⁷ Council Regulation (EU) No 679/2010 of 26 July 2010 amending Regulation (EC) No 479/2009 as regards the quality of statistical data in the context of the excessive deficit procedure (OJ L 198, 30.7.2010, p. 1).

¹⁶⁸ On 13 December 2011 the reinforced Stability and Growth Pact (SGP) entered into force with a new set of rules for economic and fiscal surveillance. These measures, known as the "six-pack", consist of five regulations and one directive proposed by the European Commission and approved in October 2010 by all 27 Member States at the time and the European Parliament.

¹⁶⁹ European statistics are developed, produced and disseminated by both the ESS and the European System of Central Banks (ESCB) but under separate legal frameworks reflecting their respective governance structures. The members of the ESCB are not involved in the production of European statistics pursuant to the Regulation on European statistics. However, with a view to minimising the reporting burden and guaranteeing the coherence necessary to produce European statistics, the ESS and the ESCB cooperate closely, while complying with the statistical principles set out in Article 2(1) of the Regulation on European statistics. Given that some European statistics may be compiled by NCBs in their capacity as members of the ESCB, the NSIs and the NCBs also cooperate closely under national arrangements with a view to ensuring the necessary cooperation between the ESS and the ESCB and to guaranteeing the production of complete and coherent European statistics.

¹⁷⁰ Regulation (EU) 2015/759 of the European Parliament and of the Council of 29 April 2015 amending Regulation (EC) No 223/2009 on European statistics (OJ L 123, 19.5.2015, p. 90).

for the compilation of EDP data and GFS in the countries are shown in Table 6.1. In Romania, the Law on the organisation and functioning of official statistics includes the principle of professional independence and applies to all statistical processes and products. In Bulgaria and Poland, although the independence of the compilers at the Ministries of Finance is not guaranteed by law, the monitoring and quality assurance of the EDP data and GFS compiled by the Ministries of Finance form part of the coordination role of the NSI.

Table 6.1
Quality and integrity of convergence statistics

Bulgaria

Institutional features relating to the quality and integrity of the statistics used in assessing the convergence process	
Legal independence of the national statistical institute	Under the Law on Statistics, statistics are based on the principles of professional independence, impartiality, objectivity, reliability, statistical confidentiality and cost effectiveness. Under Article 8 of the Law on Statistics, the President of the NSI is appointed by the Prime Minister. The term of office is fixed (seven years; reappointment is possible, only once).
Administrative supervision and budget autonomy	The NSI has the status of a state agency and is directly subordinated to the Council of Ministers. It has budget autonomy on the basis of an annual amount assigned from the state budget.
Legal mandate for data collection	The Law on Statistics determines the main principles of data collection.
Legal provisions regarding statistical confidentiality	Under Articles 25 to 27a of the Law on Statistics, the confidentiality of the statistical data is assured.
HICP inflation ¹⁾	
Compliance with legal minimum standards	Eurostat made a compliance monitoring visit in 2013 and published a report in 2015 confirming that the methods used for producing the HICP are satisfactory. A follow-up report outlining the issues that had been addressed by Bulgaria was published in 2018. There were no apparent instances of non-compliance with the HICP methodology.
Other issues	Eurostat considered the representativeness of the HICP to be generally appropriate.
Government finance statistics	
Data coverage	Revenue, expenditure, deficit and debt data are provided for the period 2014-23.
Outstanding statistical issues	No major outstanding statistical issues identified. Eurostat made an EDP visit to Bulgaria in 2023 and published the final findings on its website.
Institution responsible for the compilation of statistics	The NSI compiles the non-financial and annual financial accounts of government, as well as annual government debt. The Ministry of Finance compiles quarterly government debt and the NCB compiles the quarterly financial accounts of government.

Czech Republic

Institutional features relating to the quality and integrity of the statistics used in assessing the convergence process	
Legal independence of the national statistical institute	Under Article 5 of the State Statistical Service Act, statistics are based on objectivity, impartiality and independence. Under Article 3, the Head of the NSI is appointed by the President of the Republic.
Administrative supervision and budget autonomy	The NSI is a central statistical agency within the public administration. It has budget autonomy on the basis of an annual amount assigned from the state budget.
Legal mandate for data collection	The State Statistical Service Act determines the main principles of data collection.
Legal provisions regarding statistical confidentiality	Under Articles 16, 17 and 18 of the State Statistical Service Act, the confidentiality of the statistical data is assured.
HICP inflation ¹⁾	
Compliance with legal minimum standards	Eurostat made a compliance monitoring visit in 2019 and published a report in January 2020 confirming that, in general, the methods used for producing the HICP are satisfactory. There were no apparent instances of non-compliance with the HICP methodology. In February 2023 Eurostat reviewed the recommendations implemented by the NSI of the Czech Republic and identified two areas in which the quality of the HICP could be improved further.
Other issues	Eurostat considered the representativeness of the HICP in terms of accuracy and reliability to be generally adequate.
Government finance statistics	
Data coverage	Revenue, expenditure, deficit and debt data are provided for the period 2014-23.

Outstanding statistical issues	No major outstanding statistical issues identified. Eurostat made an EDP visit to the Czech Republic in 2021 and published the final findings on its website.
Institution responsible for the compilation of statistics	The NSI compiles the non-financial and financial accounts of government, as well as government debt.

Hungary

Institutional features relating to the quality and integrity of the statistics used in assessing the convergence process

Legal independence of the national statistical institute	Under Act CLV of 2016 on Official Statistics, statistics are compiled following the principles of objectivity, independence and confidentiality. The Head of the NSI is appointed by the Prime Minister. The term of office is fixed (six years; reappointment is possible, only twice).
Administrative supervision and budget autonomy	The NSI is a public administration under the immediate supervision of the Government. It has budget autonomy on the basis of an annual amount assigned from the state budget.
Legal mandate for data collection	Act XLVI on Statistics determines the main principles of data collection.
Legal provisions regarding statistical confidentiality	Under Article 17 of Act XLVI on Statistics, the confidentiality of the statistical data is assured.

HICP inflation¹⁾

Compliance with legal minimum standards	Eurostat made a compliance monitoring visit in 2019 and published a report in March 2020 confirming that, in general, the methods used for producing the HICP are satisfactory. Some instances of non-compliance with the HICP methodology were identified, but those were considered by Eurostat to be limited and unlikely to have a major impact in practice on the annual average rates of change in the HICP.
Other issues	Eurostat considered the representativeness of the HICP in terms of accuracy and reliability to be generally adequate.

Government finance statistics

Data coverage	Revenue, expenditure, deficit and debt data are provided for the period 2014-23.
Outstanding statistical issues	No major outstanding statistical issues identified. Eurostat made an EDP visit to Hungary in 2023 and will publish the final findings on its website.
Institution responsible for the compilation of statistics	The NSI compiles the non-financial accounts of government. The NCB compiles government debt and the financial accounts of government.

Poland

Institutional features relating to the quality and integrity of the statistics used in assessing the convergence process

Legal independence of the national statistical institute	Under Article 1 of the Law on Public Statistics, statistics are based on reliability, objectivity and transparency. The Head of the NSI is selected by open competition and appointed by the President of the Council of Ministers. The term of office is fixed (five years).
Administrative supervision and budget autonomy	The NSI is a central agency within the public administration under supervision of the President of the Council of Ministers. It has budget autonomy on the basis of an annual amount assigned from the state budget.
Legal mandate for data collection	The Law on Official Statistics determines the main principles of data collection.
Legal provisions regarding statistical confidentiality	Under Articles 10, 11, 12, 38, 39 and 54 of the Law on Official Statistics, the confidentiality of the statistical data is assured.

HICP inflation¹⁾

Compliance with legal minimum standards	Eurostat made a compliance monitoring visit in 2015 and published a report in 2016 confirming that the methods used for producing the HICP are of a good standard and in line with legal requirements.
Other issues	In the 2016 report, Eurostat made further recommendations for increasing the accuracy and reliability of the HICP. A follow-up report issued in 2018 showed that most recommendations had been implemented or were in the process of being implemented.

Government finance statistics

Data coverage	Revenue, expenditure, deficit and debt data are provided for the period 2014-23.
Outstanding statistical issues	No major outstanding statistical issues identified. Eurostat made an EDP visit to Poland in 2022 and published the final findings on its website.
Institution responsible for the compilation of statistics	The NSI compiles the non-financial and financial accounts of government. The Ministry of Finance compiles government debt.

Romania

Institutional features relating to the quality and integrity of the statistics used in assessing the convergence process

Legal independence of the national statistical institute	The autonomy of official statistics is stated in the Statistical Law, together with the principles of confidentiality, transparency, reliability, proportionality, statistical deontology and cost/efficiency ratio. The Head of the NSI is appointed by the Prime Minister. The term of office is fixed (six years; reappointment is possible, only once).
Administrative supervision and budget autonomy	Under the Statistical Law, the NSI is a specialised institution, subordinated to the Government. It is financed via the state budget.
Legal mandate for data collection	Under the Statistical Law, "the official statistics in Romania are implemented and coordinated by the NSI".
Legal provisions regarding statistical confidentiality	The Statistical Law states that "during statistical research, from collection to dissemination, the official statistics services and statisticians have the obligation to adopt and implement all the necessary measures for protecting the data referring to individual statistics subjects (natural or legal persons), data obtained directly from statistical research or indirectly through administrative sources or from other suppliers".

HICP inflation ¹⁾

Compliance with legal minimum standards	Eurostat made a compliance monitoring visit in 2018 and published a report in February 2020 confirming that, in general, the methods used for producing the HICP are satisfactory. There were no apparent instances of non-compliance with the HICP methodology. In January 2023 Eurostat reviewed the recommendations implemented by the NSI of Romania and took good note of the progress achieved.
Other issues	Eurostat considered the representativeness of the HICP in terms of accuracy and reliability to be generally adequate.

Government finance statistics

Data coverage	Revenue, expenditure, deficit and debt data are provided for the period 2014-23.
Outstanding statistical issues	No major outstanding statistical issues identified. Eurostat made an EDP visit to Romania in 2023 and will publish the final findings on its website.
Institution responsible for the compilation of statistics	The NSI compiles the non-financial accounts of government. The Ministry of Finance compiles government debt. The NCB compiles the financial accounts of government.

Sweden

Institutional features relating to the quality and integrity of the statistics used in assessing the convergence process

Legal independence of the national statistical institute	Under Section 3 of the Official Statistics Act, statistics are objective and available to the public. The Head of the NSI is appointed by the Government. The term of office is fixed (six years; three-year reappointment possible, only once).
Administrative supervision and budget autonomy	The NSI is a central statistics agency, subordinated to, but not part of, the Ministry of Finance. Approximately half of its turnover is provided by the Ministry of Finance, the other half stems from charging government agencies and commercial customers for statistical production and advice.
Legal mandate for data collection	The Official Statistics Act determines the main principles of data collection.
Legal provisions regarding statistical confidentiality	Under Sections 5 and 6 of the Official Statistics Act, the confidentiality of the statistical data is assured.

HICP inflation ¹⁾

Compliance with legal minimum standards	Eurostat made a compliance monitoring visit in 2011 and published a report in 2013 confirming that, in general, the methods used for producing the HICP are satisfactory. Some instances of non-compliance with the HICP methodology were identified, but those were considered by Eurostat to be limited and unlikely to have a major impact in practice on the annual average rates of change in the HICP. In March 2022 Eurostat reiterated that Statistics Sweden should take measures to bring the coverage of the HICP into line with the legal requirements in some areas, albeit stating that those measures were not expected to affect annual HICP inflation significantly.
Other issues	Eurostat considered the representativeness of the HICP in terms of accuracy and reliability to be generally adequate.

Government finance statistics

Data coverage	Revenue, expenditure, deficit and debt data are provided for the period 2014-23.
Outstanding statistical issues	There is a public unit currently classified as a monetary financial institution, which may be subject to a reclassification into the general government sector. Eurostat made an EDP visit to Sweden in 2022 and published the final findings on its website.
Institution responsible for the compilation of statistics	The NSI compiles the non-financial and financial accounts of government, as well as government debt.

Note: NCB stands for national central bank.

1) See Eurostat's website for the [full reports on the findings and recommendations of the HICP compliance monitoring visits](#) for each country.

6.2 HICP inflation

This section considers the methodology and quality of the statistics underlying the measurement of price developments, specifically the Harmonised Index of Consumer Prices (HICP). The HICP was developed for the purpose of assessing convergence in terms of price stability on a comparable basis. It is published for all EU Member States by Eurostat.¹⁷¹ The HICP covering the euro area as a whole has been the main measure of price developments for the monetary policy of the ECB since January 1999.

Article 1 of Protocol (No 13) on the convergence criteria (annexed to the Treaties) requires price convergence to be measured by means of the CPI on a comparable basis, taking into account differences in national definitions. The framework regulation introduced to establish HICPs, Council Regulation (EC) No 2494/95¹⁷², was adopted in October 1995 and subsequently replaced by Regulation (EU) 2016/792¹⁷³, which entered into force in June 2016. The HICPs have also been harmonised on the basis of EU Council and European Parliament regulations. They use common standards for the coverage of the items, the territory and the population included (all these elements are major reasons for differences between national CPIs). Common standards have also been established in several other areas, for example the treatment of new goods and services.

The HICPs use annually updated expenditure weights (or, until 2011, less frequent updates if this did not have a significant effect on the index) and cover all goods and services included in household final monetary consumption expenditure. The latter is derived from the national accounts domestic concept of household final consumption expenditure but excludes owner-occupied housing. The prices observed are the prices households actually pay for goods and services in monetary transactions and thus include all taxes (minus subsidies) on products, e.g. VAT and excise duties. Expenditure on health, education and social services is covered to the extent that it is financed (directly or through private insurance) by households and not reimbursed by the government. The “HICP – administered prices” includes only prices which are directly set or significantly influenced by the government, including national regulators. It is based on a common definition and compilation, and is published by Eurostat.

Eurostat must ensure that the statistical practices used to compile national HICPs comply with HICP methodological requirements and that good practices in the field of consumer price indices are being followed. Eurostat carries out compliance monitoring visits and publishes its findings in information notes made available on its website.

¹⁷¹ See Eurostat’s website for details on the [HICP legislative framework](#). Eurostat has also published [recommendations and a methodological manual](#).

¹⁷² Council Regulation (EC) No 2494/95 of 23 October 1995 concerning harmonized indices of consumer prices (OJ L 257, 27.10.1995, p. 1).

¹⁷³ Regulation (EU) 2016/792 of the European Parliament and of the Council of 11 May 2016 on harmonised indices of consumer prices and the house price index, and repealing Council Regulation (EC) No 2494/95 (OJ L 135, 24.5.2016, p. 11).

6.3 Government finance statistics

This section describes the methodology and quality of the statistics used to measure fiscal developments. GFS are based mainly on national accounts concepts as defined in the ESA 2010¹⁷⁴ and Commission Regulation (EU) No 220/2014¹⁷⁵. They refer to the institutional sector “general government” as defined in the ESA 2010. This comprises central government, state government (in Member States with a federal structure), local government and social security funds. It typically does not include public corporations.

The general government deficit (-)/surplus (+) is equal to the ESA 2010 item “net lending (+)/net borrowing (-)”, which in turn is equal to “total revenue” minus “total expenditure”. The primary government deficit/surplus is the government deficit/surplus excluding interest expenditure.

The general government debt is the sum of the outstanding gross liabilities at nominal value (face value) in currency and deposits, debt securities (e.g. government bills, notes and bonds) and loans. It excludes financial derivatives, such as swaps¹⁷⁶, as well as trade credits¹⁷⁷ and other liabilities not represented by a financial document, such as overpaid tax advances. It also excludes contingent liabilities, such as government guarantees and pension commitments. While government debt is a gross concept in the sense that neither financial nor non-financial assets are deducted from liabilities, it is consolidated within the general government sector and therefore does not include government debt held by other government units.

Government deficit and debt ratios are expressed as a percentage of GDP at current market prices.

6.3.1 Data source

The national central banks (NCBs) provide the ECB with detailed GFS data under the ECB’s GFS Guideline¹⁷⁸. Although the Guideline is only legally binding for the euro area NCBs, the non-euro area EU NCBs also transmit GFS data to the ECB by the same deadlines and using the same procedures. The Guideline lays down requirements for the transmission of annual data with detailed breakdowns of annual revenue and expenditure and the deficit-debt adjustment. In addition, it requests

¹⁷⁴ See Regulation (EU) No 549/2013 of the European Parliament and of the Council of 21 May 2013 on the European system of national and regional accounts in the European Union (OJ L 174, 26.6.2013, p. 1).

¹⁷⁵ Commission Regulation (EU) No 220/2014 of 7 March 2014 amending Council Regulation (EC) No 479/2009 as regards references to the European system of national and regional accounts in the European Union (OJ L 69, 8.3.2014, p. 101).

¹⁷⁶ However, on the basis of a Eurostat guidance note released in 2008, lump sums received by government under off-market interest rate swaps are treated as government loans.

¹⁷⁷ A 2012 Eurostat decision stipulates that trade credits that are refinanced without recourse to the original holder and trade credits that are renegotiated beyond the simple extension of the initial maturity need to be reclassified as loans and are thus included in the EDP general government debt.

¹⁷⁸ Guideline (EU) 2020/1552 of the European Central Bank of 14 October 2020 amending Guideline ECB/2013/23 on government finance statistics (ECB/2020/50) (OJ L 354, 26.10.2020, p. 22).

figures on general government debt with breakdowns by instrument, by initial and residual maturity and by holder.

6.3.2 Methodological issues

GFS must comply with the ESA 2010 and reflect decisions and guidelines issued by Eurostat for specific cases involving the general government sector.

The borderline classification cases between the financial, non-financial and general government sectors continue to be examined closely by Eurostat and national statistical compilers and may lead to further reclassifications and changes in the EDP and GFS data.

In the Czech Republic and Hungary, there are monetary financial institutions (MFIs) that are reclassified into the general government sector for EDP purposes. These units are classified as part of the financial sector in other statistical data compiled by the NCB (e.g. monetary statistics and securities statistics). The resultant discrepancy in sector classification between those statistics and GFS is well documented and has been made known to users. However, one MFI in Hungary will be reclassified into the general government sector also in financial accounts statistics and balance of payments statistics, with effect from the 2024 benchmark revision.

In Sweden, a public unit is currently classified as part of the financial sector and is on the ECB's list of MFIs, but may be reclassified into the general government sector subject to the outcome of methodological discussions at the European level.

6.4 Exchange rates

Article 3 of Protocol (No 13) on the convergence criteria defines what is meant by the criterion on participation in the exchange rate mechanism of the European Monetary System. The bilateral exchange rates of the Member States' currencies vis-à-vis the euro are daily reference rates recorded by the ECB at 14:15 CET and subsequently published on the ECB's website.¹⁷⁹ Nominal and real effective exchange rates (EERs) are constructed by applying trade weights (based on a geometric weighting) to the bilateral nominal and real exchange rates of the Member States' currencies vis-à-vis the currencies of 41 trading partners. Both nominal and real EER statistics are published by the ECB.

6.5 Long-term interest rates

Article 4 of Protocol (No 13) on the convergence criteria requires interest rates to be measured on the basis of long-term government bonds or comparable

¹⁷⁹ Since 1 July 2016 the reference rates have been published at around 16:00 CET. For details, see "[ECB introduces changes to euro foreign exchange reference rates](#)", *press release*, ECB, 7 December 2015.

securities, taking into account differences in national definitions. While Article 5 assigns the responsibility for providing the statistical data for the application of the Protocol to the European Commission, the ECB, given its expertise in the area, assists in this process by defining representative long-term interest rates and collecting the data from the NCBs for transmission to the Commission. This is a continuation of the work carried out by the EMI as part of the preparations for Stage Three of EMU in close cooperation with the Commission. The conceptual work resulted in the definition of seven key features to be considered in the calculation of long-term interest rates, as presented in Table 6.2. Long-term interest rates refer to bonds denominated in national currency.

Table 6.2

Statistical framework for defining long-term interest rates for the purpose of assessing convergence

Concept	Recommendation
Bond issuer	The bond should be issued by the central government.
Maturity	As close as possible to ten years' residual maturity. Any replacement of bonds should minimise maturity drift; the structural liquidity of the market must be considered.
Coupon effects	No direct adjustment.
Taxation	Gross of tax.
Choice of bonds	The selected bonds should be sufficiently liquid. This requirement should determine the choice between benchmark or sample approaches, depending on national market conditions.
Yield formula	The "redemption yield" formula should be applied.
Aggregation	Where there is more than one bond in the sample, a simple average of the yields should be used to produce the representative rate.

6.6 Other factors

The last paragraph of Article 140(1) of the Treaty states that the reports of the European Commission and the ECB shall take account of, in addition to the four main criteria, the results of the integration of markets, the situation and development of the national balance of payments and an examination of the development of unit labour costs and other price indices. Whereas, for the four main criteria, Protocol (No 13) stipulates that the Commission will provide the data to be used for the assessment of compliance and describes those statistics in more detail, it makes no reference to the provision of statistics for these "other factors".

With regard to the results of the integration of markets, two sets of indicators are used. These are i) statistics on financial development and integration referring to the structure of the financial system,¹⁸⁰ and ii) statistics on financial and non-financial integration with the euro area.¹⁸¹

¹⁸⁰ Debt securities issued by resident corporations, stock market capitalisation, MFI credit to non-government residents and claims of euro area MFIs on resident MFIs.

¹⁸¹ External trade and investment position with the euro area.

The data covering the structure of the financial system are provided by the NCBs. The indicators concerning the debt securities issued by resident financial corporations (MFIs excluding the national central bank and non-monetary financial corporations) and non-financial corporations are compiled in accordance with the methodology set out in Guideline (EU) 2022/971¹⁸². The indicator relating to stock market capitalisation refers to listed shares issued by resident corporations following the methodology given in the same Guideline. The indicators concerning MFI credit to residents and claims of euro area MFIs on resident MFIs are based on available data collected by the ECB as part of the MFI balance sheet statistics collection framework. The data are obtained from the countries under review and, for the latter indicator, also from the euro area countries covered by Regulation (EU) No 2021/379¹⁸³. Historical data are compiled by the relevant NCBs, where appropriate. For the indicators mentioned in this paragraph, the statistical data relating to the euro area cover the countries that had adopted the euro at the time to which the statistics relate.

Balance of payments and international investment position statistics are compiled in accordance with the concepts and definitions laid down in the sixth edition of the IMF's Balance of Payments and International Investment Position Manual (BPM6) and with guidance provided by the ECB in its Guideline on external statistics^{184,185} and by Eurostat. This Convergence Report examines developments in the current (goods, services, primary income and secondary income) and capital accounts; the sum of the balances of these two accounts corresponds to the net lending/net borrowing of the total economy. In addition, developments in the main components of the financial account are presented together with the net international investment position and gross external debt of each country. Exports and imports of goods and services are presented vis-à-vis both the rest of the world and the euro area countries. Direct and portfolio investment assets and liabilities with the euro area are also directly identified. Forecasted data are taken from the European Commission's economic forecasts.¹⁸⁶

The Convergence Report also looks at the development of unit labour costs and other price indices. With regard to producer price indices, these data refer to domestic sales of total industry excluding construction. The statistics are collected on a harmonised basis under the EU Regulation on European business statistics¹⁸⁷.

¹⁸² Guideline (EU) 2022/971 of the European Central Bank of 19 May 2022 on the Centralised Securities Database and the production of securities issues statistics and repealing Guideline ECB/2012/21 and Guideline (EU) 2021/834 (ECB/2022/25) (OJ L 166, 22.6.2022, p. 147).

¹⁸³ Regulation (EU) 2021/379 of the European Central Bank of 22 January 2021 on the balance sheet items of credit institutions and of the monetary financial institutions sector (recast) (ECB/2021/2) (OJ L 73, 3.3.2021, p. 16).

¹⁸⁴ Guideline of the European Central Bank of 9 December 2011 on the statistical reporting requirements of the European Central Bank in the field of external statistics (ECB/2011/23), recast of Guideline ECB/2004/15 of 16 July 2004, as amended by Guidelines ECB/2013/25 of 30 July 2013, ECB/2015/392 of 26 November 2015, ECB/2018/19 of 2 August 2018, ECB/2020/52 of 14 October 2020 and ECB/2022/23 of 5 May 2022.

¹⁸⁵ See also "EU Balance of Payments and International Investment Position statistical sources and methods – B.o.p. and i.i.p. e-book", ECB, Frankfurt am Main, October 2023.

¹⁸⁶ These economic forecasts are made by the Directorate-General for Economic and Financial Affairs (DG ECFIN) on behalf of the European Commission.

¹⁸⁷ Regulation (EU) No 2019/2152 of the European Parliament and of the Council of 27 November 2019 on European business statistics (OJ L 327, 17.12.2019, p. 1).

Statistics on unit labour costs (calculated as compensation per employee divided by GDP chain-linked volumes per person employed) are derived from data provided under the ESA 2010 transmission programme.

7 Examination of compatibility of national legislation with the Treaties

The following country assessments report only on those provisions of national legislation which the ECB considered to be relevant from the perspective of their compatibility with provisions on the independence of NCBs, members of NCBs' decision-making bodies and Governors in the Treaty (Article 130) and the Statute (Articles 7 and 14.2), provisions on confidentiality (Article 37 of the Statute), prohibitions on monetary financing (Article 123 of the Treaty) and privileged access (Article 124 of the Treaty), and the single spelling of the euro as required by EU law. While, in particular, the independence requirements and the monetary financing prohibition are applicable to all Member States, including those with a derogation since the date of their accession to the European Union, the following country assessments additionally cover the perspective of legal integration of the NCBs into the Eurosystem (in particular as regards Articles 12.1 and 14.3 of the Statute).¹⁸⁸

7.1 Bulgaria

7.1.1 Compatibility of national legislation

The following legislation forms the legal basis for Българска народна банка (Bulgarian National Bank) and its operations:

- the Bulgarian Constitution,¹⁸⁹
- the Law on Българска народна банка (Bulgarian National Bank) published on 13 February 2024 (hereinafter the “Law on BNB”).¹⁹⁰ The Law on BNB enters into force and repeals and replaces the previous Law on Българска народна банка (Bulgarian National Bank)¹⁹¹ as of the date stipulated in the Council Decision on the adoption by the Republic of Bulgaria of the euro, adopted in accordance with Article 140(2) of the Treaty, and in the Council Regulation, adopted in accordance with Article 140(3) of the Treaty. There are no additional conditions for the entry into force of the Law on BNB.

The Law on counter-corruption¹⁹² applies to public office holders.

¹⁸⁸ According to Section 2.2.2 of this Convergence Report.

¹⁸⁹ Constitution of the Republic of Bulgaria, Darjaven vestnik issue 56, 13.7.1991.

¹⁹⁰ Law on Българска народна банка (Bulgarian National Bank), Darjaven vestnik issue 13, 13.2.2024.

¹⁹¹ Law on Българска народна банка (Bulgarian National Bank), Darjaven vestnik issue 46, 10.6.1997.

¹⁹² Darjaven vestnik issue 84, 6.10.2023.

There have been several changes in relation to the points identified in the ECB's Convergence Report of June 2022, also addressing the recommendations made in previous Convergence Reports.

7.1.2 Independence of the NCB

With regard to the independence of Българска народна банка (Bulgarian National Bank), the Law on BNB, the Law on counter-corruption and the Bulgarian Constitution have been examined.

Institutional independence

Article 6 of the Law on BNB prohibits European Union institutions, bodies, offices or agencies, the Council of Ministers or the governments of other EU Member States, as well as any other bodies and institutions from giving instructions to Българска народна банка (Bulgarian National Bank), the Governor or the members of the Governing Council. This provision is in line with Article 130 of the Treaty and Article 7 of the Statute.¹⁹³

Article 99 of the Bulgarian Constitution governs the formation of the government. Article 99(5) provides that if no agreement is reached on the formation of a government, the President of the Republic of Bulgaria, following consultations with the parliamentary groups and acting on a motion by the caretaker prime minister-designate, shall appoint a caretaker cabinet, and shall schedule new elections within two months. A caretaker prime minister shall be appointed from among the Chairperson of the National Assembly, the Governor or a Deputy Governor of Българска народна банка (Bulgarian National Bank), the President or a Vice-President of the Bulgarian National Audit Office, and the Ombudsman or a deputy thereof. In principle, such a possible appointment of a Governor or a Deputy Governor, entailing the interruption of their term of office, risks compromising the independent exercise of the powers and carrying out the tasks and duties conferred upon the NCB. In particular, in case of an interruption of the term of office, the risk may arise that the Governor or Deputy Governor may take position as caretaker prime minister, which is incompatible with the position of the NCB, before going back to their position as Governor or Deputy Governor and then being conflicted with stances that they may have taken as caretaker prime minister. In any event, pursuant to Article 130 TFEU, when exercising the powers and carrying out the tasks and duties conferred upon them by the Treaties and the Statute, members of the decision-making bodies of the NCBs must not seek or take instructions from Union institutions, bodies, offices or agencies, from any government of a Member State or from any other body. Furthermore, the governments of the Member States undertake to respect this principle and not to seek to influence the members of the decision-making bodies of the NCBs in the performance of their tasks. It follows from Article 130 TFEU that a

¹⁹³ See paragraph 3.2 of Opinion CON/2018/53.

member of an NCB's decision-making body cannot at the same time assume the function as a member of a national government, in particular not as prime minister. Otherwise, independent exercise of the powers and carrying out of the tasks and duties, in which the Governor or a Deputy Governor of Българска народна банка (Bulgarian National Bank) can take an independent position, which may be different to that of the government, is logically not conceivable. It is moreover imperative that, once appointed, the Governor or Deputy Governor of Българска народна банка (Bulgarian National Bank), as caretaker prime minister and member of the government, should be required to fully respect the institutional independence of Българска народна банка (Bulgarian National Bank) and its decision-making bodies in compliance with Article 130 TFEU. Moreover, the risk that the Governor or Deputy Governor may take position as caretaker prime minister, which is incompatible with the position of the Българска народна банка (Bulgarian National Bank), before going back to their position as Governor or Deputy Governor and then being conflicted with stances that they may have taken as caretaker prime minister, would only be sufficiently mitigated by requiring the Governor or Deputy Governor to resign when appointed as caretaker prime minister, in order to exclude the materialisation of this risk. Any future amendment to the Law on BNB, which implements Article 99(5) of the Bulgarian Constitution, must be made in line with these principles.

Personal independence

Article 15(1) and (2) of the Law on BNB lists the grounds on which members of the Governing Council may be relieved from office. Article 15(1) provides that the National Assembly may relieve the Governor from office in accordance with Article 14.2 of the Statute. Article 15(2) provides that other members of the Governing Council may be relieved from office if they no longer fulfil the conditions required for the performance of their duties or if they have been found guilty of serious misconduct in accordance with Article 14.2 of the Statute. Article 15(1) and (2) of the Law on BNB complies with Article 14.2 of the Statute.¹⁹⁴

In 2023, Article 98(1) of the Law on counter-corruption replaced Article 80(1) of the Law on counter corruption and unlawfully acquired assets forfeiture, which had replaced Article 33(1) of the Law on the prevention of conflicts of interests, providing that the ascertainment of a conflict of interests by an enforceable legal act is a ground for relieving the Governor, Deputy Governors and the other members of the Governing Council of Българска народна банка (Bulgarian National Bank) from office, unless otherwise provided for in the Constitution or the Statute or special legislation. Article 98(2) of the Law on counter-corruption provides that the relieve from office must follow the procedure established in the relevant laws. It is understood that in the case of the Governor, Deputy Governors and the other members of the Governing Council of Българска народна банка (Bulgarian National Bank) this refers to Article 15(1) and (2) of the Law on BNB and that this reference entails that Article 98(1) of the Law on counter-corruption cannot apply in relation to the Governor or other members of the

¹⁹⁴ See paragraph 3.1 of Opinion CON/2018/53.

Governing Council of Българска народна банка (Bulgarian National Bank) because the wording of Article 98(1) of the Law on counter-corruption ensures that the ascertainment of a conflict of interest in accordance with that Law will not be a ground for removal from office of a senior public office holder where it is otherwise provided for in special legislation, such as the Law on BNB.¹⁹⁵

Article 15(3) of the Law on BNB establishes that the grounds for relieving a Deputy Governor or another member of the Governing Council of Българска народна банка (Bulgarian National Bank) other than the Governor from office must be established by decision of the Governing Council of Българска народна банка (Bulgarian National Bank). Such decisions are adopted according to a procedure determined by the Governing Council of Българска народна банка (Bulgarian National Bank) and have the immediate effect of suspending the members concerned from the exercise of their duties. The decisions are subject to appeal before Върховния административен съд (the Supreme Administrative Court) within 7 days and the Supreme Administrative Court has 14 days to issue a final ruling on an appeal. The final ruling of the Supreme Administrative Court on an appeal is sent to the national authority, which has the competence to relieve from office the members of the Governing Council of Българска народна банка (Bulgarian National Bank). The final ruling is binding on the appointing authority under Article 13 of the Law on BNB. The ECB understands that Article 15(3) of the Law on BNB aims to ensure that within the administrative procedure for dismissal of any member of the decision-making bodies of Българска народна банка (Bulgarian National Bank) other than the Governor, it is possible to request a review by national courts of the decision of the Governing Council of Българска народна банка (Bulgarian National Bank) establishing the grounds for relieving a Deputy Governor or another member of the Governing Council of Българска народна банка (Bulgarian National Bank) other than the Governor from office. The judicial review of such a decision may lead to its annulment. The annulment of a decision of the Governing Council of Българска народна банка (Bulgarian National Bank) establishing the grounds for relieving a Deputy Governor or another member of the Governing Council of Българска народна банка (Bulgarian National Bank) other than the Governor from office precludes the adoption of a decision by the appointing authority to dismiss the relevant member of the Governing Council of Българска народна банка (Bulgarian National Bank). In addition, the ECB understands that when deciding on the dismissal, the appointing authority cannot consider and adopt additional grounds for dismissal that were not established in the decision of the Governing Council of Българска народна банка (Bulgarian National Bank). The ECB further understands that, in accordance with general administrative law, an appeal before the Supreme Administrative Court could suspend the application of the decision of the Governing Council of Българска народна банка (Bulgarian National Bank). Based on the above understanding, Article 15(3) of the Law on BNB is consistent with Article 130 of the Treaty and with the Statute.¹⁹⁶

Article 13(1) and (2) of the Law on BNB, which replaced Article 12(1) and (2) of the previous Law on BNB, provides for the National Assembly's powers to elect the

¹⁹⁵ See paragraph 3.1 of Opinion CON/2021/2 and paragraph 3.1.4 of Opinion CON/2022/45.

¹⁹⁶ See paragraph 3.2 of Opinion CON/2022/45.

Governor and the Deputy Governors of Българска народна банка (Bulgarian National Bank). The ECB notes that any proper election or appointment of members of an NCB's decision-making body must enable them to assume office following their election. Once elected or appointed, the Governor and the other members of the Governing Council of Българска народна банка (Bulgarian National Bank) may not be relieved from office under conditions other than those mentioned in Article 14.2 of the Statute, even if they have not yet taken up their duties.

As noted above, Article 99(5) of the Bulgarian Constitution provides that the Governor or a Deputy Governor of Българска народна банка (Bulgarian National Bank) may be appointed by the President of the Republic of Bulgaria as a caretaker prime minister for a period of two months. Pursuant to Article 14.2. of the Statute, a Governor may be relieved from office only if he or she no longer fulfils the conditions required for the performance of his or her duties or if he or she has been guilty of serious misconduct. Consequently, the appointment of the Governor of Българска народна банка (Bulgarian National Bank) as a caretaker prime minister may not amount to a relieving from office without the existence of such a ground. It is understood that the appointment of the Governor of Българска народна банка (Bulgarian National Bank) as caretaker prime minister is subject to the acceptance of the appointment by the Governor of Българска народна банка (Bulgarian National Bank)¹⁹⁷. Based on this understanding that the appointment of the Governor of Българска народна банка (Bulgarian National Bank) as a caretaker prime minister presupposes his or her acceptance, the appointment would not amount to a relieving from office. In such a situation, there is no need for the protection of the personal independence of the Governor of Българска народна банка (Bulgarian National Bank) by the mechanism of Article 14.2. of the Statute¹⁹⁸.

7.1.3 Confidentiality

Article 4 of the Law on BNB provides that, without prejudice to Article 37 of the Statute, Българска народна банка (Bulgarian National Bank) may not disclose or transmit to other persons any information related to the ESCB, nor any information obtained that constitutes a banking, professional, commercial or other legally protected secret of the banks and the other participants in monetary and credit transactions. Article 24(1) of the Law on BNB provides that, without prejudice to Article 37 of the Statute, the employees of Българска народна банка (Bulgarian National Bank) shall respect confidentiality concerning negotiations, deals contracted, the amount of assets on

¹⁹⁷ In the light of the requirements flowing from Article 130 TFEU as to the independence of members of decision-making bodies of NCBs other than the Governor, it is understood that the appointment of a Deputy Governor of Българска народна банка (Bulgarian National Bank) as caretaker prime minister is also subject to the acceptance of the appointment by the Deputy Governor of Българска народна банка (Bulgarian National Bank).

¹⁹⁸ In this context, it is noted that any provision in Bulgarian law governing the replacement of the Governor of Българска народна банка (Bulgarian National Bank), in particular any future amendment to the Law on BNB seeking to implement Article 99(5) of the Bulgarian Constitution, cannot mandate the appointment of another person as Governor for only two months. In accordance with Article 14.2. of the Statute, first subparagraph, the term of office of a Governor of an NCB shall be no less than five years. See Chapter 2.2.3. on "Independence on NCBs", Section on "Minimum term of office for Governors", and Opinion CON/2018/23.

customers' deposits and their transactions, and information received by Българска народна банка (Bulgarian National Bank) , as well as any circumstances concerning the activities of Българска народна банка (Bulgarian National Bank) and its customers, which constitute business, banking, professional, commercial or other legally protected secrets, even after termination of their employment relationship. Under Article 37 of the Statute, professional secrecy is an ESCB-wide matter, which is duly acknowledged in Article 4 and Article 24(1) of the Law on BNB.

7.1.4 Monetary financing and privileged access

In past Convergence Reports the ECB considered that certain provisions of the Law on BNB arising from the particularities of the currency-board regime were incompliant with the monetary financing prohibition. The Law on BNB adopted in 2024 which enters into force on the date stipulated in the Council Decision on the adoption by the Republic of Bulgaria of the euro, has repealed those provisions.

Pursuant to the Law on credit institutions,¹⁹⁹ Българска народна банка (Bulgarian National Bank) operates a central credit register (Article 56) and a bank account register (Article 56a). The costs of obtaining information from these registers by government and judicial authorities are to be borne by the State budget. In past Convergence Reports the ECB considered that in order to further ensure compatibility with the prohibition of monetary financing, the Law on credit institutions would benefit from a limitation of the liability of Българска народна банка (Bulgarian National Bank) in relation to the operation of the two registers.²⁰⁰ The provisions of both Articles 56 and 56a have been amended to waive the liability of Българска народна банка (Bulgarian National Bank) in relation to the operation of the two registers. Instead of Българска народна банка (Bulgarian National Bank), the State will be liable for damages resulting from the operation of the two registers in accordance with the general regime for State liability.²⁰¹ This makes the rules compliant with the prohibition of monetary financing.

7.1.5 Legal integration of the NCB into the Eurosystem

In past Convergence Reports the ECB considered, with regard to legal integration of Българска народна банка (Bulgarian National Bank) into the Eurosystem, that the Law on BNB needed to be adapted in several respects. The Law on BNB, which was adopted in 2024, addresses these elements, as set out below.

¹⁹⁹ Darjaven vestnik issue 59, 21.07.2006.

²⁰⁰ See paragraph 3.1.6 of Opinion CON/2015/46, paragraph 3.2.1 of Opinion CON/2016/19 and paragraph 2.2 of Opinion CON/2016/57.

²⁰¹ See paragraph 3.2 of Opinion CON/2021/2.

Tasks

Monetary policy

Article 2(1) and Article 17, items 3 and 4, and Articles 37, 38, 39 and 43 , which provide for the powers of Българска народна банка (Bulgarian National Bank) in the field of monetary policy and instruments for the implementation thereof, recognise the ECB's powers in this field.

Collection of statistics

Article 3(8) and Article 52 of the Law on BNB, which provide for the powers of Българска народна банка (Bulgarian National Bank) relating to the collection of statistics, recognise the ECB's powers in this field.

Official foreign reserve management

Articles 39 to 42 of the Law on BNB, which provide for the powers of Българска народна банка (Bulgarian National Bank) with regard to the management of official foreign reserves, recognise the ECB's powers in this field.

Payment systems

Articles 3(5) of the Law on BNB, which provides for the powers of Българска народна банка (Bulgarian National Bank) with regard to the promotion of the smooth operation of payment systems, recognises the ECB's powers in this field.

Issue of banknotes

Article 3(2) and Articles 26 to 36 of the Law on BNB, which provide for the powers of Българска народна банка (Bulgarian National Bank) with regard to the issue of banknotes and coins, recognise the Council's and the ECB's powers in this field.²⁰²

²⁰² See paragraph 3.2 of Opinion CON/2023/27.

Financial provisions

Appointment of independent auditors

Article 7(7) of the Law on BNB, which provides that the external auditor is appointed by the Governing Council on the basis of a procedure complying with the Law on public procurement, recognises the Council's and the ECB's powers under Article 27.1 of the Statute.

Financial reporting

Articles 53 to 57 of the Law on BNB reflect the obligation to comply with the Eurosystem's regime for financial reporting of NCB operations, pursuant to Article 26 of the Statute.

International cooperation

Article 5(2) and Article 17, items 11 and 12, of the Law on BNB, which provide for the powers of Българска народна банка (Bulgarian National Bank) with regard to international cooperation, recognise the ECB's powers in this field.

7.1.6 Conclusions

The Law on BNB has been amended to reflect and implement the recommendations made in the ECB's Convergence Report of June 2022. As a result, and subject to the conditions and interpretations set out in this chapter, the national legislation is consistent with the Treaty and the Statute.

7.2 Czech Republic

7.2.1 Compatibility of national legislation

The following legislation forms the legal basis for Česká národní banka and its operations:

- the Czech Constitution,²⁰³
- the Law on Česká národní banka (hereinafter the "Law on CNB").²⁰⁴

²⁰³ Constitutional Law No 1/1993 Coll.

²⁰⁴ Law No 6/1993 Coll.

- the Law No 166/1993 Coll. on the Supreme Audit Office (hereinafter the “Law on NKU”).

In relation to the points identified in the ECB’s Convergence Report of June 2022, the comments made in that report are largely repeated.

7.2.2 Independence of the NCB

With regard to Česká národní banka’s independence, the Law on CNB needs to be adapted as set out below.

Functional independence

Article 2(1) of the Law on CNB provides that in addition to the primary objective of price stability, Česká národní banka’s objective is “to ensure financial stability and the safe and sound operation of the financial system in the Czech Republic”. In line with Article 127(1) of the Treaty, the secondary objective of Česká národní banka should be stated to be without prejudice to Česká národní banka’s primary objective of maintaining price stability.

Institutional independence

Article 3 of the Law on CNB obliges Česká národní banka to submit a report on monetary development to the Chamber of Deputies at least twice a year for review; the Law on CNB also provides for an optional extraordinary report to be prepared pursuant to a Chamber of Deputies resolution. The Chamber of Deputies has the power to acknowledge the report or ask for a revised report; such a revised report must comply with the Chamber of Deputies’ requirements. These parliamentary powers could potentially breach the prohibition on giving instructions to NCBs pursuant to Article 130 of the Treaty and Article 7 of the Statute.

In addition, Article 47(5) of the Law on CNB requires Česká národní banka to submit a revised report if the Chamber of Deputies rejects its annual financial report. This revised report must comply with the Chamber of Deputies’ requirements. Such parliamentary powers breach the prohibition on approving, annulling or deferring decisions. Article 3 and Article 47(5) of the Law on CNB are therefore incompatible with central bank independence and should be adapted accordingly.

Further, Article 130 of the Treaty and Article 7 of the Statute are partially mirrored in the Law on CNB. Article 9(1) of the Law on CNB expressly prohibits Česká národní banka and its Board from seeking or taking instructions from the President of the Republic, from Parliament, from the Government, from administrative authorities of the Czech Republic, from the bodies, institutions or other entities of the European Union, from governments of the Member States or from any other body, but it does not expressly prohibit the Government from seeking to influence the members of Česká

národní banka's decision-making bodies in situations where this may have an impact on Česká národní banka's fulfilment of its ESCB-related tasks. In this respect the Law on CNB needs to be adapted to be fully consistent with Article 130 of the Treaty and Article 7 of the Statute.²⁰⁵

Pursuant to the Law on NKU, the Supreme Audit Office (NKU) is empowered to audit Česká národní banka's financial management as regards its operating expenditure and expenditure for the purchase of property. The ECB understands that: (i) the NKU's auditing powers in relation to Česká národní banka are without prejudice to Article 9 of the Law on CNB, which concerns the general prohibition on Česká národní banka seeking or taking instructions from other entities; and (ii) the NKU has no power to interfere with either the external auditors' opinion or with Česká národní banka's ESCB-related tasks. In so far as this understanding is correct, the NKU's auditing powers vis-à-vis Česká národní banka are not incompatible with central bank independence.

Personal independence

The Law on CNB is silent on the right of national courts to review a decision to dismiss any member, other than the Governor, from Česká národní banka's Board who is involved in the performance of ESCB-related tasks. Even though this right may be available under general law, providing specifically for such a right of review would increase legal certainty.

7.2.3 Monetary financing and privileged access

Under Article 33a of the Law on CNB, Česká národní banka, upon request, may exceptionally provide the Financial Market Guarantee System (FMGS) with short-term credit guaranteed by government bonds or other securities underwritten by the Government and owned by the FMGS, for a maximum of three months, in order to address an urgent situation, where the FMGS does not have sufficient funds to perform its tasks and this situation might jeopardise the stability of the financial market. Even if such funding is discretionary, temporary and in the interests of financial stability,²⁰⁶ it remains the case that Article 123(1) of the Treaty prohibits any type of credit facility in favour of "bodies governed by public law". Given the features of the FMGS, the provisions laid down in the Law on CNB are not compatible with the monetary financing prohibition and should be amended accordingly.²⁰⁷ The FMGS qualifies as a "body governed by public law" within the meaning of Article 123(1) of the Treaty, as has been recently clarified. In particular, the FMGS has all of the following characteristics: (a) it is established for the specific purpose of meeting needs in the general interest, not having an industrial or commercial character; (b) it has legal

²⁰⁵ See Section 2.2.2 of this Convergence Report.

²⁰⁶ See paragraphs 3.1.2 and 3.1.3 of Opinion CON/2015/22, and paragraph 3.2. of Opinion CON/2016/60.

²⁰⁷ See *supra*, page 34 and Opinions CON/2020/24 and CON/2021/17.

personality; and (c) it is closely dependent on the public sector entities referred to in Article 123(1) of the Treaty, given that, although only a minority of the members of FMGS's governing body are representatives of the Ministry of Finance, the Ministry of Finance has in fact the right to appoint and dismiss all the members of the FMGS's governing body.

7.2.4 Legal integration of the NCB into the Eurosystem

With regard to Česká národní banka's legal integration into the Eurosystem, the Law on CNB and Law No 2/1969 Coll., establishing ministries and other central administrative bodies of the Czech Republic (hereinafter the "Law on competences") need to be adapted as set out below.

Economic policy objectives

Article 2(1) of the Law on CNB, the last sentence of which provides that without prejudice to its primary objective, Česká národní banka shall support the general economic policies of the Government leading to sustainable economic growth and the general economic policies in the EU with a view to contributing to the achievement of the objectives of the EU, is not fully compatible with Article 127(1) of the Treaty and Article 2 of the Statute. The Law on CNB should make it clear that the objective of financial stability and the objective of supporting the general economic policies of the Government leading to sustainable growth are subordinate not only to the primary objective of price stability as specified in Section 7.2.2. but also to the secondary objective of the ESCB.

Tasks

Monetary policy

Article 2(2)(a), Article 5(1) and Part Five (namely Articles 23 to 26) of the Law on CNB, which provide for Česká národní banka's powers in the field of monetary policy and instruments for the implementation thereof, do not recognise the ECB's powers in this field.

Articles 28, 29, 32 and 33 of the Law on CNB, which empower Česká národní banka to enter into certain financial transactions, also fail to recognise the ECB's powers in this field.

Official foreign reserve management

Article 35(c) and Articles 36 and 47a of the Law on CNB, which provide for Česká národní banka's powers relating to foreign reserve management, do not recognise the

ECB's powers in this field. Article 4(1) of the Law on competences, according to which the Ministry of Finance is the central administrative body for, inter alia, "foreign exchange affairs including the State's claims and obligations towards foreign entities" does not recognise the ECB's powers in this field.

Payment systems

Article 2(2)(c) and Articles 38 and 38a of the Law on CNB, which provide for Česká národní banka's powers relating to the smooth operation of payment systems, do not recognise the ECB's powers in this field. Article 4(1) of the Law on competences, according to which the Ministry of Finance is the central administrative body for, inter alia, "payments systems", does not recognise the ECB's powers in this field.

Issue of banknotes

Article 2(2)(b) of the Law on CNB, which empowers Česká národní banka to issue banknotes and coins, and Part Four of the Law on CNB, namely Articles 12 to 22, which specify Česká národní banka's powers in this field and the related implementing instruments, do not recognise the Council's and the ECB's powers in this field.

Financial provisions

Appointment of independent auditors

Article 48(2) of the Law on CNB, which provides that Česká národní banka's annual financial statements are audited by auditors selected on the basis of an agreement between Česká národní banka's Board and the Minister for Finance, does not recognise the Council's and the ECB's powers under Article 27.1 of the Statute.

Financial reporting

Article 48 of the Law on CNB does not reflect Česká národní banka's obligation to comply with the Eurosystem's regime for financial reporting of NCB operations, pursuant to Article 26 of the Statute.

Exchange rate policy

Article 35 of the Law on CNB, which authorises Česká národní banka to conduct exchange rate policy, does not recognise the Council's and the ECB's powers in this field. Article 4 of the Law on competences also fails to recognise the Council's and the ECB's powers in this field.

International cooperation

Article 2(3) of the Law on CNB, which empowers Česká národní banka to cooperate and negotiate agreements with the central banks of other countries, international financial institutions and other foreign and international organisations performing similar tasks to those performed by Česká národní banka, does not recognise the ECB's powers in this field.

Miscellaneous

Article 37 of the Law on CNB, which provides for the respective legislative powers of Česká národní banka and the Ministry of Finance in areas relating, inter alia, to currency, the circulation of money, the financial market, the adoption of the euro in the Czech Republic, the payment system, foreign exchange management, and the status, competence, organisation and activities of Česká národní banka, does not recognise the Council's and the ECB's powers in this field.

Article 46a of the Law on CNB, which sets out the sanctions against third parties which fail to comply with their statistical obligations, does not recognise the Council's and the ECB's powers to impose sanctions.

7.2.5 Conclusions

The Law on CNB and the Law on competences do not comply with all the requirements for central bank independence, the monetary financing prohibition and legal integration into the Eurosystem. The Czech Republic is a Member State with a derogation and must therefore comply with all adaptation requirements under Article 131 of the Treaty.

7.3 Hungary

7.3.1 Compatibility of national legislation

The following legislation forms the legal basis for the Magyar Nemzeti Bank and its operations:

- The consolidated version of the Fundamental Law of Hungary,²⁰⁸
- Law CXXXIX of 2013 on the Magyar Nemzeti Bank (hereinafter the "Law on the MNB").²⁰⁹

²⁰⁸ Magyarország Alaptörvénye, Magyar Közlöny 2013/163. (X.3.).

The Law on the MNB has been amended several times since the ECB's Convergence Report of June 2022. As a result, some additional points are included in this year's assessment. Nevertheless, there have been no major changes in relation to the points identified in that Convergence Report, and those comments are therefore largely repeated in this year's assessment.

7.3.2 Independence of the NCB

With regard to the Magyar Nemzeti Bank's independence, the Law on the MNB, Law XXVII of 2008,²¹⁰ Government Decree 89/2023 (III. 22.) on economic and financial measures²¹¹ and Government Decree 471/2022 (XI. 21.) on certain economic measures²¹² need to be adapted as set out below.

Institutional independence

After introducing significant changes in 2013-2015,²¹³ minor amendments were made to the Law on the MNB. In the past two years, the Magyar Nemzeti Bank has been entrusted with additional tasks arising from the implementation of EU legislation.²¹⁴ Given the nature of these changes, it is unlikely that they will have a material impact on the institutional framework and organisational and governance stability of the Magyar Nemzeti Bank.

²⁰⁹ A Magyar Nemzeti Bankról szóló 2013. évi CXXXIX. törvény, Magyar Közlöny 2013/158. (IX.26.). Law CXXXIX of 2013 on the Magyar Nemzeti Bank repealed Law CCVIII of 2011 on the Magyar Nemzeti Bank with effect from 1 October 2013. See Opinions CON/2013/56 and CON/2013/71.

²¹⁰ Law XXVII of 2008 on the oath of certain public officials (egyes közjogi tisztségviselők esküjéről és fogadalmáról szóló 2008. évi XXVII. törvény).

²¹¹ Gazdasági, finanszírozási tárgyú intézkedésekről szóló 89/2023. (III. 22.) Korm. rendelet.

²¹² Egyes gazdasági tárgyú intézkedésekről szóló 471/2022. (XI. 21.) Korm. rendelet.

²¹³ The most notable amendment was the integration of the Hungarian Financial Supervisory Authority (HFSA) into the Magyar Nemzeti Bank as a general legal successor to the HFSA's scope of competence, rights and obligations (see Articles 176 to 183 of the Law on the MNB as well as Opinions CON/2013/56 and CON/2013/71). Further amendments concerned the allocation of new tasks to the Magyar Nemzeti Bank, such as: resolution tasks (Law XXXVII of 2014); supervisory tasks involving the verification of compliance with the new legal measures applicable to consumer loan contracts (Law XL of 2014); mediation of complaints and the initiation of legal proceedings in the public interest (Law XL of 2014 and Law LXXXV of 2015). The combination of the changes to the institutional framework of the Magyar Nemzeti Bank and the frequency of changes to the Law on the MNB, not always backed by robust justification of the need to amend the Magyar Nemzeti Bank's institutional framework, were mentioned in previous Convergence Reports as adversely affecting the organisational and governance stability of the Magyar Nemzeti Bank and having an impact on its institutional independence. The principle of central bank independence requires that a central bank has a stable legal framework to enable it to function.

²¹⁴ Article 40 of the Law on the MNB now covers the following EU secondary legislation as well: Regulation (EU) No 260/2012 of the European Parliament and of the Council of 14 March 2012 establishing technical and business requirements for credit transfers and direct debits in euro and amending Regulation (EC) No 924/2009 (OJ L 94, 30.3.2012, p. 22); Regulation (EU) 2019/1238 of the European Parliament and of the Council of 20 June 2019 on a pan-European Personal Pension Product (PEPP) (OJ L 198, 25.7.2019, p. 1); Regulation (EU) 2021/1230 of the European Parliament and of the Council of 14 July 2021 on cross-border payments in the Union (OJ L 274, 30.7.2021, p. 20); Regulation (EU) 2022/858 of the European Parliament and of the Council of 30 May 2022 on a pilot regime for market infrastructures based on distributed ledger technology, and amending Regulations (EU) No 600/2014 and (EU) No 909/2014 and Directive 2014/65/EU (OJ L 151, 2.6.2022, p. 1).

Article 1(2) of the Government Decree 89/2023 (III. 22.) on economic and financial measures provides that, until 1 April 2024,²¹⁵ voluntary mutual insurance funds, home savings and loan associations, private pensions and private pension funds, insurance institutions, entities regulated by the acts on investment firms, commodity dealers, collective investment firms and their managers²¹⁶ may not purchase any Hungarian forint-denominated debt instrument issued by the central bank of a Member State of the Union. The same prohibition applies to natural persons whose investments exceed HUF 20,000,000.²¹⁷ In addition, Article 1(1) of Government Decree 471/2022 (XI. 21.) on certain economic measures stipulates that, until 1 April 2024,²¹⁸ in the case of the same persons and entities covered by Government Decree 89/2023, the interest paid on demand deposits with a maximum maturity of one year under deposit agreements concluded with credit institutions may not exceed, the average yield of the last auction of the discount Treasury bill issued by the Hungarian State with a remaining maturity of three months, as published on the official website of the Államadósság Kezelő Központ (Hungarian Government Debt Management Agency). These provisions of Government Decree 89/2023 and Government Decree 471/2022 interfere with the independence of the Magyar Nemzeti Bank, since they prevent the Magyar Nemzeti Bank from independently choosing the necessary means and instruments to conduct an efficient monetary policy and to independently achieve price stability.²¹⁹ Therefore, Government Decree 89/2023 and Government Decree 471/2022 need to be adapted in this regard.

Personal independence

Law XXVII of 2008 specifies the wording of the oath that the members of the Monetary Council – including the Governor – are required to take.²²⁰ Pursuant to Article 9(7), in conjunction with Articles 10(3) and 11(2) of the Law on the MNB, the Governor and the Deputy Governors of the Magyar Nemzeti Bank must take an oath before Hungary's President, while other members of the Monetary Council take an oath before the Parliament. Law XXVII of 2008 specifies the wording of the oath to be taken by public officials appointed by the Parliament.²²¹ Therefore, it is not clear whether the Governor and Deputy Governors take the same oath as the other members of the Monetary Council.

²¹⁵ The restriction as it was first introduced was to apply until 30 June 2023. Its period of application has been extended several times.

²¹⁶ As set out in Article 39(1)(a), (d), (f), (i), (l) and (m) of the Law on the MNB.

²¹⁷ See Article [1(2)] of the Government Decree 89/2023 (III. 22.) on economic and financial measures.

²¹⁸ The restriction as it was first introduced was to apply until 30 June 2023. Its period of application has been extended several times.

²¹⁹ See paragraphs 3.4 and 3.5 of Opinion CON/2023/10.

²²⁰ This has been noted in all ECB's Convergence Reports since 2010.

²²¹ Law XXVII of 2008 on the oath of certain public officials (egyes közjogi tisztségviselők esküjéről és fogadalmáról szóló 2008. évi XXVII. törvény). The wording of the oath is: "I, ... [name of the person taking the oath], hereby undertake to be faithful to Hungary and to its Fundamental Law, I will comply and ensure compliance with its laws, I will fulfil my office as a ... [name of the position] for the benefit of the Hungarian people. [Depending on the belief of the person taking the oath] So help me God!"

The Magyar Nemzeti Bank's Governor acts in a dual capacity as a member of both the Magyar Nemzeti Bank's Monetary Council and the ECB decision-making bodies. The wording of the oath should take into account and reflect the status, obligations and duties of the Governor as a member of the ECB's decision-making bodies. Furthermore, the other members of the Monetary Council are also involved in the performance of ESCB-related tasks. The oath taken should not hinder the Governor, Deputy Governors and other members of the Monetary Council from performing ESCB-related tasks. Law XXVII of 2008 and Articles 9(7), 10(3) and 11(2) of the Law on the MNB need to be adapted in this regard.²²²

In addition, in accordance with Article 152(2) of the Law on the MNB, by way of exception from the general rule laid down in Article 152(1), all employees of the Magyar Nemzeti Bank, including the members of the Monetary Council, may: (1) hold membership of any kind in some but not all of the entities²²³ subject to the Magyar Nemzeti Bank's supervisory powers, which fall under the scope of the laws enumerated in Article 39 of the Law on the MNB;²²⁴ (2) have an employment relationship or any other work-related relationship, including by being executive officer or a supervisory board member, in a financial institution in which the Magyar Nemzeti Bank holds shares; and (3) be a supervisory board member of a non-profit business association the purpose of which is the resolution of entities subject to Article 39. In addition, pursuant to Article 153(1) of the Law on the MNB, employees of the Magyar Nemzeti Bank, including the members of the Monetary Council, performing the Magyar Nemzeti Bank's basic tasks can maintain an employment relationship, including by being an executive officer or a supervisory board member, with financial institutions in which the Magyar Nemzeti Bank holds shares. Furthermore, pursuant to Article 153(6) of the Law on the MNB,²²⁵ by way of exception from Article 152, Article 153(1) to (5) and Articles 154 to 156 of the Law on the MNB, the members of the Monetary Council may, without being subject to a formal disclosure requirement (unless it amounts to an employment relationship), be an executive officer or a member of a supervisory board of a business association under the majority ownership of the Magyar Nemzeti Bank, as well as a member of the management, board of trustees or supervisory board of a foundation established by the Magyar

²²² Law XXVII of 2008 was amended by Law XIV of 2014, but these changes did not affect the assessment of the Hungarian law laid down in this section.

²²³ These entities are voluntary mutual insurance funds, private pension funds, cooperative credit institutions and insurance associations.

²²⁴ These acts are as follows: (a) the Law on voluntary mutual insurance funds; (b) the Law on the Hungarian Export-Import Bank Corporation and the Hungarian Export Credit Insurance Corporation; (c) the Law on credit institutions and financial enterprises; (d) the Law on home savings and loan associations; (e) the Law on mortgage loan companies and mortgage bonds; (f) the Law on private pensions and Private Pension Funds; (g) the Law on the Hungarian Development Bank Limited Company; (h) the Law on credit institutions and financial enterprises; (i) the Law on the capital markets; (j) the Law on insurance institutions and the insurance business; (k) the Law on the distance marketing of consumer financial services; (l) the Law on occupational retirement pensions and institutions for occupational retirement provision; (m) the Law on investment firms and commodity dealers, and on the regulations governing their activities; (n) the Law on collective investment trusts and their managers, and on the amendment of financial regulations; (o) the Law on reinsurance; (p) the Law on the pursuit of the business of payment services; (q) the Law on insurance against civil liability in respect of the use of motor vehicles; (r) the Law on the central credit information system; (s) the Law on settlement finality in payment and securities settlement systems; (t) the Law on payment service providers.

²²⁵ As introduced by Law LXXXV of 2015 on amendments to specific acts in order to enhance the development of the system of financial intermediation (egyes törvényeknek a pénzügyi közvetítőrendszer fejlesztésének előmozdítása érdekében történő módosításáról szóló 2015. évi LXXXV. törvény).

Nemzeti Bank. On the basis that it gives rise to potential conflicts of interest, the exception provided for in Article 152(2) - in conjunction with Article 153(1) - and Article 153(6) of the Law on the MNB should be removed in relation to the entities subject to the Magyar Nemzeti Bank's supervisory powers that fall under the scope of the laws enumerated in Article 39 of the Law on the MNB, in order to safeguard the personal independence of the members of the Monetary Council. Furthermore, in relation to entities that are not subject to the Magyar Nemzeti Bank's supervisory powers and do not fall under the scope of the laws enumerated in Article 39 of the Law on the MNB, it should be clarified that the memberships or relationships specified in the abovementioned provisions of the Law on the MNB are not permitted if they give rise to a conflict of interest.

In addition, Article 153(4) of the Law on the MNB stipulates that all employees of the Magyar Nemzeti Bank, including the members of the Monetary Council, must notify the Magyar Nemzeti Bank when acquiring financial instruments subject to the Law CXXXVIII of 2007 on Investment Service Providers and Commodity Traders and the Rules of their Services except for state bonds and securities issued by open-ended public investment funds. The notification must be made within three working days of acquiring the instruments. In order to avoid any potential conflict of interest, however, this notification obligation should cover all instruments including state bonds and securities issued by open-ended public investment funds.

In addition, Article 156(7) of the Law on the MNB in conjunction with Article 152(1), sets out post-employment conflict of interest rules for the members of the Monetary Council. It provides the members of the Monetary Council with an exemption from the cooling-off period of six months with regard to any membership or shareholder relationship, employment relationship or work-related contractual relationship, executive officer relationship or supervisory board membership with any of the entities subject to the Magyar Nemzeti Bank's supervisory powers, which fall under the scope of the laws enumerated in Article 39 of the Law on the MNB and in which the Hungarian State or the Magyar Nemzeti Bank has a majority stake.²²⁶ Providing for such an exemption may give rise to potential conflicts of interest for the members of the Monetary Council. In order to safeguard those members' personal independence, the exemption from the post-employment restrictions provided for in Article 156(7) of the Law on the MNB should be removed as regards the entities subject to the Magyar Nemzeti Bank's supervisory powers and should be amended to clarify that such membership is not permitted if it gives rise to a conflict of interest as regards the other entities covered by Article 156(7) of the Law on the MNB.

Article 157 of the Law on the MNB defines the rules that members of the Monetary Council must abide by when submitting their declarations of wealth. The Governor and the Deputy Governors must also follow these rules, by reference to the application of the provisions laid down in Law XXXVI of 2012 on the Parliament governing the declaration of wealth of members of the Parliament and related proceedings. Pursuant to Article 90(3) of Law XXXVI of 2012, which applies to the members of the Monetary Council by virtue of Article 157(1) and Article 183/L of the Law on the MNB, in the case

²²⁶ Introduced to Article 156(7) of the Law on the MNB by Article 174 of Law LXXXV of 2015.

of non-compliance with the obligation to submit a declaration of wealth, the members of the Monetary Council will be prohibited from carrying out their duties and, as a consequence, they will not be entitled to receive their remuneration for the period of non-compliance. The sanction provided for in Article 90(3) of Law XXXVI of 2012 in effect allows the members of the Monetary Council to be temporarily removed from office for grounds other than those pursuant to Article 14.2 of the Statute. The provisions of Article 157(2) of the Law on the MNB should be adapted²²⁷ so that the members of the Monetary Council may not be dismissed for reasons other than those laid down in Article 14.2 of the Statute.²²⁸

Financial independence

In the past two years, the Magyar Nemzeti Bank's recapitalisation and reimbursement regime was replaced twice. First, Article 166(3) of the Law on the MNB was amended to provide that if the amount of equity fell below the subscribed capital at the end of the year under review, the difference would be reimbursed from the central budget directly to the retained earnings over a period of five years, with equal instalments being paid every year, within 30 days of the shareholder's receipt of the notification of the report for the year under review.²²⁹ Additionally, if the amount of the equity exceeded the subscribed capital, all outstanding repayment obligations would cease. If, within the five-year period, the central budget incurred a new reimbursement obligation, Article 166(3) of the Law on the MNB would apply to the fulfilment of this obligation if the central budget ensured that the Magyar Nemzeti Bank's equity did not remain below the level of subscribed capital for a longer period.²³⁰

As a result of the second amendment, Article 166(3) of the Law on the MNB currently provides that if the equity of the Magyar Nemzeti Bank is below the subscribed capital for a prolonged period of time, it must be ensured, by direct reimbursement to the retained earnings provided from the central budget, that the amount of the Magyar Nemzeti Bank's equity should be at least at the level of the subscribed capital within a reasonable period of time, in order to comply with the principle of financial independence. In addition, the Executive Board of the Magyar Nemzeti Bank must approve a year-by-year forecast of the preliminary level of the equity at the end of the previous year and its expected development and send the report to the shareholder and the Fiscal Council by 30 April.²³¹ The State authorities seem to have a wide margin of discretion to determine when the Magyar Nemzeti Bank's equity would be

²²⁷ See Section 2.2.2 of this Convergence Report.

²²⁸ See paragraphs 2.3 to 2.5 of Opinion CON/2014/8.

²²⁹ In accordance with Article 6(2) of the Law on the MNB.

²³⁰ Law LXXVII of 2022 on the amendment to Law CXXXIX of 2013 on the Magyar Nemzeti Bank (a Magyar Nemzeti Bankról szóló 2013. évi CXXXIX. törvény módosításáról szóló 2022. évi LXXVII. törvény).

²³¹ See Article 6(2) and Article 12(4)(b) as amended by Law CXII of 2023 and 12(8) of the Law on the MNB. This reimbursement mechanism closely resembles the recapitalisation mechanism of the Hrvatska Narodna Banka (HNB), as discussed in paragraph 3.5 of Opinion CON/2023/24.

restored up to the level of the Magyar Nemzeti Bank's subscribed capital, which, as such, is not inconsistent with the Treaty and the Statute of the ESCB.²³²

The Magyar Nemzeti Bank's dividend payment regime was also modified in the past two years.²³³ Article 166(1) of the Law on the MNB currently provides that if the amount of the Magyar Nemzeti Bank's equity exceeds its subscribed capital at the end of the year under review, the Magyar Nemzeti Bank will pay 50% of its profit for the year under review as a dividend (automatic dividend payment). Article 166(1a) of the Law on the MNB stipulates that the Magyar Nemzeti Bank will pay dividends, based on a decision of its Executive Board, from the positive amount of its retained earnings supplemented by the loss or 50% of its profit from the year under review, up to the amount of the equity exceeding the subscribed capital (discretionary dividend payment). According to Article 166(1b) of the Law on the MNB, the dividend payment is due within 30 days of the Magyar Nemzeti Bank sending the notification of the report for the year under review to the shareholders. The ECB is of the view that the Law on the MNB may prescribe how its profits are to be allocated. Profits may be distributed to the State budget only after any accumulated losses from previous years have been covered and financial provisions deemed necessary to safeguard the real value of the Magyar Nemzeti Bank's capital and assets have been created. The Magyar Nemzeti Bank is best placed to assess independently what level of reserves is necessary to enable it to perform its tasks, and such a decision should not be the subject of a third party's decision.²³⁴

Article 183 of the Law on the MNB, read in conjunction with Article 176, provided that on 1 October 2013 all employees of the HFSA would be employees of the Magyar Nemzeti Bank and that the Magyar Nemzeti Bank was to bear the financial obligations arising from any employment relations which HFSA staff transferred to the Magyar Nemzeti Bank may have had with the HFSA in the past. This provision alone, taken together with the mass redundancy scheme provided for under Article 183(10) of the Law on the MNB and the aim of eliminating positions not essential for the discharge of duties in order to optimise staff management, is incompatible with the Magyar Nemzeti Bank's financial independence and more specifically its autonomy in staff matters. It impeded the Magyar Nemzeti Bank's ability to decide on employing and retaining

²³² See paragraph 3.7 of Opinion CON/2023/24.

²³³ Law LXXVII of 2022 on the amendment to Law CXXXIX of 2013 on the Magyar Nemzeti Bank (a Magyar Nemzeti Bankról szóló 2013. évi CXXXIX. törvény módosításáról szóló 2022. évi LXXVII. törvény) and Law CXII of 2023 on the Magyar Nemzeti Bank (a Magyarország gazdasági stabilitásáról szóló 2011. évi CXCV. törvény, valamint a Magyar Nemzeti Bankról szóló 2013. évi CXXXIX. törvény módosításáról szóló 2023. évi CXII. törvény).

²³⁴ See paragraph 3.4 of Opinion CON/2022/37 and paragraph 3.8 of Opinion CON/2023/24.

necessary and qualified staff for the Magyar Nemzeti Bank. See, also, the following Section regarding compatibility with the prohibition on monetary financing.²³⁵

7.3.3 Monetary financing and privileged access

Article 36 of the Law on the MNB provides that if circumstances arise which jeopardise the financial system's stability due to a credit institution's operations, the Magyar Nemzeti Bank may extend an emergency loan to such credit institution subject to observing the prohibition on monetary financing in Article 146 of the Law on the MNB. However, it would be useful to specify that such loans are granted independently and at the Magyar Nemzeti Bank's full discretion, which may make such extensions conditional if necessary and against adequate collateral, thus introducing an additional safeguard which should minimise the possibility of the Magyar Nemzeti Bank suffering any loss.

Article 37 of the Law on the MNB provides that on request, the Magyar Nemzeti Bank at its full discretion may provide a loan to the National Deposit Insurance Fund, subject to the prohibition on monetary financing in Article 146 of the Law on the MNB, in urgent and exceptional cases threatening the stability of the financial system as a whole and the smooth completion of cash transactions, the term of which loan may not be longer than three months. Law LXXXV of 2015 extended the scope of Article 37 in order to enable such emergency short-term loan facilities to be provided to the Hungarian

²³⁵ As noted in the section on institutional independence, over the past years the Magyar Nemzeti Bank has been entrusted with several new tasks. The legal provisions entrusting the Magyar Nemzeti Bank with these new tasks that required additional human and financial resources within a relatively short period of time were seen, in previous Convergence Reports, as an instrument to influence the Magyar Nemzeti Bank's ability to fulfil its mandate, both operationally and financially. Therefore, this raised concerns as regards the provisions' compliance with the principle of financial independence. Any allocation of new tasks should be supplemented by the necessary resources to carry them out. See paragraph 2.2 of Opinion CON/2014/62 and paragraph 3.4 of Opinion CON/2014/72. It is also important to note that, as introduced by Law LXIX of 2017, the Magyar Nemzeti Bank also acts, within its existing tasks, as a competent authority to implement several delegated acts related to Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (OJ L 173, 12.6.2014, p. 349) and Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 (OJ L 173, 12.6.2014, p. 84). The Magyar Nemzeti Bank also implements Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014 (OJ L 171, 29.6.2016, p. 1), and shall function as a competent authority as referred to in Article 16 of Regulation (EU) 2015/2365 of the European Parliament and of the Council of 25 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012 (OJ L 337, 23.12.2015, p. 1). In addition, the Magyar Nemzeti Bank implements the following Regulations: Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012 (OJ L 347, 28.12.2017, p. 35); Regulation (EU) 2017/1129 of the European Parliament and the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC (OJ L 168, 30.6.2017, p. 12); and Regulation (EU) 2019/1156 of the European Parliament and of the Council of 20 June 2019 on facilitating cross-border distribution of collective investment undertakings and amending Regulations (EU) No 345/2013, (EU) No 346/2013 and (EU) No 1286/2014 (OJ L 188, 12.7.2019, p. 55). The Magyar Nemzeti Bank also acts in compliance with Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on money market funds (OJ L 169, 30.6.2017, p. 8) and with Regulation (EU) 2017/1991 of the European Parliament and of the Council of 25 October 2017 amending Regulation (EU) No. 345/2013 on European venture capital funds and Regulation (EU) No. 346/2013 on European social entrepreneurship funds (OJ L 293, 10.11.2017, p. 1).

Investor Protection Fund, under the same conditions as to the National Deposit Insurance Fund. This provision is compatible with the monetary financing prohibition. As also already clarified in ECB opinions,²³⁶ it may be useful to specify that such loans are extended against adequate collateral, thus introducing an additional safeguard which should minimise the possibility of the Magyar Nemzeti Bank suffering any loss.

The integration of the HFSA into the Magyar Nemzeti Bank took place on 1 October 2013. Based on Articles 176 to 181 of the Law on the MNB, all of the HFSA's assets were transferred to the Magyar Nemzeti Bank. The Magyar Nemzeti Bank also became a general legal successor to all obligations of the HFSA including, inter alia, its contractual relationships, pending procurement procedures, out-of-court redress procedures, tax-related administrative procedures as well as any other type of legal procedure (including pending administrative legal procedures)²³⁷. As a consequence, any payment obligation from a legal relationship or a requirement to pay compensation following any judgment handed down by a Hungarian court granting compensation to an individual or entity challenging a prior decision of the HFSA is to be borne by the Magyar Nemzeti Bank.

Although Article 177(6) of the Law on the MNB provides for compensation by the State to the Magyar Nemzeti Bank for all expenses resulting from the above-mentioned obligations that would exceed the assets taken over from the HFSA, the Law on the MNB does not specifically lay down the procedure and deadlines applicable to financing by the State and reimbursement of the Magyar Nemzeti Bank. This can only be considered to be an ex-post financing scheme. The provisions applying to the assignment of the obligations of the HFSA to the Magyar Nemzeti Bank were not accompanied by measures that would fully insulate the Magyar Nemzeti Bank from all financial obligations resulting from any activities and contractual relationships of the HFSA originating prior to the transfer of tasks, and the provisions of the Law on the MNB introduced a time gap between the costs arising and the Hungarian State reimbursing the Magyar Nemzeti Bank, should the expenses incurred at the Magyar Nemzeti Bank exceed the value of assets taken over from the HFSA. As mentioned in previous Convergence Reports, such a scenario would constitute a breach of the prohibition on monetary financing laid down in Article 123 of the Treaty as well as of the principle of financial independence under Article 130. Hence the Magyar Nemzeti Bank must be insulated from all financial obligations resulting from the prior activities or legal relationships of the HFSA.

Article 183 of the Law on the MNB read in conjunction with Article 176 of the Law on the MNB provides that the Magyar Nemzeti Bank bears the financial obligations arising from the employment relationships which HFSA staff transferred to the Magyar Nemzeti Bank may have had with the HFSA in the past. In order to comply with Article 123 of the Treaty, the Magyar Nemzeti Bank should be insulated from all obligations arising out of employment relationships between any new Magyar Nemzeti Bank staff

²³⁶ See, for example, paragraph 9.3 of Opinion CON/2011/104.

²³⁷ See paragraph 3.7 of Opinion CON/2008/83.

member and the HFSA, in the light of the mass redundancy scheme provided for under Article 183(10) of the Law on the MNB²³⁸.

7.3.4 Single spelling of the euro

In several Hungarian legal acts²³⁹ the name of the single currency is spelled in a way ("euró"), which is inconsistent with EU law. Under the Treaties a single spelling of the word "euro" in the nominative singular case is required in all EU and national legislative provisions, taking into account the existence of different alphabets. The Hungarian legal acts in question should therefore be amended accordingly.²⁴⁰

The ECB expects that the correct spelling of the word "euro" will be applied in Hungarian legal acts and the euro changeover law. Only when all national legal acts use the correct spelling of the word "euro" will Hungary comply with the Treaties.

7.3.5 Legal integration of the NCB into the Eurosystem

With regard to the Magyar Nemzeti Bank's legal integration into the Eurosystem, the Law on the MNB needs to be adapted as set out below.

Economic policy objectives

Article 3(2) of the Law on the MNB provides that the Magyar Nemzeti Bank supports, without prejudice to the primary objective of price stability, the maintenance of the stability of the financial intermediary system, the enhancement of its resilience, its sustainable contribution to economic growth and the Government's general economic policies and environmental sustainability policy. This provision is incompatible with Article 127(1) of the Treaty and Article 2 of the Statute as it does not reflect the secondary objective of supporting the general economic policies in the EU.

²³⁸ Although this concern and the one explained in the previous paragraph remain, they are obviously less strong than they were in the immediate years that followed the integration of the HFSA into the Magyar Nemzeti Bank as, due to the passage of time, it is less likely that Magyar Nemzeti Bank has to assume new financial obligations resulting from the legal succession of HFSA.

²³⁹ For example, Law LV of 2023 on the 2024 central budget of Hungary (Magyarország 2024. évi központi költségvetéséről szóló 2023. évi LV. törvény) and Law CIX of 2023 on the amendment of certain Laws related to strengthening the competitiveness of domestic economic operators and increasing the efficiency of public administration (a hazai gazdasági szereplők versenyképességének erősítésével és a közigazgatás hatékonyságának növelésével összefüggő egyes törvények módosításáról szóló 2023. évi CIX. törvény).

²⁴⁰ See paragraph 3.3.1 of Opinion CON/2006/55.

Tasks

Monetary policy

Article 41 of the Fundamental Law of Hungary and Article 1(2) and Articles 4, 9, 16 to 22, 159 and 171 of the Law on the MNB establishing the Magyar Nemzeti Bank's powers in the field of monetary policy and instruments for the implementation thereof do not recognise the ECB's powers in this field.

Collection of statistics

Although Article 4(6) of the Law on the MNB refers to the Magyar Nemzeti Bank's obligation to transfer specific statistical data to the ECB in accordance with Article 5 of the Statute, Articles 1(2) and 171(1) and Articles 9, 12, 30 and 160 of the Law on the MNB establishing the Magyar Nemzeti Bank's powers relating to the collection of statistics do not recognise the ECB's powers in this field.

Official foreign reserve management

Article 1(2), Article 4(3), (4) and (12), Article 9 and Article 159(2) of the Law on the MNB, which provide for the Magyar Nemzeti Bank's powers in the field of foreign reserve management, do not recognise the ECB's powers in this field.

Payment systems

Article 1(2), Article 4(5) and (12), Articles 9, 13, 27 and 28, and Article 171 (3) of the Law on the MNB establishing the Magyar Nemzeti Bank's powers with regard to the promotion of the smooth operation of payment systems do not recognise the ECB's powers in this field.

Issue of banknotes

Article K of the Fundamental Law and Article 1(2), Article 4(2) and (12), Articles 9, 12, 23 to 26 and Articles 171(1) and 172(2) of the Law on the MNB establishing the Magyar Nemzeti Bank's exclusive right to issue banknotes and coins do not recognise the Council's and the ECB's powers in this field.

Financial provisions

Appointment of independent auditors

Article 144 of the Law on the MNB providing that the President of the State Audit Office must be consulted before the Magyar Nemzeti Bank's auditor is elected or their dismissal is proposed, Article 6(1) of the Law on the MNB, which provides for the shareholder's power to appoint and dismiss the auditor, and Article 15 of the Law on the MNB do not recognise the Council's and the ECB's powers under Article 27.1 of the Statute.

Financial reporting

Article 12(4)(b) and Article 147 of the Law on the MNB and Law C of 2000,²⁴¹ in conjunction with Government Decree 221/2000,²⁴² do not reflect the Magyar Nemzeti Bank's obligation to comply with the Eurosystem's regime for financial reporting of NCB operations, pursuant to Article 26 of the Statute.

Exchange rate policy

Article 1(2), 4(4) and (12), Articles 9 and 22 of the Law on the MNB lay down the Government's and the Magyar Nemzeti Bank's respective powers in the area of exchange rate policy. These provisions do not recognise the Council's and the ECB's powers in this field.

International cooperation

Article 1(2), 135(5) of the Law on the MNB providing that, upon authorisation by the Government, the Magyar Nemzeti Bank may undertake tasks arising at international financial organisations, unless otherwise provided for by a legislative act, fails to recognise the ECB's powers as far as issues under Article 6 of the Statute are concerned.

Miscellaneous

Articles 75 and 76 of the Law on the MNB do not recognise the ECB's powers to impose sanctions.

²⁴¹ Law C of 2000 on Accounting (a számvitelről szóló 2000. évi C. törvény).

²⁴² Government Decree 221/2000 (XII.19.) on the special reporting and accounting requirements of the Magyar Nemzeti Bank (a Magyar Nemzeti Bank éves beszámoló készítési és könyvvizelési kötelezettségének sajátosságairól szóló 221/2000 (XII.19) Kormányrendelet).

With regard to Article 132 of the Law on the MNB, which entitles the Magyar Nemzeti Bank to be consulted on draft national legislation related to its tasks, it is noted that consulting the Magyar Nemzeti Bank does not obviate the need to consult the ECB under Articles 127(4) and 282(5) of the Treaty.

As set out in Section 7.4.2, Article 9(7) of the Law on the MNB requires the members of the Monetary Council to make an oath in accordance with the wording specified in Article 1 of Law XXVII of 2008. Article 9(7) of the Law on the MNB needs to be adapted to comply with Article 14.3 of the Statute.²⁴³

7.3.6 Conclusions

The Fundamental Law of Hungary, the Law on the MNB, Law XXVII of 2008, Government Decree 89/2023 and Government Decree 471/2022 do not comply with all the requirements for central bank independence, the prohibition on monetary financing, and legal integration into the Eurosystem. Other Hungarian legal acts do not comply with the requirements for the single spelling of the euro. Hungary is a Member State with a derogation and must therefore comply with all adaptation requirements under Article 131 of the Treaty.

7.4 Poland

7.4.1 Compatibility of national legislation

The following legislation forms the legal basis for Narodowy Bank Polski and its operations:

- the Polish Constitution,²⁴⁴
- the Law on Narodowy Bank Polski (hereinafter the “Law on NBP”),²⁴⁵
- the Law on the Bank Guarantee Fund, deposit guarantee system and compulsory restructuring (hereinafter the “Law on the Fund”),²⁴⁶
- the Law on banking (hereinafter the “Law on banking”),²⁴⁷

²⁴³ See paragraph 3.7 of Opinion CON/2008/83.

²⁴⁴ Konstytucja Rzeczypospolitej Polskiej of 2 April 1997, Dziennik Ustaw of 1997, No 78, item 483, with further amendments.

²⁴⁵ Ustawa o Narodowym Banku Polskim of 29 August 1997. Consolidated version published in Dziennik Ustaw of 2022, item 2025.

²⁴⁶ Ustawa o Bankowym Funduszu Gwarancyjnym, systemie gwarantowania depozytów oraz przymusowej restrukturyzacji of 10 June 2016. Consolidated version published in Dziennik Ustaw of 2024, item 487.

²⁴⁷ Ustawa Prawo bankowe of 29 August 1997. Consolidated version published in Dziennik Ustaw of 2023, item 2488, with further amendments.

- the Law on settlement finality in the payment and settlement systems and on the supervision of such systems.²⁴⁸

No major new legislation has been enacted in relation to the points identified in the ECB's Convergence Report of June 2022, and those comments are therefore largely repeated in this year's assessment.

7.4.2 Independence of the NCB

With regard to Narodowy Bank Polski's independence, the Polish Constitution, the Law on NBP and the Law on the State Tribunal²⁴⁹ need to be adapted in the respects set out below. Currently, the Polish Constitution specifies that Narodowy Bank Polski "shall have the exclusive right to issue money and to formulate and implement monetary policy".²⁵⁰ The Law on NBP states that "the primary objective of the activity of Narodowy Bank Polski shall be to maintain price stability, while supporting the economic policies of the Government insofar as this does not constrain the pursuit of the primary objective of Narodowy Bank Polski".²⁵¹ The ECB understands that these provisions necessarily imply that Narodowy Bank Polski carries out its tasks and pursues its objectives independently of any other authority. Accordingly, the well-established case-law of the Constitutional Tribunal derives the principle of the independence of Narodowy Bank Polski from a functional interpretation of the content of Article 227 of the Polish Constitution²⁵².

Institutional independence

Article 11(3) of the Law on NBP, which provides that Narodowy Bank Polski's Governor represents Poland's interests within international banking institutions and, unless the Council of Ministers decides otherwise, within international financial institutions, needs to be adapted to comply with Article 130 of the Treaty and Article 7 of the Statute.

Article 23(1)(2) of the Law on NBP, which obliges Narodowy Bank Polski's Governor to forward draft monetary policy guidelines to the Council of Ministers and the Minister for Finance, needs to be adapted to comply with Article 130 of the Treaty and Article 7 of the Statute.

The Supreme Audit Office (NIK), a constitutional body, has wide powers under Article 203(1) of the Polish Constitution to control the activities of, among others, all public

²⁴⁸ Ustawa o ostateczności rozrachunku w systemach płatności i systemach rozrachunku papierów wartościowych oraz zasadach nadzoru nad tymi systemami of 24 August 2001. Consolidated version published in Dziennik Ustaw of 2024, item 585.

²⁴⁹ Ustawa o Trybunale Stanu of 26 March 1982. Consolidated version published in Dziennik Ustaw of 2022, item 762, with further amendments.

²⁵⁰ See Article 227(1), second sentence, of the Polish Constitution.

²⁵¹ See Article 3(1) of the Law on NBP.

²⁵² See the judgements of the Constitutional Tribunal in cases K 25/99 of 28 June 2000, K 26/03 of 24 November 2003, U 4/06 of 22 September 2006, Kp 4/08 of 16 July 2009 and K 23/23 of 11 January 2024..

administrative authorities and Narodowy Bank Polski as regards their legality, economic prudence, efficiency and diligence. The scope of the NIK's control should be clearly defined, should be without prejudice to the activities of Narodowy Bank Polski's independent external auditors,²⁵³ should comply with the prohibition on giving instructions to an NCB and its decision-making bodies and should not interfere with the NCB's ESCB-related tasks. In particular, it should be ensured that when auditing Narodowy Bank Polski, the application by the NIK of the "efficiency criterion" does not extend to an evaluation of Narodowy Bank Polski's activities related to its primary objective of price stability.²⁵⁴ Article 203(1) of the Polish Constitution needs to be adapted to comply with Article 130 of the Treaty and Article 7 of the Statute.

Personal independence

Article 9(5) of the Law on NBP regulates the dismissal of Narodowy Bank Polski's Governor by the Sejm (lower house of Parliament) upon request of the President of the Republic of Poland, if he or she has:

- been unable to fulfil his or her duties due to prolonged illness,
- been convicted of a criminal offence under a final court sentence,
- submitted an untruthful disclosure declaration, confirmed by a final court judgment,²⁵⁵
- been prohibited by the State Tribunal from occupying executive positions or holding posts of particular responsibility in state bodies.²⁵⁶

Moreover, under Article 25(3) in conjunction with Article 3 and Article 1(1)(3) of the Law on the State Tribunal, Narodowy Bank Polski's Governor may also be relieved from office²⁵⁷ if he or she violates the Constitution or a law.²⁵⁸

The ECB understands that the grounds listed above in principle do not constitute new grounds for dismissal of Narodowy Bank Polski's Governor in addition to those

²⁵³ For the activities of the NCB's independent external auditors see, as an example, Article 27.1 of the Statute.

²⁵⁴ See paragraph 3.6 of Opinion CON/2011/9.

²⁵⁵ The provision was added with effect from 15 March 2007 by Article 37a of the Law on disclosure of information relating to documents of state security services from the period 1944-1990 (Ustawa o ujawnianiu informacji o dokumentach organów bezpieczeństwa państwa z lat 1944-1990 oraz treści tych dokumentów of 18 October 2006. Consolidated version published in Dziennik Ustaw of 2024, item 273).

²⁵⁶ Such prohibition by the State Tribunal is one of the sanctions enumerated in Article 25(1)(2) of the Law on the State Tribunal.

²⁵⁷ As the relevant legislation currently stands, it is not entirely clear whether the relieving in accordance with Article 25(3) of the Law on the State Tribunal also requires the involvement of the Sejm and the President of the Republic of Poland.

²⁵⁸ The indictment by the Sejm of the Governor of Narodowy Bank Polski before the State Tribunal results, by operation of law, in suspension of the Governor from office. According to the judgment of the Polish Constitutional Court of 11 January 2024 (Case K 23/23), the provision of Article 11(1), second sentence, of the Law on the State Tribunal, in conjunction with Article 13(1a) of that Law, is unconstitutional and needs to be amended by the Sejm, insofar as it allows for the suspension of the Governor as a result of a resolution of the Sejm adopted by only an absolute majority of votes in the presence of at least half of the statutory number of deputies.

contained in Article 14.2 of the Statute. However, Article 25(3) in conjunction with Article 3 and Article 1(1)(3) of the Law on the State Tribunal could be understood as extending the scope of serious misconduct beyond Article 14.2 of the Statute to mere violations of the law. For the sake of legal clarity, the potential inconsistency resulting from these provisions with the grounds of dismissal contained in Article 14.2 of the Statute should be removed.²⁵⁹ Until then, these provisions should be interpreted in line with Article 14.2 of the Statute.

With regard to security of tenure and grounds for dismissal of other members of Narodowy Bank Polski's decision-making bodies involved in the performance of ESCB-related tasks (i.e. the members of the Management Board, and in particular the First Deputy Governor, and the members of the Monetary Policy Council), Article 13(5) and Article 17(2b), second sentence, of the Law on NBP provide the following grounds for dismissal:

- an illness which permanently prevents them from performing their responsibilities,
- a conviction for a criminal offence under a final court sentence,
- submission of an untruthful lustration declaration, and this has been confirmed by a final court judgment,²⁶⁰
- non-suspension of membership of a political party or trade union.

The grounds listed above and Article 14(3) of the Law on NBP, which reaffirms the possibility of dismissal of a member of the Monetary Policy Council of Narodowy Bank Polski for a conviction for a criminal offence, therefore need to be interpreted in line with Article 130 of the Treaty.²⁶¹

The Governor of Narodowy Bank Polski acts in dual capacity as a member of Narodowy Bank Polski's decision-making bodies and of the relevant decision-making bodies of the ECB. Article 9(3) of the Law on NBP, which specifies the wording of the oath sworn by Narodowy Bank Polski's Governor, needs to be adapted to reflect the status and the obligations and duties of the Governor of Narodowy Bank Polski as member of the relevant decision-making bodies of the ECB.

The Law on NBP is silent on the right of national courts to review a decision to dismiss any member of the NCB's decision-making bodies who is involved in the performance of ESCB-related tasks. Even though this right may be available under general Polish law for any member of the NCB's decision-making bodies other than the Governor

²⁵⁹ See Section 2.2.2. of this Convergence Report, sub-section on "Compatibility' versus 'Harmonisation'".

²⁶⁰ This provision was added with effect from 15 March 2007 by Article 37a of the Law on disclosure of information relating to documents of state security services from the period 1944-1990 (Ustawa o ujawnianiu informacji o dokumentach organów bezpieczeństwa państwa z lat 1944-1990 oraz treści tych dokumentów of 18 October 2006. Consolidated version published in Dziennik Ustaw of 2024, item 273).

²⁶¹ See Section 2.2.3 of this Convergence Report, sub-section on "Personal Independence", in particular the paragraph on "Security of tenure and grounds for relieving from office of members of NCBs' decision-making bodies, other than Governors, who are involved in the performance of ESCB-related tasks".

(whose dismissal falls within the jurisdiction of the Court of Justice of the European Union), providing specifically for such a right of review would increase legal certainty.

Financial independence

In March 2019 the Law amending the Law on prohibitions regarding conducting of business activities by public officials and the Law on NBP²⁶² entered into force. According to Article 66(3) of the amended Law on NBP, the upper salary limit (salary cap) for all employees (excluding members of the Management Board of Narodowy Bank Polski) is set at 60% of the salary of the Governor of Narodowy Bank Polski (the salary of the Governor is determined on the basis of other provisions which have not been amended). However, amendments included in any legislative proposal that lead to reductions in remuneration are not compatible with the principle of financial independence if the ability of the relevant national central bank to employ and retain staff to perform independently the tasks conferred on it by the Treaty and the Statute is affected. Any adopted legislative solution should provide for a cooperation mechanism with Narodowy Bank Polski, to ascertain if it considers that an exception to a cap on remuneration is required. Such an exception should be decided upon in close and effective cooperation with Narodowy Bank Polski, taking due account of its views, to ensure its ongoing ability to independently carry out its tasks.²⁶³ As such close and effective cooperation with Narodowy Bank Polski is not provided for in the present legal framework regarding the salary cap, the legislation does not satisfy the requirements of Article 130 of the Treaty and Article 7 of the Statute.

7.4.3 Confidentiality

Article 23(7) of the Law on NBP specifies instances in which data collected from individual financial institutions, as well as statistical surveys, studies and assessments enabling identification of individual entities, are subject to disclosure by Narodowy Bank Polski to external parties. One such instance covers disclosure to “unspecified recipients”, under “separate applicable provisions”.²⁶⁴ Such disclosure may potentially affect data protected under the ESCB’s confidentiality regime and therefore the Law on NBP should be adapted to fully comply with Article 37 of the Statute.²⁶⁵

In addition, since NIK has wide powers under Article 203(1) of the Polish Constitution to control the activities of Narodowy Bank Polski, as mentioned in Section 7.4.2, NIK also has wide access to Narodowy Bank Polski’s confidential information and documents. However, pursuant to Article 37 of the Statute in conjunction with Article 130 of the Treaty, NIK’s access to Narodowy Bank Polski’s confidential information and documents must be limited to that necessary for the performance of NIK’s

²⁶² Ustawa z dnia 22 lutego 2019 r. o zmianie ustawy o ograniczeniu prowadzenia działalności gospodarczej przez osoby pełniące funkcje publiczne oraz ustawy o Narodowym Banku Polskim, Dz. U. 2019 item 371.

²⁶³ See paragraph 2.2.3 of Opinion CON/2019/3.

²⁶⁴ Article 23(7)(3) of the Law on NBP.

²⁶⁵ See Opinion CON/2008/53.

statutory tasks. Such access must also be without prejudice both to the ESCB's independence and to its confidentiality regime, to which the members of the NCBs' decision-making bodies and staff are subject. In addition, the relevant Polish legislation should be amended to stipulate that NIK shall safeguard the confidentiality of information and documents disclosed by Narodowy Bank Polski to an extent corresponding to that applied by Narodowy Bank Polski.

7.4.4 Monetary financing and privileged access

Article 42(1) in conjunction with Article 3(2)(5) of the Law on NBP provides for Narodowy Bank Polski's powers to grant refinancing credit to banks satisfying specified conditions.²⁶⁶ In addition, Article 42(3) of the Law on NBP allows Narodowy Bank Polski to grant refinancing credit for the purpose of implementing a bank recovery plan, which is initiated in the event of a bank infringing, or being likely to infringe, certain requirements relating to, among other things, own funds and liquidity ratio.²⁶⁷ Granting of refinancing credit is in all cases subject to the general rules of the Law on banking, with the modifications resulting from the Law on NBP.²⁶⁸ Safeguards currently contained in such rules aiming at ensuring timely repayment of the credit do not fully exclude an interpretation that would allow an extension of refinancing credit to a bank undergoing recovery proceedings which then becomes insolvent.²⁶⁹ More explicit safeguards in relation to all financial institutions receiving liquidity support from Narodowy Bank Polski are needed to avoid incompatibility with the monetary financing prohibition under Article 123 of the Treaty.²⁷⁰ The Law on NBP should be adapted to make clear that such liquidity support is only temporary and it may not be extended to insolvent financial institutions.

Article 43 of the Law on NBP in conjunction with Articles 270 and 306 of the Law on the Fund provides for Narodowy Bank Polski's powers to grant, at its discretion, short-term credit to the Bank Guarantee Fund (hereinafter the "Fund") related to the financing of its deposit guarantee function, if a threat to financial stability arises and in view of its urgent needs. Given the current features of the Fund, the provisions laid down in the Law on NBP and the Law on the Fund regarding the possibility of NBP granting loans to the Fund are not compatible with the monetary financing prohibition and should be amended accordingly. The Fund qualifies as a "body governed by public law" within the meaning of Article 123(1) of the Treaty. In particular, the Fund has all of the following characteristics: (a) it has been established for the purpose of

²⁶⁶ Narodowy Bank Polski's decision whether to grant refinancing credit is based on its assessment of the bank's ability to repay the principal amount and the interest on time (Article 42(2) of the Law on NBP).

²⁶⁷ Article 142(1) and (2) of the Law on banking.

²⁶⁸ Article 42(7) of the Law on NBP.

²⁶⁹ Under the Law on banking which applies to the provision of refinancing credit by Narodowy Bank Polski, a commercial bank may extend credit to an uncreditworthy borrower, provided that: (i) qualified security is established; and (ii) a recovery programme is instituted, which the crediting bank considers will ensure the borrower's creditworthiness during a specified period (Article 70(2) of the Law on banking). Furthermore, Narodowy Bank Polski may demand early repayment of any refinancing credit if the financial situation of the credited bank has worsened to the extent of putting the timely repayment at risk (Article 42(6) of the Law on NBP).

²⁷⁰ See Opinion CON/2013/5.

meeting needs in the general interest – especially tasks related to financial stability, administering the deposit guarantee scheme and resolution; (b) it has legal personality; and (c) it is closely dependent on public sector entities referred to in Article 123(1) of the Treaty, as the majority of the members of the Fund’s Council, which acts as the Fund’s administrative board, are appointed by the Minister competent for financial institutions and the Chairman of the Financial Supervisory Authority.²⁷¹ Additionally, the Fund is included in the catalogue of entities that are part of the public sector for the purposes of the Law of 27 August 2009 on public finance.²⁷²

Article 220(2) of the Polish Constitution provides that “the budget shall not provide for covering a budget deficit by way of contracting credit obligations to the State’s central bank”. While this provision prohibits the State from financing its budgetary deficit via Narodowy Bank Polski, the ECB understands that it does not constitute an implementation of Article 123 of the Treaty prohibiting monetary financing, and its aim and function are therefore not identical to those of the said Treaty prohibition. Article 123 of the Treaty, supplemented by Council Regulation (EC) No 3603/93, is directly applicable, so it may not be reproduced or transposed into national legislation.

7.4.5 Legal integration of the NCB into the Eurosystem

With regard to Narodowy Bank Polski’s legal integration into the Eurosystem, the Polish Constitution and the Law on NBP need to be adapted in the respects set out below.

Economic policy objectives

Article 3(1) of the Law on NBP provides that Narodowy Bank Polski’s primary objective is to maintain price stability, while supporting the economic policies of the Government, insofar as this does not constrain the pursuit of its primary objective. This provision is incompatible with Article 127(1) of the Treaty and Article 2 of the Statute, as it does not reflect the ESCB’s secondary objective of supporting the general economic policies in the Union.

Tasks

Monetary policy

Article 227(1) and (6) of the Constitution and Article 3(2)(5), Articles 12, 23 and 38 to 50a and 53 of the Law on NBP, which provide for Narodowy Bank Polski’s powers with regard to monetary policy, do not recognise the ECB’s powers in this field.

²⁷¹ See Opinion CON/2021/17.

²⁷² Ustawa o finansach publicznych. Consolidated version published in Dziennik Ustaw of 2023, item 1270, with further amendments.

Collection of statistics

Article 3(2)(7) and Article 23 of the Law on NBP, which provides for Narodowy Bank Polski's powers relating to the collection of statistics, do not recognise the ECB's powers in this field.

Official foreign reserve management

Article 3(2)(2) and Article 52 of the Law on NBP, which provide for Narodowy Bank Polski's powers in the field of foreign exchange management, do not recognise the ECB's powers in this field.

Payment systems

Article 3(2)(1) of the Law on NBP, which provides for Narodowy Bank Polski's powers in organising monetary settlements, does not recognise the ECB's powers in this field.

Issue of banknotes

Article 227(1) of the Constitution and Article 4 and Articles 31 to 37 of the Law on NBP, which provide for Narodowy Bank Polski's exclusive powers to issue and withdraw banknotes and coins having the status of legal tender, do not recognise the Council's and the ECB's powers in this field.

Financial provisions

Appointment of independent auditors

Article 69(1) of the Law on NBP, which provides for the auditing of Narodowy Bank Polski, does not recognise the Council's and the ECB's powers under Article 27.1 of the Statute. The powers of the NIK to control the activities of Narodowy Bank Polski should be clearly defined by legislation and should be without prejudice to the activities of Narodowy Bank Polski's independent external auditors, as laid down in Article 27.1 of the Statute.

Exchange rate policy

Articles 3(2)(3) and 17(4)(2) and Article 24 of the Law on NBP, which provide for Narodowy Bank Polski's power to implement the exchange rate policy set in agreement with the Council of Ministers, do not recognise the Council's and the ECB's powers in this field.

International cooperation

Articles 5(1) and 11(3) of the Law on NBP, which provide for Narodowy Bank Polski's right to participate in international financial and banking institutions, do not recognise the ECB's powers in this field.

Miscellaneous

Article 9(3) of the Law on NBP, which specifies the wording of the oath sworn by Narodowy Bank Polski's Governor, needs to be adapted to comply with Article 14.3 of the Statute.

With regard to Article 21(4) of the Law on NBP, which provides for Narodowy Bank Polski's rights to present its opinion on draft legislation concerning the activity of banks and having significance to the banking system, it is noted that consulting Narodowy Bank Polski does not obviate the need to consult the ECB under Articles 127(4) and 282(5) of the Treaty.

7.4.6 Conclusions

The Polish Constitution, the Law on NBP and the Law on the State Tribunal do not comply with all the requirements of central bank independence, confidentiality, the monetary financing prohibition and legal integration into the Eurosystem. Poland is a Member State with a derogation and must therefore comply with all adaptation requirements under Article 131 of the Treaty.²⁷³

7.5 Romania

7.5.1 Compatibility of national legislation

The following legislation forms the legal basis for Banca Națională a României and its operations:

- Law No 312/2004 on the Statute of Banca Națională a României (hereinafter the "Law on BNR").²⁷⁴

There have been no changes in relation to the points identified in the ECB's Convergence Report of June 2022 concerning the Law on BNR, and therefore those comments are largely repeated in this year's assessment.

²⁷³ For a detailed review of necessary adaptations of the Constitution, the Law on NBP and other laws, see Opinion CON/2011/9.

²⁷⁴ Published in Monitorul Oficial al României, Part One, No 582, 30.6.2004.

7.5.2 Independence of the NCB

With regard to Banca Națională a României's independence, the Law on BNR and other legislation needs to be adapted in the respects set out below.

Institutional independence

Article 3 of the Law on BNR does not expressly prohibit the Government from seeking to influence the members of Banca Națională a României's decision-making bodies in situations where this may have an impact on Banca Națională a României's fulfilment of its ESCB-related tasks. In this respect the Law on BNR needs to be adapted to be fully consistent with Article 130 of the Treaty and Article 7 of the Statute.²⁷⁵

Personal independence

Article 33(7) of the Law on BNR provides that no member of the Board of Banca Națională a României may be recalled from office for reasons other than or following a procedure other than those provided for in Article 33(6) of the Law on BNR. Article 33(6) of the Law on BNR contains grounds for dismissal which are compatible with those laid down in Article 14.2 of the Statute. Law 161/2003 on certain measures for transparency in the exercise of public dignities, public functions and business relationships and for the prevention and sanctioning of corruption,²⁷⁶ and Law 176/2010 on the integrity in the exercise of public functions and dignities,²⁷⁷ define the conflicts of interest and incompatibilities applicable to the Governor and the other members of the Board of Banca Națională a României and require them to report on their interests and wealth. The ECB understands that the sanctions provided for in these Laws for the breach of such obligations as well as the automatic resignation mechanism in cases of incompatibility²⁷⁸ do not constitute new grounds for dismissal of the Governor or other members of the Board of Banca Națională a României in addition to those contained in Article 33 of the Law on BNR.

Financial independence

Article 43 of the Law on BNR provides that each month, Banca Națională a României must transfer to the State budget an 80% share of the net revenues left after deducting expenses relating to the financial year, including provisions for credit risk, and any losses relating to previous financial years that remain uncovered. This arrangement

²⁷⁵ See Section 2.2.2 of this Convergence Report.

²⁷⁶ Published in Monitorul Oficial al României, Part One, No 279, 21.4.2003.

²⁷⁷ Published in Monitorul Oficial al României, Part One, No 621, 2.9.2010.

²⁷⁸ According to the relevant provisions of Article 99 of Law 161/2003, if a member of the Board of Banca Națională a României or an employee occupying a leading position with Banca Națională a României does not choose within a given period of time between their function and the one which they have declared to be incompatible with their function, they are considered to have resigned from their function and the Parliament takes note of the resignation.

may in certain circumstances amount to an intra-year credit, which in turn may undermine the financial independence of Banca Națională a României. Article 43(3) of the Law on BNR also provides that Banca Națională a României sets up provisions for credit risk in accordance with its rules, after having consulted the Ministry of Public Finance. The ECB notes that NCBs must be free to independently create financial provisions to safeguard the real value of their capital and assets.

Article 43 of the Law on BNR should therefore be adapted to ensure that such arrangement does not undermine the ability of Banca Națională a României to carry out its ESCB tasks in an independent manner.

Pursuant to Articles 21 and 23 of Law 94/1992 on the organisation and functioning of the Court of Auditors,²⁷⁹ the Court of Auditors is empowered to control the establishment, management and use of the public sector's financial resources, including Banca Națională a României's financial resources, and to audit the management of the funds of Banca Națională a României. The scope of audit by the Court of Auditors is further defined in Article 47(2) of the Law on BNR, which provides that commercial operations performed by Banca Națională a României, as shown in the revenue and expenditure budget and in the annual financial statements, shall be subject to auditing by the Court of Auditors. As the provisions of Law 94/1992 on the organisation and functioning of the Court of Auditors expressly apply to Banca Națională a României, in the interests of legal certainty it should be clarified in Romanian legislation that the scope of audit by the Court of Auditors is provided by Article 47(2) of the Law on BNR and is therefore limited to commercial operations performed by Banca Națională a României.²⁸⁰

7.5.3 Confidentiality

Pursuant to Article 52(2) of the Law on BNR, the Governor may release confidential information on the four grounds listed. Under Article 37 of the Statute, professional secrecy is an ESCB-wide matter. Therefore, the ECB assumes that such release is without prejudice to the confidentiality obligations towards the ECB and the ESCB.

7.5.4 Monetary financing and privileged access

Articles 6(1) and 29(1) of the Law on BNR expressly prohibit direct purchase on the primary market by Banca Națională a României of debt instruments issued by the State, central and local public authorities, autonomous public service undertakings, national societies, national companies and other majority State-owned companies. Such prohibition has been extended by Article 6(2) to other bodies governed by public law and public undertakings in Member States. Furthermore, under Article 7(2) of the Law on BNR, Banca Națională a României is prohibited from granting overdraft facilities or any other type of credit facility to the State, central and local public

²⁷⁹ Published in Monitorul Oficial al României, Part One, No 238, 3.4.2014.

²⁸⁰ For the activities of the NCB's independent external auditors see, for example, Article 27.1 of the Statute.

authorities, autonomous public service undertakings, national societies, national companies and other majority State-owned companies. Article 7(4) extends this prohibition to other bodies governed by public law and public undertakings in Member States. The range of public sector entities referred to in these provisions needs to be extended to be fully consistent with Article 123 of the Treaty and aligned with the definitions contained in Regulation (EC) No 3603/93²⁸¹.

Pursuant to Article 7(3) of the Law on BNR, majority State-owned credit institutions are exempted from the prohibition on granting overdraft facilities and any other type of credit facility in Article 7(2) and benefit from loans granted by Banca Națională a României in the same way as any other credit institution eligible under Banca Națională a României's regulations Article 7(3) of the Law on BNR should be adapted to be fully consistent with the wording of Article 123(2) of the Treaty, which only exempts publicly owned credit institutions "in the context of the supply of reserves by central banks".²⁸²

Article 26 of the Law on BNR provides that, to carry out its task of ensuring financial stability, in exceptional cases and only on a case-by-case basis, Banca Națională a României may grant to credit institutions loans which are unsecured or secured by assets other than assets eligible to collateralise the monetary or foreign exchange policy operations of Banca Națională a României. Article 26 does not contain sufficient safeguards to prevent such lending from potentially breaching the monetary financing prohibition contained in Article 123 of the Treaty, especially given the risk that such lending could result in the provision of solvency support to a credit institution experiencing financial difficulties, and should be adapted accordingly.

Article 43 of the Law on BNR provides that Banca Națională a României must transfer to the State budget an 80% share of the net revenues left after deducting expenses relating to the financial year, including provisions for credit risk, and losses related to the previous financial years that remained uncovered. The 80% of the net revenues is transferred monthly before the 25th day of the following month, based on a special statement. The adjustments relating to the financial year are performed by the deadline for submission of the annual balance sheet, based on a rectifying special statement. This provision is constructed in a way which does not rule out the possibility of an intra-year anticipated profit distribution in circumstances where Banca Națională a României accumulates profits during the first half of the year but suffers consecutive losses during the second half of the year. Although the State is under an obligation to make adjustments after the closure of the financial year and would therefore have to return any excessive distributions to Banca Națională a României, this would only happen after the deadline for submission of the annual balance sheet and may therefore be viewed as amounting to an intra-year credit to the State. Article 43 should be adapted to ensure that such an intra-year credit is not possible to rule out the possibility of breaching the monetary financing prohibition in Article 123 of the Treaty.

²⁸¹ See Section 2.2.2 of this Convergence Report.

²⁸² See Section 2.2.2 of this Convergence Report.

7.5.5 Legal integration of the NCB into the Eurosystem

With regard to Banca Națională a României's legal integration into the Eurosystem, the Law on BNR needs to be adapted in the respects set out below.

Economic policy objectives

Article 2(3) of the Law on BNR provides that, without prejudice to the primary objective of price stability, Banca Națională a României must support the State's general economic policy. This provision is incompatible with Article 127(1) of the Treaty, as it does not reflect the ESCB's secondary objective of supporting the general economic policies in the Union.

Tasks

Monetary policy

Article 2(2)(a), Article 5, Articles 6(3) and 7(1), Articles 8, 19 and 20 and Article 33(1)(a) of the Law on BNR, which provide for the powers of Banca Națională a României in the field of monetary policy and instruments for the implementation thereof, do not recognise the ECB's powers in this field.

Collection of statistics

Article 49 of the Law on BNR, which provides for the powers of Banca Națională a României relating to the collection of statistics, does not recognise the ECB's powers in this field.

Official foreign reserve management

Articles 2(2)(e) and 9(2)(c) and Articles 30 and 31 of the Law on BNR, which provide for the powers of Banca Națională a României relating to foreign reserve management, do not recognise the ECB's powers in this field.

Payment systems

Article 2(2)(b), Article 22 and Article 33(1)(b) of the Law on BNR, which provide for the role of Banca Națională a României in relation to the smooth operation of payment systems, do not recognise the ECB's powers in this field.

Issue of banknotes

Article 2(2)(c) and Articles 12 to 18 of the Law on BNR, which provide for Banca Națională a României's role in issuing banknotes and coins, do not recognise the Council's and the ECB's powers in this field.

Financial provisions

Appointment of independent auditors

Article 36(1) of the Law on BNR, which provides that the annual financial statements of Banca Națională a României are audited by financial auditors that are legal entities authorised by the Financial Auditors Chamber in Romania and selected by the Board of Banca Națională a României through a tender procedure, does not recognise the ECB's and the Council's powers under Article 27.1 of the Statute.

Financial reporting

Article 37(3) of the Law on BNR, which provides that Banca Națională a României establishes the templates for the annual financial statements after having consulted the Ministry of Public Finance, and Article 40 of the Law on BNR, which provides that Banca Națională a României adopts its own regulations on organising and conducting its accounting, in compliance with the legislation in force and having regard to the advisory opinion of the Ministry of Public Finance, and that Banca Națională a României registers its economic and financial operations in compliance with its own chart of accounts, also having regard to the advisory opinion of the Ministry of Public Finance, do not reflect Banca Națională a României's obligation to comply with the Eurosystem's regime for financial reporting of NCB operations, pursuant to Article 26 of the Statute.

Exchange rate policy

Article 2(2)(a) and (d), Article 9 and Article 33(1)(a) of the Law on BNR, which empower Banca Națională a României to conduct exchange rate policy, do not recognise the Council's and the ECB's powers in this field.

Articles 10 and 11 of the Law on BNR, which allow Banca Națională a României to draw up regulations on monitoring and controlling foreign currency transactions in Romania and to authorise foreign currency capital operations, transactions on foreign currency markets and other specific operations, do not recognise the Council's and the ECB's powers in this field.

7.5.6 Miscellaneous

With regard to Article 3(2) of the Law on BNR, which entitles Banca Națională a României to be consulted on draft national legislation, consulting Banca Națională a României does not obviate the need to consult the ECB under Articles 127(4) and 282(5) of the Treaty.

Article 57 of the Law on BNR does not recognise the ECB's powers to impose sanctions.

Article 4(5) of the Law on BNR entitles Banca Națională a României to conclude short-term credit arrangements and to perform other financial and banking operations with other entities, including central banks, and provides that such arrangements are possible only if the credit is repaid within one year. The ECB notes that such a limitation is not foreseen in Article 23 of the Statute.

7.5.7 Conclusions

The Law on BNR does not comply with all the requirements for central bank independence, the monetary financing prohibition and legal integration into the Eurosystem. Romania is a Member State with a derogation and must therefore comply with all adaptation requirements under Article 131 of the Treaty.

7.6 Sweden

7.6.1 Compatibility of national legislation

The following legislation forms the main legal basis for Sveriges Riksbank and its operations:

- the Instrument of Government,²⁸³ which forms part of the Swedish Constitution,
- the Law on Sveriges Riksbank,²⁸⁴
- the Law on exchange rate policy.²⁸⁵

The Law on Sveriges Riksbank, which entered into force on 1 January 2023, was substantially reviewed²⁸⁶. Hence, substantial changes were made in relation to the points identified in the ECB's Convergence Report of June 2022.

²⁸³ SFS 1974:152.

²⁸⁴ SFS 2022:1568.

²⁸⁵ SFS 1998:1404.

7.6.2 Independence of the NCB

With regard to Sveriges Riksbank's independence, the Instrument of Government and the Law on Sveriges Riksbank need to be adapted in the respects set out below.

Institutional independence

Article 13 of Chapter 9 of the Instrument of Government states that Sveriges Riksbank is an authority under the Swedish Parliament and that Sveriges Riksbank is responsible for formulating and implementing monetary policy, implementing currency interventions, holding and managing a foreign currency reserve, promoting a well-functioning payment system and carrying out other basic tasks pursuant to special legislation. Article 15 of Chapter 9 of the Instrument of Government states that no public authority may determine how Sveriges Riksbank is to decide in matters for which it is responsible under Article 13 and that Sveriges Riksbank may not request or receive instructions from anyone within these areas of responsibility. The Law on Sveriges Riksbank contains a distinction between Sveriges Riksbank's monetary policy objectives, tasks and powers in Chapter 2, and its financial stability objectives, tasks and powers in Chapter 3. A narrow conceptualisation of monetary policy and a broad conceptualisation of financial stability, combined with the prohibition on Sveriges Riksbank seeking and taking instructions pursuant to the Instrument of Government applying only in the area of monetary policy, would not provide the legally required compatibility with the Treaties and the Statute of the ESCB.²⁸⁷

Article 3 of Chapter 2 of the Law on Sveriges Riksbank states that Sveriges Riksbank shall, with the approval of the Swedish Parliament, decide on the specification of the price stability objective. The rights of third parties to approve, suspend, annul and defer an NCB's decisions are contrary to NCBs' institutional independence and incompatible with the Treaty and the Statute of the ESCB as far as ESCB-related tasks are concerned. The Swedish Parliament's right to approve or reject Sveriges Riksbank's decisions on the design of the price stability objective is therefore inconsistent with Article 130 of the Treaty.²⁸⁸

Article 1(3) of Chapter 6 of the Law on Sveriges Riksbank states that Sveriges Riksbank in its international activities shall be guided by the overall positions of the Swedish Government and the Swedish Parliament in various policy areas. This entails a risk of the Swedish Parliament influencing Sveriges Riksbank in a way that is not compatible with Article 130 of the Treaty. Therefore, this obligation should be set out in the Law on Sveriges Riksbank without prejudice to Sveriges Riksbank's independence under the Treaty.²⁸⁹

²⁸⁶ On 20 April 2020, the ECB delivered an opinion (Opinion CON/2020/13) on the Law on Sveriges Riksbank in its initially proposed form, together with proposed amendments to the Instrument of Government, the Law on exchange rate policy and other legislation included in the Swedish Government's Official Report published on 29 November 2019 (SOU 2019:46 – En ny riksbankslag).

²⁸⁷ See paragraphs 1.5, 2.7, 3.1, 3.2 and 7.2.1 Opinion CON/2020/13.

²⁸⁸ See Convergence Report, June 2022, p. 22 and paragraphs 2.5 and 4.2.2 of Opinion CON/2020/13.

²⁸⁹ See paragraph 11.2.3 of Opinion CON/2020/13.

Financial independence

Article 3 of Chapter 10 of the Law on Sveriges Riksbank provides that Sveriges Riksbank may only restore its foreign reserves for financial stability purposes. These constraints on Sveriges Riksbank's ability to increase its foreign reserves whenever necessary in pursuance of its independently formulated monetary, foreign exchange and liquidity policies clearly encroach on Sveriges Riksbank's independence under the Treaty and Statute of the ESCB in the performance of its basic monetary, foreign exchange and liquidity policies, jeopardising its capacity to achieve its Treaty-based primary objective of maintaining price stability.²⁹⁰

7.6.3 Monetary financing prohibition

Article 6(2) of Chapter 1 of the Law on Sveriges Riksbank partially reproduces Article 123 of the Treaty, which is supplemented by Regulation (EC) No 3603/93. Article 123 of the Treaty and Regulation (EC) No 3603/93 are directly applicable in the legal order of the Member State. There is a discrepancy between the wording of Article 123(2) of the Treaty and the relevant provisions of the Law on Sveriges Riksbank. The exemption from the monetary financing prohibition for publicly owned credit institutions set out in Article 123(2) of the Treaty is stated to apply only "in the context of the supply of reserves by central banks". This wording is absent from the Law on Sveriges Riksbank, thus expanding this exemption beyond the particular context envisaged under the Treaty. Nevertheless, in the event of a conflict between these provisions, the directly applicable Union provisions would prevail.²⁹¹ The ECB notes, however, that the reproduction of relevant provisions of Union law directly applicable in the legal order of the Member State is to be avoided²⁹².

Article 6(1) of Chapter 1 of the Law on Sveriges Riksbank provides that Sveriges Riksbank may not provide credits to or acquire debt instruments directly from the State, municipalities, regions or associations of municipalities, or legal persons over which the State, regions, municipalities or associations of municipalities, individually or jointly, exercise direct or indirect legal control, or institutions, bodies or offices within the European Union that are not central banks. However, this provision does not cover the public sector, including public undertakings of other Member States, and, therefore, needs to be adapted to be consistent with Article 123 of the Treaty.²⁹³

²⁹⁰ See paragraphs 2.12 and 8.2.3 of Opinion CON/2020/13 and paragraphs 3.4.3 and 3.4.5 Opinion CON/2017/17.

²⁹¹ See paragraph 5.2.2 of Opinion CON/2020/13.

²⁹² See Section 2.2.2 of this Convergence Report.

²⁹³ See Section 2.2.2 of this Convergence Report.

7.6.4 Legal integration of the NCB into the Eurosystem

With regard to Sveriges Riksbank's legal integration into the Eurosystem, the Law on Sveriges Riksbank, the Constitution and the Law on exchange rate policy need to be adapted in the respects set out below.

Economic policy objectives

Article 1 of Chapter 2 of the Law on Sveriges Riksbank provides that Sveriges Riksbank's overriding objective is to maintain permanently low and stable inflation (the price stability objective) and that without neglecting the price stability objective, the Riksbank shall contribute to the balanced development of production and employment, considering the real economy. However, the ECB notes that Article 1 is more limited than the objective of supporting the general economic policies in the Union as set out in Article 127(1) of the Treaty.

Tasks

Monetary policy

Article 13 of Chapter 9 of the Instrument of Government, which establish Sveriges Riksbank's powers in the field of monetary policy, do not recognise the ECB's powers in this field.

Articles 4, 5 and 6 of Chapter 2 of the Law on Sveriges Riksbank, which provide for Sveriges Riksbank's powers in the field of monetary policy, do not recognise the ECB's powers in this field.

Article 5 of Chapter 2 of the Law on Sveriges Riksbank states that Sveriges Riksbank may only purchase and sell financial instruments other than Swedish sovereign debt instruments when there are exceptional grounds. This restriction on Sveriges Riksbank's ability to purchase and sell financial instruments other than Swedish sovereign debt instruments constitutes a constraint in the context of Article 18 of the Statute of the ESCB, which allows the NCBs to buy and sell outright or under repurchase agreements and by lending or borrowing all manner of claims and marketable instruments, including instruments issued by sovereign and private issuers alike.²⁹⁴

Article 6 of Chapter 2 of the Law on Sveriges Riksbank, concerning Sveriges Riksbank's ability to require that a certain proportion of a financial company's investments or obligations should be equivalent to the company's deposits at Sveriges Riksbank (reserve requirement) and the payment of a financial penalty to the Swedish

²⁹⁴ See paragraph 6.2.3 of Opinion CON/2020/13.

Government in the event of a breach of this requirement, do not recognise the ECB's powers in this field.

Collection of statistics

Article 11 of Chapter 1 of the Law on Sveriges Riksbank, which establishes Sveriges Riksbank's powers relating to the collection of statistics, does not recognise the ECB's powers in this field.

Official foreign reserve management

Chapter 10 of the Law on Sveriges Riksbank, and Article 13 of Chapter 9 of the Instrument of Government, which provide for Sveriges Riksbank's powers in the field of foreign reserve management, do not recognise the ECB's powers in this field.

Payment systems

Article 13 of Chapter 9 of the Instrument of Government and Articles 1 to 5 and 8 of Chapter 3 of the Law on Sveriges Riksbank, which establish Sveriges Riksbank's powers with regard to the smooth operation of payment systems, do not recognise the ECB's powers in this field.

Issue of banknotes

Article 14 of Chapter 9 of the Instrument of Government and Chapter 4 of the Law on Sveriges Riksbank, which lay down Sveriges Riksbank's exclusive right to issue banknotes and coins, do not recognise the Council's and the ECB's powers in this field.

Financial provisions

Appointment of independent auditors

The Law on Sveriges Riksbank does not recognise the Council's and the ECB's powers under Article 27.1 of the Statute.

Exchange rate policy

Article 12 of Chapter 9 of the Instrument of Government and Chapter 10 of the Law on Sveriges Riksbank, together with the Law on exchange rate policy, lay down the powers of the Swedish Government and Sveriges Riksbank in the area of exchange

rate policy. These provisions do not recognise the Council's and the ECB's powers in this field.

International cooperation

Pursuant to Article 1 of Chapter 6 in the Law on Sveriges Riksbank, Sveriges Riksbank may serve as a liaison body in relation to international financial institutions of which Sweden is a member. This provision does not recognise the ECB's powers in this field.

Miscellaneous

With regard to Article 5(2) of Chapter 7 of the Law on Sveriges Riksbank, which provides for the General Council's right to submit consultation opinions on behalf of Sveriges Riksbank within its area of competence, it is noted that consulting Sveriges Riksbank does not obviate the need to consult the ECB under Articles 127(4) and 282(5) of the Treaty.

As specified in Chapter 2.2.4, the primacy of Union law and rules adopted thereunder also means that national laws on access by third parties to documents may not lead to infringements of the ESCB's confidentiality regime. The ECB understands that the Public Access to Information and Secrecy Act²⁹⁵ and any other relevant Swedish legislation will permit Sveriges Riksbank to apply it in a manner that ensures compliance with the ESCB's confidentiality regime.

7.6.5 Conclusions

Sweden is a Member State with a derogation and must therefore comply with all adaptation requirements under Article 131 of the Treaty. The ECB notes that the Treaty has obliged Sweden to adopt national legislation for integration into the Eurosystem since 1 June 1998. Despite the recent reform of Sveriges Riksbank, which should have aimed to achieve the required legal convergence, the Law on Sveriges Riksbank, the Instrument of Government, and the Law on exchange rate policy do not comply with all the requirements for central bank independence, the monetary financing prohibition and legal integration into the Eurosystem. Sweden has the legal duty to adapt its legislation to ensure compatibility with the Treaty and the Statute. Any legislative reform in Sweden should aim to gradually achieve consistency with ESCB standards²⁹⁶.

²⁹⁵ SFS 2009:400.

²⁹⁶ See paragraph 2.1 of Opinion CON/2020/13.

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For specific terminology please refer to the [ECB glossary](#) (available in English only).

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Conventions used in the tables

“-” data do not exist/data are not applicable
“.” data are not yet available