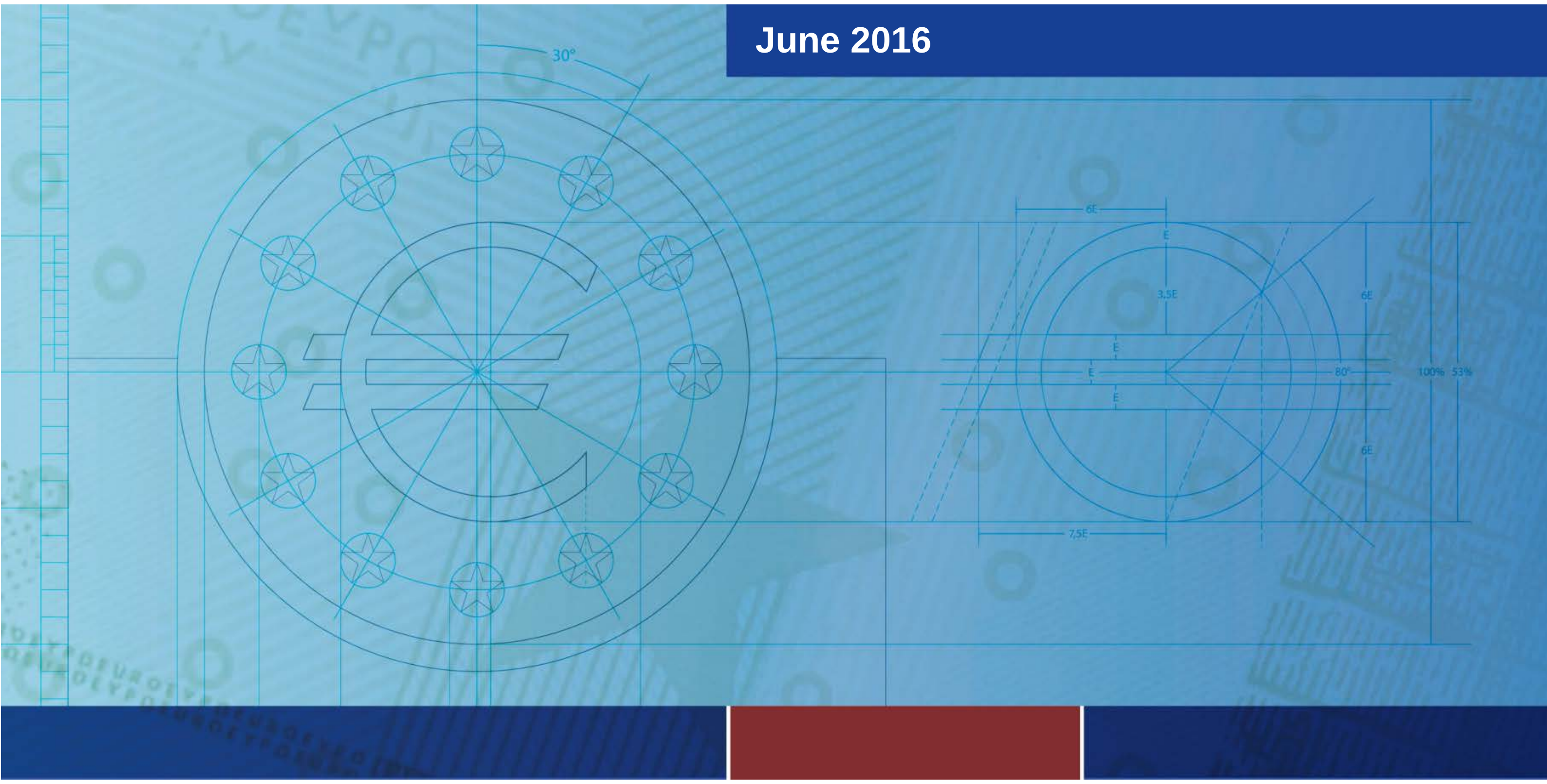
EUROPEAN CENTRAL BANK

EUROSYSTEM

Convergence Report



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1 Introduction

Since 1 January 1999 the euro has been introduced in 19 EU Member States; this report examines seven of the nine EU countries that have not yet adopted the single currency. Two of the nine countries, Denmark and the United Kingdom, gave notification that they would not participate in Stage Three of EMU. As a consequence, Convergence Reports only have to be provided for these two countries if they so request. Given the absence of such a request from either country, this report examines seven countries: Bulgaria, the Czech Republic, Croatia, Hungary, Poland, Romania and Sweden. All seven countries are committed under the Treaty on the Functioning of the European Union (hereinafter the "Treaty")[1] to adopt the euro, which implies that they must strive to fulfil all the convergence criteria.

In producing this report, the ECB fulfils its requirement under Article 140 of the Treaty. Article 140 says 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 Council of the European Union (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 seven 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 seven countries concerned, whether a high degree of sustainable economic convergence has been achieved, whether the national legislation is compatible with the Treaties and the Statute of the European System of Central Banks and of the European Central Bank (Statute), and whether the statutory requirements are fulfilled for the relevant 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, particularly government finance 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] See also the clarification of the terms "Treaty" and "Treaties" in the glossary.

It should be also recalled that, from 4 November 2014 onwards,[2] any country whose derogation is abrogated must join the Single Supervisory Mechanism (SSM) at the latest on the date on which it adopts the euro. From then on all SSM-related rights and obligations apply to that country. It is, therefore, of 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, will be subject to a comprehensive assessment.[3]

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 seven 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.

2 This is the date when 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, Article 33(2).

3 See recital 10 of Regulation ECB/2014/17 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).

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 throughout all 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. The examination of the Member State concerned based on all these factors is important to ensure that its integration into the euro area will proceed without major difficulties. Boxes 1 to 5 below briefly recall 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 (and prior to this by the EMI) in order to ensure continuity and equal treatment. In particular, a number of guiding principles are used by the ECB 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. 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 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 and the pursuit of appropriate policies after the adoption of the euro.

The common framework is applied individually to the seven 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 18 May 2016. The statistical data used in the application of the convergence criteria were 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. Convergence data on price and long-term interest rate developments are presented up to April 2016, the latest month for which data on HICPs were available. For monthly data on exchange rates, the period considered in this report ends in April 2016. Historical data for fiscal positions cover the period up to 2015. Account is also taken of forecasts from various sources, together with the most recent convergence programme of the Member State concerned and other information relevant to a forward-looking examination of the sustainability of convergence. The European Commission's Spring 2016 Economic Forecast and the Alert Mechanism Report 2016, which are taken into account in this report, were released on 4 May 2016 and 26 November 2015 respectively. This report was adopted by the General Council of the ECB on 31 May 2016.

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 latest available 12-month average of the HICP over the previous 12-month average. Hence, with regard to the rate of inflation, the reference period considered in this report is May 2015 to April 2016.

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 following three Member States: Bulgaria (-1.0%), Slovenia (-0.8%), and Spain (-0.6%). As a result, the average rate is -0.8% and, adding 1½ percentage points, the reference value is 0.7%. 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.

The inflation rates of Cyprus and Romania have been excluded from the calculation of the reference value. Price developments in these countries over the reference period resulted in a 12-month average inflation rate in April 2016 of -1.8% and -1.3% respectively. These two countries have been treated as "outliers" for the calculation of the reference value, as in both countries inflation rates were significantly lower than the comparable rates in other Member States over the reference period and this was due, in both countries, to exceptional factors. Cyprus has been undergoing an extraordinarily deep recession, with the result that its price developments have been dampened by an exceptionally large negative output gap. In Romania, the successive VAT cuts introduced recently are strongly affecting price developments, keeping HICP inflation in negative territory.

It should be noted that the concept of "outlier" has been referred to in previous ECB Convergence Reports (see, for example, the 2012, 2013 and 2014 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 comparable rates in other Member States; and second, its price developments have been strongly affected by exceptional factors. The identification of outliers does not follow any mechanical approach. The approach used was introduced to deal appropriately with potential significant distortions in the inflation developments of individual countries.

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 2 of Chapter 6).

The average rate of HICP inflation over the 12-month reference period from May 2015 to April 2016 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, among other things, factors influencing 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 for 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). According to 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 Council Regulation (EC) No 1467/97[4] as amended by Regulation (EU) No 1177/2011[5], which among other things:

- confirms the equal footing of the debt criterion with the deficit criterion by making the former operational, while allowing for a three-year period of transition for Member States exiting EDPs opened before 2011. Article 2(1a) of the Regulation provides that when it exceeds the reference value, the ratio of the government debt to GDP shall be considered sufficiently diminishing and approaching the reference value at a satisfactory pace if the differential with respect to the reference value has decreased over the previous three years at an average rate of one twentieth per year as a benchmark, based on changes over the last three years for which the data are available. The requirement under the debt criterion shall also be considered to be fulfilled if the required reduction in the differential looks set to occur over a defined three-year period, based on the Commission's budgetary forecast. In implementing the debt reduction benchmark, the influence of the economic cycle on the pace of debt reduction shall be taken into account;

- 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 specifies 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).

Moreover, the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG), which builds on the provisions of the enhanced Stability and Growth Pact, was signed on 2 March 2012 by 25 EU Member States (all EU Member States except the United

4 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.

5 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.

Kingdom, the Czech Republic and Croatia) and entered into force on 1 January 2013.[6] Title III (Fiscal Compact) provides, among other things, for a binding fiscal rule aimed at ensuring that the general government budget is balanced or in surplus. This rule is deemed to be respected if the annual structural balance meets the country-specific medium-term objective and does not exceed a deficit – in structural terms – of 0.5% of GDP. If the government debt ratio is significantly below 60% of GDP and risks to long-term fiscal sustainability are low, the medium-term objective can be set at a structural deficit of at most 1% of GDP. The TSCG also includes the debt reduction benchmark rule referred to in Council Regulation (EU) No 1177/2011, which has amended Council Regulation (EC) 1467/97.[7] The signatory Member States are required to introduce in their constitution – or equivalent law of higher level than the annual budget law – the stipulated fiscal rules accompanied by an automatic correction mechanism in case of deviation from the fiscal objective.

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 2006 to 2015, the outlook and the challenges for general government finances, and focuses on the links between deficit and debt developments. The ECB provides an analysis with respect to the effectiveness of national budgetary frameworks, as referred to in Article 2(3)(b) of Council Regulation (EC) No 1467/97 and in Council Directive 2011/85/EU.[8] Moreover, the expenditure rule as set out in Article 9(1) of Council Regulation (EC) No 1466/97[9] as amended by regulation (EU) No 1175/2011 aims to ensure a prudent financing of expenditure increases. Under the rule, among other things, EU Member States that have not yet reached their medium-term budgetary objective should ensure that the annual growth of relevant primary expenditure does not exceed a reference medium-term rate of potential GDP growth, unless the excess is matched by discretionary revenue measures. The ECB reports the European Commission's latest assessment of Member States' compliance with the expenditure rule. 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 laid down in Article 2(1a) of Council Regulation (EC) No 1467/97.

The examination of fiscal developments is based on data compiled on a national accounts basis, in compliance with the ESA 2010 (see Chapter 6). Most of the figures presented in this report were

6 The TSCG applies also to those EU Member States with a derogation that have ratified it, as from the date when the decision abrogating that derogation takes effect or as from an earlier date if the Member State concerned declares its intention to be bound at such earlier date by all or part of the provisions of the TSCG.

7 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.

8 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.

9 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.

provided by the Commission in April 2016 and include government financial positions from 2006 to 2015 as well as Commission forecasts for 2016-17.

With regard to the sustainability of public finances, the outcome in the reference year, 2015, 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 considered 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. Indeed, assessing how structural budgetary positions have changed during the crisis is particularly difficult in view of uncertainty over the level and growth rate of potential output.

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. It can also provide more information on the contribution of fiscal consolidation efforts, as reflected in the primary balance, and on the role played by special factors, as included in the deficit-debt adjustment. In addition, the structure of government debt is considered, by focusing in particular on the shares of debt with a short-term maturity and foreign currency debt, as well as their development. By 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.

Turning to a forward-looking perspective, national budget plans and recent forecasts by the European Commission for 2016-17 are considered, and account is taken of the medium-term fiscal strategy, as reflected in the convergence programme. This includes an assessment of the projected attainment of the country's medium-term budgetary objective, as foreseen in the Stability and Growth Pact, as well as of the outlook for the debt ratio on the basis of current fiscal policies. Finally, long-term challenges to the sustainability of budgetary positions and broad areas for consolidation are emphasised, particularly those related to the issue of unfunded government pension systems in connection with demographic change and to contingent liabilities incurred by the government, especially during the financial and economic crisis. In line with past practices, the analysis described above also covers most of the relevant factors identified in Article 2(3) of Council Regulation (EC) No 1467/97 as described in Box 2.

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

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 19 May 2014 to 18 May 2016. 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 are 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 benefited from central bank liquidity assistance or balance of payments support, either bilaterally or multilaterally with the involvement of the IMF and/or the EU. Both actual and precautionary assistance are considered, including access to precautionary financing in the form of, for instance, the IMF's Flexible Credit Line.

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 May 2015 to April 2016.

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 entering 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 best performing countries in terms of price stability were 1.7% (Slovenia), 1.7% (Spain) and 2.5% (Bulgaria). As a result, the average rate is 2.0% and, adding 2 percentage points, the reference value is 4.0%. 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).

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 May 2015 to April 2016 are reviewed against the background of the path of long-term interest rates over the past ten years (or otherwise 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 partly reflected the high country-specific risk premia of 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 indicators (the outstanding amount of debt securities issued by non-financial corporations, stock market capitalisation and MFI credit to the domestic private sector), which, together, measure 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 recalls 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 Articles 121(3) and 121(4) of the Treaty. These rules were adopted "in order to ensure closer coordination of economic policies and sustained convergence of the economic performances of the Member States" (Article 121(3)), following 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".[10] 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. The MIP, with both preventive and corrective arms, applies to all EU Member States, except those which, being under an international financial assistance programme, are already subject to closer scrutiny coupled with conditionality. The MIP includes an alert mechanism for the early detection of imbalances, based on a transparent scoreboard of indicators with alert thresholds for all EU Member States, combined with economic judgement. This judgement should take into account, among other things, nominal and real convergence inside and outside the euro area.[11] When assessing macroeconomic imbalances, this procedure should take due account of their severity and their potential negative economic and financial spillover effects, which aggravate the vulnerability of the EU economy and threaten the smooth functioning of EMU.[12]

2. Application of Treaty provisions

In line with past practices, 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 by 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 by Article 140(1) of the Treaty.

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[10] See 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, recital 2.

[11] See Regulation (EU) No 1176/2011, Article 4(4).

[12] See Regulation (EU) No 1176/2011, recital 17.

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 between the national legislation of each Member State with a derogation, including the statutes of its NCB, and 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. 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.[13] 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, Croatia, 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.[14] As far as the other Member States are concerned, Articles 4[15] and 5[16] of the Acts concerning the conditions of accession provide that each of

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13 Opinions CON/2010/37 and CON/2010/91.

14 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.

15 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).

these Member States shall participate in 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 or the United Kingdom, which are Member States with a special status and which have 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, Danmarks 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, Danmarks Nationalbank does not need to be legally integrated into the Eurosystem and no Danish legislation needs to be adapted.

According to Protocol (No 15) on certain provisions relating to the United Kingdom of Great Britain and Northern Ireland, annexed to the Treaties, the United Kingdom is under no obligation to adopt the euro unless it notifies the Council that it intends to do so. On 30 October 1997 the United Kingdom notified the Council that it did not intend to adopt the euro on 1 January 1999 and this situation has not changed. Pursuant to this notification, certain provisions of the Treaty (including Articles 130 and 131) and of the Statute do not apply to the United Kingdom. Accordingly, there is no current legal requirement to ensure that national legislation (including the Bank of England's statutes) is compatible with the Treaty and the Statute.

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.

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[16] 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).

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.[17]

The compatibility of national legislation is considered in the light of legislation enacted before 20 March 2016.

2.2.2 Scope of adaptation

2.2.2.1 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 in the Treaty (Article 130) and the Statute (Articles 7 and 14.2) and 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) and 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).

2.2.2.2 '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 removed. Neither the supremacy 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 EU's exclusive competence in monetary matters. Indeed, Article 14.4

[17] In particular the ECB's Convergence Reports of 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.

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 ESCB's objectives and tasks. 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.[18]

The Treaties and the Statute do not prescribe the manner in which national legislation should be adapted. This may be achieved by referring to the Treaties and the Statute, or by incorporating provisions thereof and referring to their provenance, or by deleting any incompatibility, or by a combination of these methods.

Furthermore, among other things 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 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 provisions[19] 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 and confidentiality are 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. Sweden had to bring the necessary adaptations into force by the date of establishment of the ESCB on 1 June 1998.

18 See, amongst others, Case 167/73 Commission of the European Communities v French Republic [1974] ECR 359 ('Code du Travail Maritime').

19 OJ L 189, 3.7.1998, p. 42.

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. It 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.

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

The principle of institutional independence is expressly referred to 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. If national legislation mirrors Article 130 of the Treaty and Article 7 of the Statute, it should reflect both prohibitions and not narrow the scope of their application.[20]

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

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.[21] 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.[22] 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.[23]

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20 Opinion CON/2011/104.

21 Opinion CON/2010/31.

22 Opinion CON/2009/93.

23 Opinion CON/2010/94.

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.

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. 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.[24]

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.

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 power does not impinge on the capacity of the individual NCB member

[24] Opinion CON/2014/25 and CON/2015/57.

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

The Statute's provision on security of tenure for members of NCBs' decision-making bodies further safeguards central bank independence. NCB Governors are members of the General Council of the ECB and will be members of the Governing Council upon adoption of the euro by their Member States. 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 the arbitrary dismissal of Governors by providing that Governors may only be relieved from office if they no longer fulfil the conditions required for the performance of their duties or if they have been guilty of serious misconduct, with the possibility of recourse to the Court of Justice of the European Union. 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.[25]

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 dismissal of a Governor are in line with those of Article 14.2 of the Statute. National legislation which provides for a 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.[26] When an NCB's 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.

Grounds for dismissal of Governors

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 this requirement is to prevent the authorities involved in the appointment of Governors, particularly the government or parliament, from exercising their discretion to dismiss a Governor. NCB statutes should either refer to Article 14.2 of the Statute, or incorporate its

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25 See, for example, Opinions CON/2010/56, CON/2010/80, CON/2011/104 and CON/2011/106.

26 Opinion CON/2012/89.

provisions and refer to their provenance, or delete any incompatibility with the grounds for dismissal laid down in Article 14.2, or omit any mention of grounds for dismissal (since Article 14.2 is directly applicable). Once elected or appointed, Governors may not be dismissed under conditions other than those mentioned in Article 14.2 of the Statute even if the Governors have not yet taken up their duties.

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

Personal independence would be jeopardised if the same rules for the security of tenure and grounds for dismissal of Governors were not also to apply to other members of the decision-making bodies of NCBs involved in the performance of ESCB-related tasks.[27] Various Treaty and Statute provisions require comparable security of tenure. Article 14.2 of the Statute does not restrict the security of tenure of office to Governors, while 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.

Right of judicial review

Members of the NCBs' decision-making bodies must have the right to submit any decision to dismiss them to an independent court of law, in order to limit the potential for political discretion in evaluating the grounds for their dismissal.

Article 14.2 of the Statute stipulates that NCB Governors who have been dismissed from office may refer such a decision to the Court of Justice of the European Union. National legislation should either refer to the Statute or remain silent on the right to refer such decision to the Court of Justice of the European Union (as Article 14.2 of the Statute is directly applicable).

National legislation should also provide for a right of review by the national courts of a decision to dismiss any other member of the decision-making bodies of the NCB involved in the performance of ESCB-related tasks. This right can either be a matter of general law or can 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 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. As a matter of principle, membership of a decision-making body involved in the performance of ESCB-related tasks is incompatible with the exercise

[27] The main formative ECB opinions in this area are: CON/2004/35; CON/2005/26; CON/2006/32; CON/2006/44; and CON/2007/6.

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

Even if an NCB is fully independent from a functional, institutional and personal point of view (i.e. this is guaranteed by the NCB's statutes), its overall independence 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).

Member States may not put their NCBs in a position where they have insufficient financial resources and inadequate net equity[28] to carry out their ESCB or Eurosystem-related tasks, as applicable. 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.[29] Moreover, Article 33.2 of the Statute provides[30] 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.

Additionally, the principle of financial independence requires an NCB to have sufficient means not only to perform its ESCB-related tasks but also its national tasks (e.g. financing its administration and own operations).

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. Any such situation may negatively impact on the NCB's ability to perform its ESCB-related tasks but also its national 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

[28] Opinions CON/2014/24, CON/2014/27 and CON/2014/56.

[29] Article 30.4 of the Statute only applies within the Eurosystem.

[30] Article 33.2 of the Statute only applies within the Eurosystem.

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.[31] 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;[32] NCBs should be financially able to respond to such ECB decision.

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 tasks but also over its ability to fulfil its mandate, both operationally in terms of manpower, and financially in terms of appropriate financial resources. The aspects of financial independence set out below are particularly relevant in this respect.[33] 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.

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, should be without prejudice to the activities of the NCB's independent external auditors[34] 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

[31] OJ L 115, 16.5.2000, p. 1.

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

[33] The main formative ECB opinions in this area are: 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.

[34] For the activities of the independent external auditors of the NCBs see Article 27.1 of the Statute.

the NCB's ESCB-related tasks.[35] The state audit should be done on a non-political, independent and purely professional basis.

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 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 as well as national tasks.

Profits may be distributed to the State budget only after any accumulated losses from previous years have been covered[36] and financial provisions deemed necessary to safeguard the real value of the NCB's capital and assets have been created. Temporary or ad hoc legislative measures amounting to instructions to the NCBs in relation to the distribution of their profits are not admissible.[37] Similarly, a tax on an NCB's unrealised capital gains would also impair the principle of financial independence.[38]

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 cooperation with the NCB, which is best placed to assess its required level of reserve capital.[39] 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.[40]

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.

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[35] Opinions CON/2011/9, CON/2011/53 and CON/2015/57.

[36] Opinion CON/2009/85.

[37] Opinion CON/2009/26 and Opinion CON/2013/15.

[38] Opinion CON/2009/63 and Opinion CON/2009/59.

[39] Opinion CON/2009/83 and Opinion CON/2009/53.

[40] Opinion CON/2009/26 and Opinion CON/2012/69.

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. Also, an NCB may not be put into a position where it has limited control or no control over its staff, or where the government of a Member State can influence its policy on staff matters.[41] 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, taking due account of its views, to ensure the ongoing ability of the NCB to independently carry out its tasks.[42] 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.[43]

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. 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. [44] NCBs should ensure that such bodies protect the confidentiality of information and documents disclosed at a level corresponding to that applied by the NCBs.

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41 Opinion CON/2008/9, Opinion CON/2008/10 and Opinion CON/2012/89.

42 The main Opinions are 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 and CON/2014/7.

43 Opinion CON/2014/38.

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

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 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.

2.2.5.1 Prohibition on monetary financing

The monetary financing prohibition is laid down in Article 123(1) of the Treaty, which prohibits overdraft facilities or any other type of credit facility with the ECB or the NCBs of Member States 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; and the purchase directly from these public sector entities by the ECB or NCBs of debt instruments. The Treaty contains one exemption from the 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). Moreover, the ECB and the NCBs may act as fiscal agents for the public sector bodies referred to above (Article 21.2 of the Statute). 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[45] which makes it clear that the prohibition includes any financing of the public sector's obligations vis-à-vis third parties.

The monetary financing prohibition is of essential importance to ensuring that the primary objective of monetary policy (namely to maintain price stability) is not impeded. Furthermore, central bank financing of the public sector lessens the pressure for fiscal discipline. 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.[46]

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[45] 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.

[46] See Convergence Report 2008, page 23, footnote 13, containing a list of formative EMI/ECB opinions in this area adopted between May 1995 and March 2008. Other formative ECB opinions in this area are: CON/2008/46; CON/2008/80; CON/2009/59 and CON/2010/4.

National legislation transposing the monetary financing prohibition

In general, it is unnecessary to transpose Article 123 of the Treaty, supplemented by Regulation (EC) No 3603/93, into national legislation as they are both directly applicable. If, however, national legislative provisions mirror these directly applicable EU provisions, they may not narrow the scope of application of the monetary financing prohibition or extend the exemptions available under EU law. For example, national legislation providing for the financing by the NCB of a Member State's financial commitments to international financial institutions (other than the IMF in the capacities foreseen in Regulation (EC) No 3603/93)[47] or to third countries is incompatible with the monetary financing prohibition.

Financing of the public sector or of public sector obligations to third parties

National legislation may not require an NCB to finance either the performance of functions by other public sector bodies or the public sector's obligations vis-à-vis third parties. In particular, national legislation may not confer on an NCB the task of financing the activities of third parties where such financing does not relate to any of the tasks and functions of the central bank, but is a responsibility of the government.[48] For example, national laws authorising or requiring an NCB to finance judicial or quasi-judicial bodies that are independent of the NCB and operate as an extension of the government are incompatible with the monetary financing prohibition. In order to ensure compliance with the monetary financing prohibition, a new task entrusted to an NCB must be fully and adequately remunerated if it is: (a) not a central bank task or an action that facilitates the performance of a central bank task; or (b) linked to a government task and performed in the government's interest.[49]

Important criteria for qualifying a new task as a government task are: (a) its atypical nature; (b) the fact that it is discharged on behalf of and in the exclusive interest of the government; and (c) its impact on the institutional, financial and personal independence of the NCB. In particular, a task may be qualified as a government task if the performance of the new task meets one of the following conditions: (a) it creates inadequately addressed conflicts of interests with existing central bank tasks; (b) it is disproportionate to the NCB's financial or organisational capacity; (c) it does not fit into the NCB's institutional set-up; (d) it harbours substantial financial risks and (e) it exposes the members of the NCB decision-making bodies to political risks that are disproportionate and that may also negatively impact on them in terms of their personal independence.[50]

47 Opinion CON/2013/16.

48 Opinion CON/2006/15.

49 Opinions CON/2011/30, CON/2015/36 and CON/2015/46.

50 Opinions CON/2015/22, CON/2015/36 and CON/2015/46.

Some of the new tasks conferred on NCBs that the ECB considers to be government tasks are: (a) tasks relating to financing resolution funds or financial arrangements as well as those relating to deposit guarantee or investor compensation schemes;[51] (b) tasks relating to the establishment of a central register of bank account numbers;[52] and (c) tasks of a credit mediator.[53] However, central bank tasks may be, inter alia, supervisory tasks or tasks relating to those supervisory tasks, such as those relating to consumer protection in the area of financial services,[54] supervision over credit-acquiring companies[55] or supervision of consumer credit providers and intermediaries.[56] Based on the understanding that administrative resolution tasks and supervisory tasks complement each other, tasks relating to the exercise of technical resolution powers and decision-making could also be considered central bank tasks provided that they do not undermine an NCB's independence in accordance with Article 130 of the Treaty and Article 7 of the Statute.[57] Thus, the provision of resources by an NCB to a supervisory authority does not give rise to monetary financing concerns insofar as the NCB will be financing the performance of a legitimate financial supervisory task under national law as part of its mandate, or as long as the NCB can contribute to and have influence on the decision-making of the supervisory authorities.[58]

Moreover, no bridge financing may be provided by an NCB to enable a Member State to honour its obligations in respect of State guarantees of bank liabilities.[59] Also, the distribution of central bank profits which have not been fully realised, accounted for and audited does not comply with the monetary financing prohibition. 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 remunerated at market value and the transfer should take place at the same time as the remuneration.[60]

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.[61]

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51 Opinions CON/2011/103 and CON/2012/22. See also section entitled ‘Financial support for resolution funds or financial arrangements and deposit insurance or investor compensation schemes’ for some specific cases.

52 Opinions CON/2015/36 and CON/2015/46.

53 Opinion CON/2015/12.

54 Opinion CON/2007/29.

55 Opinion CON/2015/45.

56 Opinion CON/2015/54.

57 Opinion CON/2015/22.

58 Opinion CON/2010/4.

59 Opinion CON/2012/4.

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

61 Opinion CON/2009/63.

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.[62] Along the same lines, national legislation that requires an NCB to obtain approval from the government prior to taking resolution actions under a broad range of circumstances, but which does not limit the NCB's liability to its own administrative acts, would be incompatible with the monetary financing prohibition.[63]

Financial support for credit and/or financial institutions

National legislation which provides for financing by an NCB, granted independently and at their full discretion, of credit institutions other than in connection with central banking tasks (such as monetary policy, payment systems or temporary liquidity support operations), in particular the support of insolvent credit and/or other financial institutions, would be incompatible with the monetary financing prohibition.

This applies, in particular, to the support of insolvent credit institutions. The rationale is that by financing an insolvent credit institution, an NCB would be assuming a government task.[64] The same concerns 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.[65] 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.[66]

62 Opinion CON/2013/56.

63 Opinion CON/2015/22.

64 Opinion CON/2013/5.

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

66 Opinion CON/2012/4, footnote 42 referring to further relevant Opinions in this field.

To this end, inserting references to Article 123 of the Treaty in national legislation should be considered.

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

While administrative resolution tasks are generally considered as related to those referred to in Article 127(5) of the Treaty, the financing of any resolution fund or financial arrangement is not in line with the monetary financing prohibition.[67] 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.[68] To this end, national legislation should clarify that the NCB will not assume or finance any of these entities' obligations.[69]

The Deposit Guarantee Schemes Directive[70] and the Investor Compensation Schemes Directive[71] provide that the costs of financing deposit guarantee schemes and investor compensation schemes must be borne, respectively, by credit institutions and investment firms themselves. 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 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.[72] To this end, inserting references to Article 123 of the Treaty in national legislation should be considered. When exercising its discretion to grant a loan, the NCB must ensure that it is not de facto taking over a government task.[73] In particular, central bank support for deposit guarantee schemes should not amount to a systematic pre-funding operation.[74]

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 enable NCBs to continue to provide the fiscal agent service

67 Opinion CON/2015/22.

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

69 Opinions CON/2015/33 and CON/2015/35.

70 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).

71 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).

72 Opinion CON/2015/40.

73 Opinions CON/2011/83 and CON/2015/52.

74 Opinion CON/2011/84.

traditionally provided by central banks to governments and other public entities without automatically breaching the monetary financing prohibition. 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;[75] (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;[76] 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.[77]

National legislation on the fiscal agency function should be compatible with EU law in general, and with the monetary financing prohibition in particular.[78] Taking into account the express recognition in Article 21.2 of the Statute of the provision of fiscal agency services as a legitimate function traditionally performed by NCBs, the provision by central banks of fiscal agency services complies with the prohibition on monetary financing, 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.[79] 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 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 the prohibition's objectives. 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.[80] 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.[81]

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

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

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

78 Opinion CON/2013/3.

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

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

81 Opinion CON/2012/9.

2.2.5.2 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.'

Under Article 1(1) of Council Regulation (EC) No 3604/93,[82] 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.[83] Member States' legislation in this area may not establish such privileged access.

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.[84] In the area of prudential supervision, EU secondary legislation has established a number of requirements to ensure the soundness of credit institutions.[85] 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.[86] Additionally, credit institutions are commonly referred to as 'banks' and require an authorisation by a competent Member State authority to provide services.[87]

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[82] 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 is now Article 124 of the Treaty.

[83] See Article 3(2) of and recital 10 of Regulation (EC) No 3604/93.

[84] Opinion of Advocate General Elmer in Case C-222/95 *Parodi v Banque H. Albert de Bary* [1997] ECR I-3899, paragraph 24.

[85] See: (i) 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 (ii) 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).

[86] See point (1) of Article 4(1) of Regulation (EU) No 575/2013.

[87] See Article 8 of Directive 2013/36/EU.

Although minimum reserves might be seen as a part of prudential requirements, they are usually part of an NCB's operational framework and used as a monetary policy tool in most economies, including in the euro area.[88] In this respect, paragraph 2 of Annex I to Guideline ECB/2014/60[89] 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.[90] 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.[91]

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.

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'.[92] Consistent with this, Council Regulation (EC) No 974/98 of 3 May 1998 on the introduction of the euro[93] 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.

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

[89] 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).

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

[91] 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).

[92] 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'.

[93] OJ L 139, 11.5.1998, p. 1.

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. While this principle applies to all types of 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 which 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 an NCB's compliance with the Eurosystem's requirements. These include provisions that could prevent the NCB from taking part in implementing the single monetary policy, as defined by the ECB's decision-making bodies, or hinder a Governor from fulfilling their duties as a member of the ECB's Governing Council, or which do not respect the ECB's prerogatives. Distinctions are made between economic policy objectives, tasks, financial provisions, exchange rate policy and international cooperation. Finally, other areas where an NCB's statutes may need to be adapted are mentioned.

2.2.7.1 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.[94]

2.2.7.2 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.[95] 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.[96] 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.

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.[97] 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.[98]

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

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

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

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

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

98 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.

implementation of the single monetary policy. In particular, this applies to the extension of State guarantees to cover interbank deposits.[99]

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.[100]

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, while the right to issue euro banknotes belongs to the ECB and the NCBs. National legislative provisions enabling the government to influence issues such as the denominations, production, volume or withdrawal of euro 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 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.[101]

With regard to foreign reserve management,[102] any Member State that has adopted the euro and which does not transfer its official foreign reserves[103] 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

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99 Opinions CON/2009/99 and CON/2011/79.

100 Opinion CON/2010/8.

101 Opinion CON/2008/34.

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

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

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 requirements and to make timely preparations in the field of statistics in order for them to become Member States whose currency is the euro.[104] 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.[105]

2.2.7.3 Financial provisions

The financial provisions in the Statute comprise rules on financial accounts,[106] auditing,[107] capital subscription,[108] the transfer of foreign reserve assets[109] and the allocation of monetary income.[110] NCBs must be able to comply with their obligations under these provisions and therefore any incompatible national provisions must be repealed.

2.2.7.4 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.

2.2.7.5 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).

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[104] Opinion CON/2013/88.

[105] Opinion CON/2015/5 and CON/2015/24.

[106] Article 26 of the Statute.

[107] Article 27 of the Statute.

[108] Article 28 of the Statute.

[109] Article 30 of the Statute.

[110] Article 32 of the Statute.

2.2.7.6 Miscellaneous

In addition to the above issues, in the case of 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).

3 The state of economic convergence

Compliance with the convergence criteria has increased since the ECB's 2014 Convergence Report, with progress made in several countries in bringing inflation rates down towards euro area levels (see Table 3.1). Progress has also been made in all countries in reducing fiscal imbalances. However, none of the countries examined in this report participates in ERM II, and some countries' currencies have experienced sizeable fluctuations against the euro over the last few years. Finally, significant progress has been achieved in reducing long-term interest rate differentials versus the euro area.

Table 3.1

Overview table of economic indicators of convergence

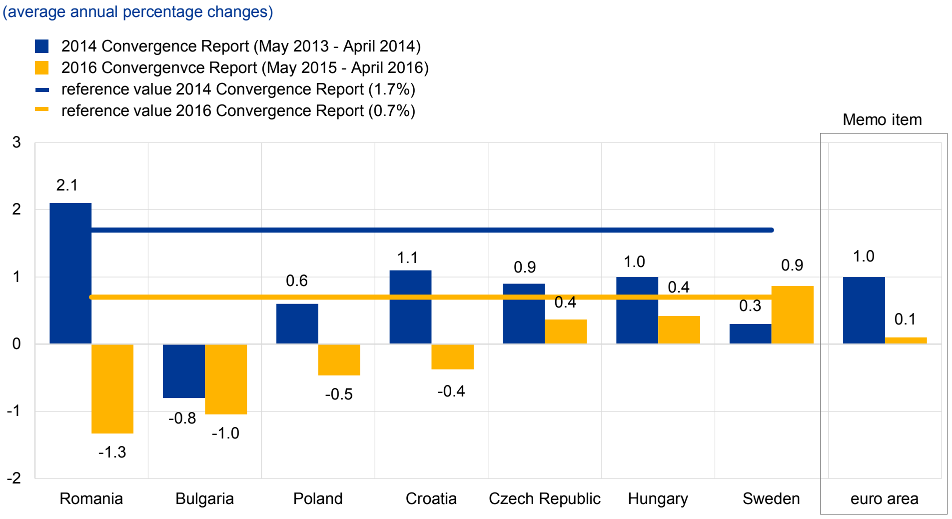
		Price stability	Government budgetary developments and projections			Exchange rate		
		HICP inflation 1)	Country in excessive deficit 2), 3)	General government surplus (+)/ deficit (-) 4)	General Government debt 4)	Currency participating in ERM II 3)	Exchange rate vis-à-vis euro 3), 5)	Long-term interest rate 6)
Bulgaria	2014	-1.6	No	-5.4	27.0	No	0.0	3.3
	2015	-1.1	No	-2.1	26.7	No	0.0	2.5
	2016	-1.0	No	-2.0	28.1	No	0.0	2.5
Czech Republic	2014	0.4	No	-1.9	42.7	No	-6.0	1.6
	2015	0.3	No	-0.4	41.1	No	0.9	0.6
	2016	0.4	No	-0.7	41.3	No	0.9	0.6
Croatia	2014	0.2	Yes	-5.5	86.5	No	-0.7	4.1
	2015	-0.3	Yes	-3.2	86.7	No	0.3	3.6
	2016	-0.4	Yes	-2.7	87.6	No	0.5	3.7
Hungary	2014	0.0	No	-2.3	76.2	No	-4.0	4.8
	2015	0.1	No	-2.0	75.3	No	-0.4	3.4
	2016	0.4	No	-2.0	74.3	No	-0.7	3.4
Poland	2014	0.1	Yes	-3.3	50.5	No	0.3	3.5
	2015	-0.7	No	-2.6	51.3	No	0.0	2.7
	2016	-0.5	No	-2.6	52.0	No	-4.2	2.9
Romania	2014	1.4	No	-0.9	39.8	No	-0.6	4.5
	2015	-0.4	No	-0.7	38.4	No	0.0	3.5
	2016	-1.3	No	-2.8	38.7	No	-1.0	3.6
Sweden	2014	0.2	No	-1.6	44.8	No	-5.2	1.7
	2015	0.7	No	0.0	43.4	No	-2.8	0.7
	2016	0.9	No	-0.4	41.3	No	0.6	0.8
Reference value 7)		0.7		-3.0	60.0			4.0

Sources: European Commission (Eurostat, DG ECFIN) and European System of Central Banks.
1) Average annual percentage change. Data for 2016 refer to the period from May 2015 to April 2016.
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 2016 refers to the period up to the cut-off date for statistics (18 May 2016).
4) As a percentage of GDP. Data for 2016 are taken from the European Commission's Spring 2016 Economic Forecast.
5) Average annual percentage change. A positive (negative) number denotes an appreciation (depreciation) vis-à-vis the euro.
6) Average annual interest rate. Data for 2016 refer to the period from May 2015 to April 2016.
7) The reference values for HICP inflation and long-term interest rates refer to the period from May 2015 to April 2016; for the general government balance and debt, the reference values are defined in Article 126 of the Treaty on the Functioning of the European Union and the related Protocol (No 12) on the excessive deficit procedure.

The economic environment has become more favourable since the publication of the last Convergence Report. Economic activity has started to gain momentum again in most EU Member States and gradually become broader-based in the countries covered by the report. This reflects the impact of rising real disposable incomes supported by the absence of inflationary pressures in most countries, accommodative monetary policies and increasing signs of economic stabilisation in several euro area countries. The incipient recovery has led to significant improvements in the labour market in almost all countries under review; in Croatia unemployment has remained very high. In all countries further progress has been made with regard to correcting external imbalances and reducing the dependence on external funding, particularly in the banking sector. This enhanced the resilience of most of the countries under review during the recent episodes of turmoil in emerging markets outside the EU. However, individual countries still have significant vulnerabilities of various kinds, which, if not adequately tackled, are likely to restrain the convergence process over the long term.

Regarding the price stability criterion, the 12-month average inflation rate was below – in some cases well below – the reference value of 0.7% in six of the seven countries examined in this report (see Chart 3.1). Bulgaria, Croatia, Poland and Romania recorded negative inflation rates. In Sweden inflation was above the reference value. In the 2014 Convergence Report, Romania was the only country that recorded an inflation rate above the then applicable reference value of 1.7%.

Chart 3.1
HICP inflation



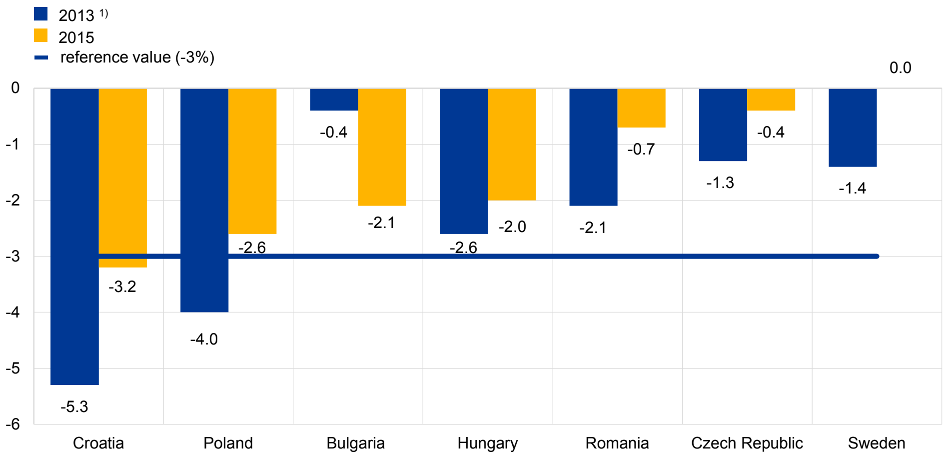
Source: Eurostat.

As regards the fiscal criteria, among the countries under review, only Croatia is, at the time of publication of this report, subject to an EU Council decision on the existence of an excessive deficit. This is in contrast to the situation identified in the 2014 Convergence Report, when the Czech Republic and Poland were also subject to excessive deficit procedures; these procedures were abrogated in June 2014 (Czech Republic) and June 2015 (Poland). In 2015, the headline fiscal balance stood at or below the 3% of GDP reference value in all countries except Croatia, whereas in the 2014 report Croatia and Poland were reported as having posted a fiscal deficit-to-GDP ratio above 3% in 2013 (see Chart 3.2a). As in the 2014 Convergence Report, Croatia and Hungary were in 2015 the only countries with a general government debt-to-GDP ratio above the 60% reference value. In Croatia the debt ratio was notably higher compared with the 2013 data, while in Hungary it was slightly lower. Poland’s debt-to-GDP ratio was above 50% in 2015. In the Czech Republic and Sweden the ratio was below 50%, in Romania it was below 40%, and in Bulgaria it was below 30% (see Chart 3.2b).

Chart 3.2 a

General government surplus (+) or deficit (-)

(percentages of GDP)

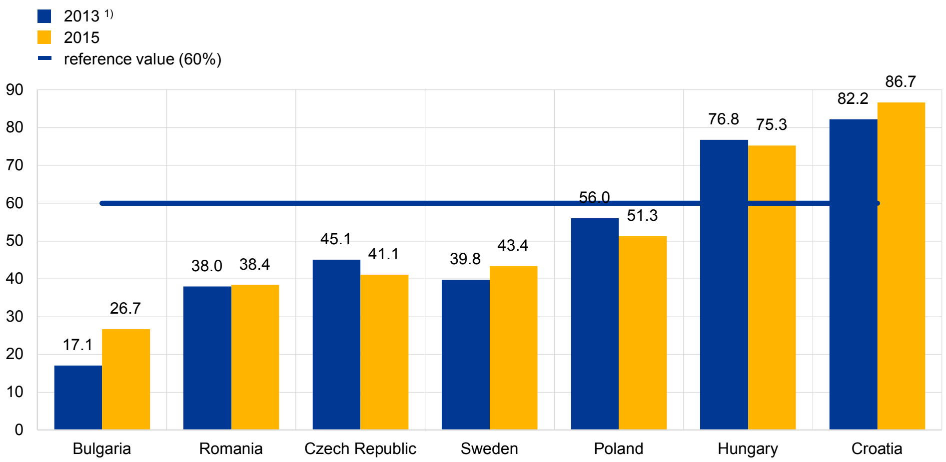


Source: Eurostat.
1) Data have been revised slightly since the 2014 Convergence Report.

Chart 3.2 b

General government gross debt

(percentages of GDP)



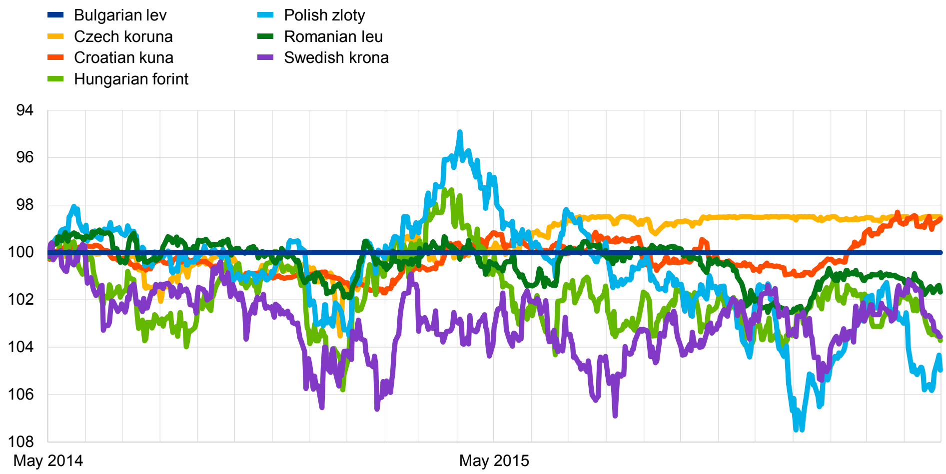
Source: Eurostat.
1) Data have been revised slightly since the 2014 Convergence Report.

As regards the exchange rate criterion, none of the countries under review participates in ERM II. In several countries the exchange rate exhibited a relatively high degree of volatility over the two-year reference period. Exceptions were the currencies of Bulgaria and Croatia; the former country has a currency board vis-à-vis the euro, while the latter operates a tightly managed float. Most other currencies under review weakened against the euro over the reference period, most notably the Polish zloty (see Chart 3.3). By contrast, the Czech koruna and the Croatian kuna strengthened modestly against the euro.

Chart 3.3

Bilateral exchange rates vis-à-vis the euro

(daily data; average of May 2014 = 100; 19 May 2014-18 May 2016)



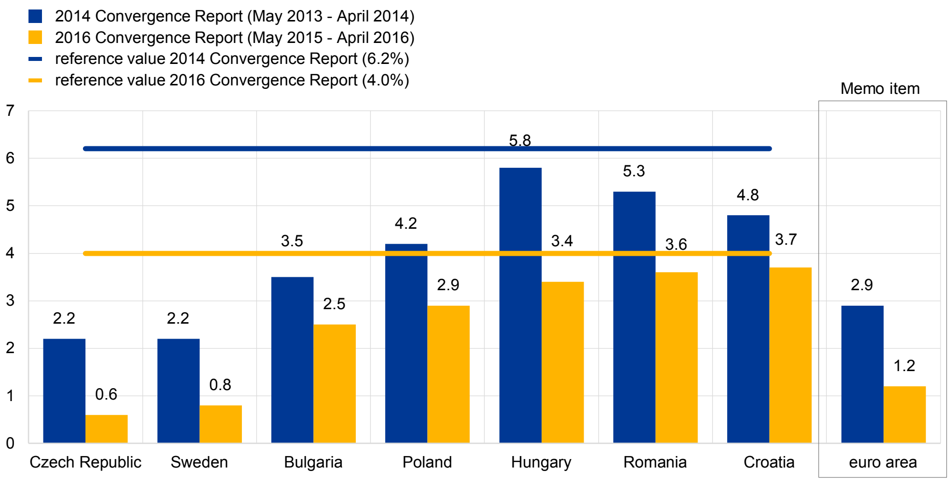
Source: ECB
Note: An upward (downward) movement indicates an appreciation (depreciation) of the local currency.

With regard to the convergence of long-term interest rates, all seven countries under review recorded, as in 2014, long-term interest rates below the reference value, which was 4% (Chart 3.4). Interest rates were lowest in the Czech Republic and Sweden.

Chart 3.4

Long-term interest rates

(percentages, annual average)



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 EMU showed that weak fundamentals, an excessively loose macroeconomic stance at country level and overly optimistic expectations about the convergence in real incomes pose risks not only for the countries concerned but also for the smooth functioning of the euro area as a whole. Fulfilment of the numerical convergence criteria at a point in time is, by itself, not a guarantee of smooth membership of the euro area. Countries joining the euro area should thus demonstrate the sustainability of their convergence processes and their capacity to live up to the permanent commitments which euro adoption represents. This is in the country's own interest, as well as in the interest of the euro area as a whole.

Lasting policy adjustments are required in many of the countries under review to achieve sustainable convergence. A prerequisite for sustainable convergence is macroeconomic stability and in particular 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. Favourable conditions for an efficient use of capital and labour in the economy are needed to enhance total factor productivity and long-run economic growth. Sustainable convergence also requires sound institutions and a supportive business environment. 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 imbalances, such as excessive asset price increases and credit boom-bust cycles. Finally, an appropriate framework for the supervision of financial institutions needs to be in place.

3.1 The price stability criterion

In April 2016 six of the seven countries under review recorded a 12-month average inflation rate below – in several cases well below – the reference value of 0.7% for the price stability criterion. Inflation was very low in the EU over the reference period, mainly owing to the significant fall in oil prices. This was reflected in a reference value of 0.7% (see Box 1 in Chapter 2). In all the countries examined, inflation was very low by historical standards. The Czech Republic and Hungary recorded low positive inflation rates below the reference value. In Bulgaria, Croatia, Poland and Romania, inflation stood in negative territory. In Sweden inflation was above the reference value.

Over the past ten years both the average level and the volatility of inflation have varied significantly across the countries examined. Over this period Bulgaria, Hungary and Romania recorded an average HICP inflation rate well above 3%. In the Czech Republic, Croatia and Poland, the average inflation rate was closer to 2%. In Sweden inflation averaged 1.4% over the past ten years. During this period, price dynamics were particularly volatile in Bulgaria, although inflation in the Czech Republic, Croatia, Hungary, Poland and Romania also fluctuated within a relatively wide range. Sweden recorded the lowest volatility in inflation rates. The marked cross-country differences in the average level and the volatility of inflation over the longer term contrast with the small inflation differentials over the reference period from May 2015 to April 2016, indicating the progress made towards convergence over the recent past. To some extent, the recent developments also reflect common oil price shocks.

The longer-term price developments mirrored a more volatile macroeconomic environment in many countries. In the years leading up to the global financial crisis, inflation accelerated amid robust economic growth in all countries examined. At the same time, macroeconomic imbalances were building up in some central and eastern European economies, particularly in the form of excessive credit growth and large current account deficits. In most of the countries under review, average annual inflation peaked in 2008, before declining substantially in 2009 amid an abrupt economic downturn and a fall in global commodity prices. In the following years, price developments became more heterogeneous, partly reflecting differences in the strength of the economic recovery and country-specific measures related to administered prices. In 2013 inflation embarked on a downward trend in all countries under review, reaching historical lows and often even negative levels. This broad-based movement has mainly reflected developments in global commodity prices, low imported inflationary pressures and persistent spare capacity in some countries. The developments in global commodity prices have had a particularly pronounced impact on central and eastern European economies, given the relatively large weight of energy and food in their HICP baskets. In some of the countries under review, cuts in administered prices and indirect taxes, base effects from past increases in indirect taxes or a strengthening of the nominal effective exchange rate also exerted downward pressure on inflation. Against this backdrop, monetary policy conditions have been loosened considerably over recent years.

While inflation is expected to increase moderately in the coming years, there are concerns over the longer term regarding the sustainability of inflation convergence in most of the countries examined. In 2016 and 2017 inflation is expected to gradually increase from the current very low levels in all countries under review, according to the European Commission’s Spring 2016 Economic Forecast. This partly reflects base effects related to the recent decline in oil prices. However, the fragile global economic recovery, coupled with persistent spare capacity in some countries, is expected to keep underlying inflationary pressures contained. The risks to the price outlook are broadly balanced in most countries. A key downside risk relates to heightened uncertainties regarding developments in the global economy, which could reduce external price pressures. In most of the countries under review, upside risks to inflation could arise from stronger than expected domestic price and wage pressures amid strengthening economic activity and tightening labour market conditions. Looking further ahead, in many of 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.

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 implementation of further structural reforms. In particular, wage increases should reflect labour productivity growth at firm level and take into account labour market conditions and developments in competitor countries. In addition, continued reform effort is needed to further improve the functioning of labour and product markets and maintain favourable conditions for economic expansion and employment growth. To that end, measures to support stronger governance and further improvements in the quality of institutions are essential in the central and eastern European economies. Given the limited room for manoeuvre for monetary policy under the tightly managed exchange rate regime in Croatia, as well as the currency board framework in Bulgaria, it is imperative that other policy areas support the capacity of these economies to cope with country-specific shocks and to avoid the build-up of macroeconomic imbalances. Financial sector and supervisory policies should be aimed at further safeguarding financial stability. In this respect, the recommendations of the European Systemic Risk Board should also be implemented.

3.2 The government budgetary position criterion

At the time of publication of this report, only Croatia is subject to an EU Council decision on the existence of an excessive deficit. The deadline for correcting the excessive deficit situation in Croatia is 2016. All the other countries under review posted a fiscal deficit-to-GDP ratio at or below the 3% reference value in 2015. Croatia recorded a deficit of 3.2% of GDP; the remaining deficits were 2.6% in Poland, 2.1% in Bulgaria, 2.0% in Hungary, 0.7% in Romania and 0.4% in the Czech Republic. Sweden recorded 0%.

Between 2013 and 2015 the fiscal balance improved in most of the countries covered by this report, with the exception of Bulgaria. In Croatia, Poland, Romania and Sweden, the improved budget balances largely reflect a better macroeconomic situation, as well as structural consolidation efforts. In the case of Hungary and the Czech Republic, the better macroeconomic developments have been partially offset by a loosening in the fiscal stance. The deficit increase in Bulgaria is mostly explained by a deterioration in the structural balance.

For 2016, the European Commission forecasts the deficit-to-GDP ratio to be below the 3% reference value in all countries. Romania, Croatia and Poland are projected to post a deficit ratio below the reference value at 2.8%, 2.7% and 2.6% of GDP respectively. The deficit ratios in Bulgaria and Hungary are forecast to reach 2.0%, and those in Czech Republic and Sweden are projected to stay well below the reference value, at 0.7% and 0.4% of GDP respectively.

In Croatia and Hungary the debt ratio was above 60% of GDP in 2015, while in the other countries under review the debt levels were below or well below this threshold (see Table 3.1). Since 2013 the government debt-to-GDP ratio has increased by 9.6 percentage points in Bulgaria, 4.5 percentage points in Croatia and 3.7 percentage points in Sweden. In Hungary and Romania the debt ratios changed only slightly. In the same period Poland and the Czech Republic posted notable reductions in their debt ratios (by 4.7 and 4.1 percentage points of GDP respectively). Taking a longer perspective, between 2006 and 2015, the government debt-to-GDP ratio increased substantially in Croatia (by 47.8 percentage points), Romania (by 26.2 percentage points), the Czech Republic (by 13.1 percentage points) and Hungary (by 10.7 percentage points), while in the rest of the countries the changes were smaller.

For 2016, the European Commission projects a rise in the debt ratio in Bulgaria, the Czech Republic, Croatia, Poland and Romania, with opposite dynamics in Hungary and Sweden. The Commission's projections also indicate that the debt ratio will remain below the 60% reference value in all countries except Croatia and Hungary in 2016.

Looking ahead, it is essential for the countries examined to achieve and/or maintain sound and sustainable fiscal positions. Croatia – which is subject to an EU Council decision on the existence of an excessive deficit – must comply with its EDP commitments in a credible and timely manner and bring its budget deficit below the reference value in 2016. Further consolidation is also required in Bulgaria, Hungary and Poland, which have yet to attain their medium-term budgetary objectives, and also in the Czech Republic and Romania, which are projected to deviate from theirs. In this respect, particular attention should be paid to limiting expenditure growth to a rate below the medium-term potential economic growth rate, in line with the expenditure benchmark rule of the revised Stability and Growth Pact. Moreover, beyond the transition period provided for under the Pact, countries whose debt-to-GDP ratio exceeds the reference value should ensure that the ratio is declining sufficiently, in accordance with the provisions of the enhanced Pact. Further consolidation would also make it easier to deal with the budgetary challenges related to the ageing of the population and to build up buffers to allow automatic stabilisers to work. 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 comprehensive structural reforms to increase potential growth and employment.

3.3 The exchange rate criterion

None of the countries examined in this report participates in ERM II. The countries under review operate under different exchange rate regimes.

The Bulgarian lev remained fixed at 1.95583 levs per euro within the framework of a currency board in the reference period. This exchange rate regime operated amid mostly low short-term interest rate differentials vis-à-vis the euro area.

The Croatian kuna and the Romanian leu traded under flexible exchange rate regimes involving – to different degrees – a managed float vis-à-vis the euro. In the case of the Croatian kuna, this was reflected in low exchange rate volatility compared with the other flexible currencies under review, amid low short-term interest rate differentials vis-à-vis the euro area. The exchange rate of the Romanian leu against the euro showed a relatively high degree of volatility, with short-term interest rate differentials vis-à-vis the euro area remaining at relatively high levels throughout the reference period. In 2009, Romania was granted an international financial assistance package, led by the EU and the IMF, followed by a precautionary financial assistance programme in 2011 and a successor programme in 2013. As these agreements have helped reduce financial vulnerabilities, they might also have contributed to reducing exchange rate pressures over the reference period.

All other currencies traded under a flexible exchange rate regime amid high exchange rate volatility in most countries. As regards the Czech Republic, however, this has since 2013 involved a commitment by Česká národní banka not to let the koruna appreciate above a level close to CZK 27 against the euro. Short-term interest rate differentials vis-à-vis the euro area were small in the Czech Republic and Sweden but relatively high in Hungary and Poland. In the case of Poland, a Flexible Credit Line arrangement with the IMF, designed to meet the demand for crisis-prevention and crisis-mitigation lending, was in place over the reference period. As this arrangement has helped to reduce risks related to financial vulnerabilities, it might also have contributed to reducing the risk of exchange rate pressures. In Sweden, over the reference period Sveriges Riksbank maintained a swap agreement with the ECB which, as it has helped to reduce financial vulnerabilities, might also have had an impact on exchange rate developments.

3.4 The long-term interest rate criterion

Over the reference period, all countries under examination recorded average long-term interest rates that were – to different degrees – below the 4.0% reference value. Long-term interest rates in the Czech Republic and Sweden were below 1%, while they stood between 2% and 3% in Bulgaria and Poland, and above 3% in Croatia, Hungary and Romania.

Since the 2014 Convergence Report long-term interest rate spreads vis-à-vis the euro area average have remained broadly stable in most of the countries under review. However, financial markets have continued to differentiate between countries on the basis of their external and internal vulnerabilities, including the developments in budgetary performance and the prospects for sustainable convergence.

3.5 Other relevant factors

According to the European Commission, most of the countries under review have made progress in addressing imbalances in their economies, albeit to a different degree. The European Commission’s in-depth reviews, the results of which were published on 8 March 2016, concluded that Sweden was experiencing macroeconomic imbalances, and that Bulgaria and Croatia were experiencing excessive macroeconomic imbalances[111]. As regards Bulgaria, the Commission stated that the economy continues to be characterised by remaining fragilities in the financial sector and high corporate indebtedness, which need to be addressed through the full implementation of ambitious reforms As regards Croatia, the Commission found that limited progress had been made towards the correction of macroeconomic imbalances, while the implementation of the reform agenda had suffered significant delays, partly due to parliamentary elections held in November 2015. While the European Commission classified the other countries under review as having no imbalances, various challenges also exist for these countries.

External deficits have been reduced in recent years. The MIP scoreboard shows that three-year average current account balances improved further in 2015 (see Table 3.2). In Sweden, however, the large current account surplus remained unchanged compared with 2014 (just below the 6% of GDP indicative threshold). Surpluses were also observed in Hungary, Croatia, Bulgaria and the Czech Republic, whereas deficits were reported in Poland and Romania.

The negative net international investment position as a share of GDP has diminished but stayed at high levels in almost all countries under review. On the positive side, the net foreign liabilities of the central and eastern European countries are mainly in foreign direct investment, which is assessed to constitute a stable form of financing. In 2015 the net international investment position was beyond the indicative threshold of -35% of GDP in five out of the seven countries under review. Net foreign liabilities were particularly sizeable in Croatia, where they exceeded 70% of GDP. Net foreign liabilities were smallest in the Czech Republic (31.5% of GDP) and Sweden (1.6% of GDP).

In terms of price and cost competitiveness, over the three-year period from 2013 to 2015, real effective exchange rates depreciated to different degrees in most of the examined countries, with Romania and Croatia being the only exceptions. The three-year growth rate of unit labour costs, which in the pre-crisis years stood at very high levels in almost all countries, has generally remained below the indicative threshold of 12% over recent years. Over the five-year period from 2011 to 2015, gains in export market shares were experienced in Romania and, to a lesser extent, Bulgaria, Poland and the Czech Republic. The other countries' export market shares decreased.

House prices have increased again in all countries under review except Croatia. This follows a downward correction from the high levels reached in the pre-crisis phase. Sweden has recorded particularly strong increases in house prices over recent years, partly due to supply-side bottlenecks and historically low interest rates.

[111] For countries identified as having excessive imbalances the MIP Regulation (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) foresees the possibility for the EU Council, upon a recommendation by the European Commission, to recommend that the Member State concerned takes corrective action. This would result in the country entering a different procedure, i.e. the excessive imbalance procedure (EIP).

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	2013	0.3	-73.5	-1.0	0.2	15.2
	2014	0.4	-74.8	-2.8	6.0	17.0
	2015	1.2	-60.7	-4.1	14.4	10.8
Czech Republic	2013	-1.4	-39.4	-3.1	-9.4	4.2
	2014	-0.6	-36.8	-10.0	-5.7	3.8
	2015	0.2	-31.5	-8.0	0.4	0.1
Croatia	2013	0.0	-88.7	-4.0	-23.1	-2.9
	2014	0.6	-88.1	-1.0	-18.6	-5.8
	2015	2.3	-78.7	0.1	-3.1	-5.1
Hungary	2013	2.2	-83.5	-4.0	-20.9	6.3
	2014	2.6	-73.9	-7.0	-15.6	6.9
	2015	3.4	-68.6	-6.9	-7.2	6.1
Poland	2013	-3.4	-69.7	-4.3	0.1	3.3
	2014	-2.3	-67.1	-1.3	5.0	2.5
	2015	-1.2	-60.7	-1.0	9.1	-1.4
Romania	2013	-3.6	-61.9	0.3	14.2	-3.2
	2014	-2.1	-56.9	-1.1	20.8	6.0
	2015	-0.9	-50.2	2.7	21.7	1.1
Sweden	2013	6.0	-14.3	5.1	-16.5	8.6
	2014	5.8	-2.5	-3.6	-9.7	7.2
	2015	5.8	-1.6	-7.9	-9.9	4.0
Threshold		-4.0/+6.0	-35.0	+/-11.0	-6.0	+12.0

Table 3.2b – Internal imbalances and unemployment indicators

		Internal imbalances						New 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]	Unemploy-ment rate [7]	Activity rate [8]	Long-term unemploy-ment [8]	Youth unemploy-ment [8]
Bulgaria	2013	0.4	7.3	132.2	4.3	17	12.2	1.7	2.7	6.4
	2014	1.5	-0.3	124.3	7.2	27	12.2	3.1	0.6	-1.3
	2015	3.6	.	.	.	27	11.2	2.2	-1.2	-6.4
Czech Republic	2013	-0.8	4.4	74.1	11.3	45	6.9	2.7	0.0	0.6
	2014	1.9	1.8	72.7	4.4	43	6.7	3.0	-0.1	-2.2
	2015	3.8	.	.	.	41	6.1	2.4	-0.6	-6.9
Croatia	2013	-5.7	-0.6	119.7	3.2	82	15.7	-1.4	4.4	17.6
	2014	-1.2	0.3	120.8	0.9	87	16.9	2.0	1.7	8.9
	2015	-2.4	.	.	.	87	17.0	3.0	0.1	0.9
Hungary	2013	-4.6	-1.1	95.2	-1.0	77	10.7	2.8	-0.5	0.2
	2014	3.1	-0.5	91.3	8.5	76	9.6	4.6	-1.6	-5.6
	2015	11.6	.	.	.	75	8.2	4.9	-1.9	-10.9
Poland	2013	-4.7	3.1	75.4	7.6	56	10.0	1.7	1.4	3.6
	2014	1.1	4.8	77.9	0.6	50	9.8	2.1	0.3	-1.9
	2015	2.8	.	.	.	51	9.0	1.6	-1.1	-5.7
Romania	2013	-2.8	-1.5	66.6	1.1	38	7.0	0.0	0.8	1.6
	2014	-3.2	-2.4	62.1	1.1	40	6.9	1.6	-0.1	0.2
	2015	1.7	0.0	58.3	3.8	38	6.9	1.3	0.0	-0.9
Sweden	2013	4.7	4.7	192.4	8.8	40	7.9	2.0	-0.1	-1.2
	2014	8.6	5.9	194.0	13.4	45	8.0	1.6	0.0	0.2
	2015	12.0	.	.	.	43	7.8	1.4	0.0	-3.3
Threshold		+6.0	+14.0	133	+16.5	+60	+10.0	-0.2	0.5	2.0

Sources: European Commission (Eurostat, DG ECFIN) and European System of Central Banks.
Note: This table includes data available as of 18 May 2016, i.e. the cut-off date for this report, and therefore differs from the scoreboard published in the Alert Mechanism Report of November 2015.
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.

A relatively long period of credit expansion prior to the financial crisis left the private non-financial sector with high levels of accumulated debt in some of the countries under review. This constitutes a key vulnerability in those countries. Strong credit growth, especially in loans for house purchase in Sweden, requires close monitoring. In 2014 Sweden recorded a particularly high level of private sector debt, exceeding 190% of GDP. In addition, the stock of foreign currency loans in several countries is very large and represents a macroeconomic and financial risk, as it exposes unhedged borrowers to exchange rate risk. Risks stemming from foreign currency mismatches – affecting households and in Croatia also the public sector – are significant in Croatia, Romania and, to a lesser extent, Poland.

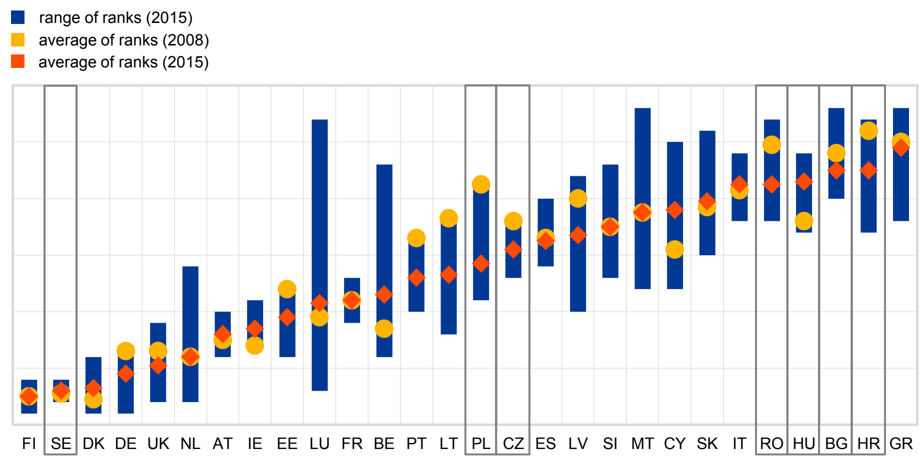
Financial sector policies should be aimed at ensuring that the financial sector makes a sound contribution to economic growth and price stability in the countries under review, and supervisory policies should be geared towards stabilising the supervisory framework, which is a precondition for joining the Single Supervisory Mechanism (SSM). In order to minimise the potential risks associated with a large share of loans being denominated in foreign currency, the recommendations of the European Systemic Risk Board (ESRB) on lending in foreign currencies should be implemented. Close cooperation between supervisors across EU countries is important to ensure the effective implementation of measures.

The adjustment process has resulted in a relatively high level of unemployment in some of the countries under review. Notably, in Croatia high levels of long-term and youth unemployment highlight the severity of domestic imbalances. Unemployment – which has generally been accompanied by a worsening of skill and/or cross-regional mismatches – is a vulnerability in many countries and poses a risk to the convergence of real incomes, also in view of adverse demographic trends.

The strength of the institutional environment is another important factor in the analysis of the sustainability of economic integration and convergence. In several central and eastern European countries, removing the existing rigidities and impediments to the efficient use and allocation of production factors would help to enhance economic potential. These reflect, for example, weaknesses in the business environment, the relatively low quality of institutions, weak governance and corruption. By hampering potential output growth, the institutional environment may also undermine a country's debt-servicing ability and make economic adjustments more difficult. It may also affect a country's ability to implement necessary policy measures.

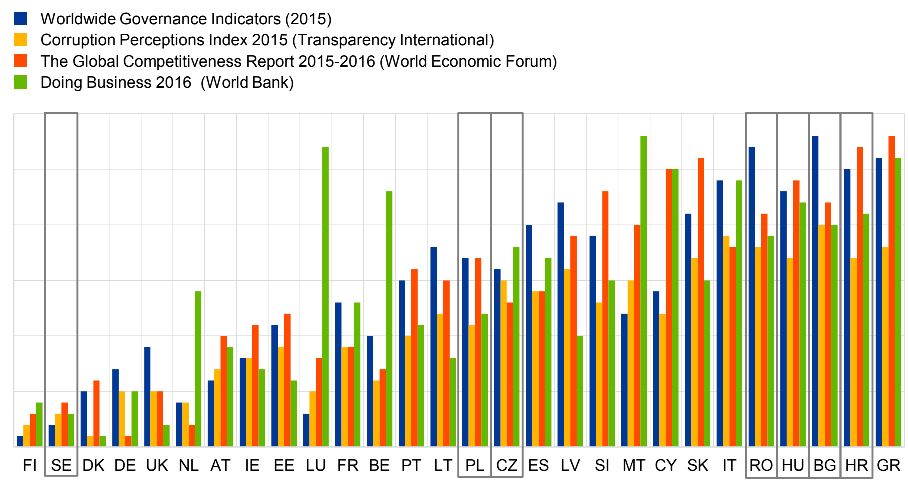
The quality of institutions and governance is relatively weak in all countries under review except Sweden. Specific institutional indicators broadly confirm an overall picture of weak quality of institutions and governance in most of the countries, although with some notable differences (Chart 3.5 and 3.6). Croatia has the weakest quality of institutions and governance among the countries under review, and is ranked second to last among the EU countries, despite some improvement over the past few years. Although countries are ranked differently depending on the source used to measure the quality of the business and institutional environment, there is clearly still significant room for improvement in this field in most of the countries.

Chart 3.5
Overview of EU country rankings in terms of institutional quality



Sources: Worldwide Governance Indicators 2015, The Global Competitiveness Report 2015-2016 (World Economic Forum), Corruption Perceptions Index 2015 (Transparency International) and Doing Business 2016 (World Bank).
Notes: Countries are ranked from one (best performer in the EU) to 28 (worst performer in the EU) and ordered according to their average position in the 2015 rankings. In the Doing Business report Malta has only been covered since the 2013 report and Cyprus only since 2010.

Chart 3.6
EU country rankings in terms of institutional quality by individual indicator



Sources: Worldwide Governance Indicators 2015, The Global Competitiveness Report 2015-2016 (World Economic Forum), Corruption Perceptions Index 2015 (Transparency International) and Doing Business 2016 (World Bank).
Note: Countries are ranked from one (best performer in the EU) to 28 (worst performer in the EU) and ordered according to their average position in the 2015 rankings.

Wide-ranging structural reforms are required in most of the countries under review to improve economic growth and competitiveness. Improving the local institutions, governance and business environment, along with further progress with the privatisation of state-owned enterprises and reinforced efforts to enhance the absorption of EU funds, would help to speed up productivity growth. This would in turn contribute to increasing competition in key regulated sectors (e.g. energy and transport), diminishing barriers to entry and encouraging much-needed private investment.

Finally, institutional features relating to the quality of the statistics are also essential to support a smooth convergence process. This applies to, among other things, the specification of the legal independence of the national statistical authority, its administrative supervision and budget autonomy, its legal mandate for data collection and its legal provisions governing statistical confidentiality, which are described in more detail in Chapter 6.

4 Country summaries

4.1 Bulgaria

In April 2016 the 12-month average rate of HICP inflation in Bulgaria was -1.0%, i.e. well below the reference value of 0.7% for the criterion on price stability. Over the past ten years this rate has fluctuated within a wide range, from -1.7% to 12.6%, and the average for that period was elevated, standing at 3.6%. Looking ahead, there are concerns regarding 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. In order to prevent the build-up of excessive price pressures and macroeconomic imbalances, the catching-up process must be supported by appropriate policies.

Bulgaria's general government deficit and debt complied with the Maastricht criteria in 2015. Bulgaria has been subject to the preventive arm of the Stability and Growth Pact since 2012. The deficit exceeded the 3% of GDP reference value in 2014. However, the European Commission assessed the excess deficit to be both exceptional and temporary, thereby not warranting the opening of an excessive deficit procedure. The European Commission's Spring 2016 Economic Forecast points to the risk of some deviation from the adjustment path towards the medium-term objective in both 2016 and 2017. Furthermore, Bulgaria faces medium risks to fiscal sustainability in the long run, partly as a result of the expected increase in age-related expenditure on health care and long-term care. Further reforms in these areas and further progress towards the medium-term objective in line with preventive-arm requirements are essential for ensuring sound public finances over the medium and long term.

In the two-year reference period from 19 May 2014 to 18 May 2016, the Bulgarian lev did not participate in ERM II, but its exchange rate was fixed at 1.95583 levs per euro within the framework of a currency board. Over the past decade Bulgaria's current and capital account has improved, while the country's net foreign liabilities remain high.

Over the reference period from May 2015 to April 2016, long-term interest rates in Bulgaria were 2.5% on average and thus below the 4.0% reference value for the interest rate convergence criterion. Long-term interest rates in Bulgaria have decreased since 2009, with 12-month average rates having declined from above 7% to below 3%.

Achieving an environment that is conducive to sustainable convergence in Bulgaria requires stability-oriented economic policies and wide-ranging structural reforms. With regard to macroeconomic imbalances, the European Commission selected Bulgaria for an in-depth review in its Alert Mechanism Report 2016 and concluded that Bulgaria is experiencing excessive macroeconomic imbalances. Bulgaria would benefit from wide-ranging structural reforms to enhance the institutional and business environment. In order to safeguard financial stability, it is essential that the authorities complete the asset quality review and stress test exercises relating to the financial sector and further improve supervisory practices.

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

4.2 Czech Republic

In April 2016 the 12-month average rate of HICP inflation in the Czech Republic was 0.4%, i.e. below the reference value of 0.7% for the criterion on price stability. Over the past ten years this rate has fluctuated within a relatively wide range, from 0.3% to 6.6%, and the overall average for that period was moderate, standing at 2.1%.

The Czech Republic's general government deficit and debt complied with the Maastricht criteria in 2015. The Czech Republic has been subject to the preventive arm of the Stability and Growth Pact since 2014. The European Commission's Spring 2016 Economic Forecast projects the structural deficit to remain below the medium-term objective over the forecast horizon and, thus, in compliance with the preventive arm's requirements. The Czech Republic is at medium risk of fiscal stress over the long term, mainly as a result of an ageing population. Broadening the scope of the current fiscal framework reforms, strictly enforcing the existing rules and making further progress towards the medium-term objective in full compliance with preventive-arm requirements are necessary in order to ensure sound public finances.

In the two-year reference period from 19 May 2014 to 18 May 2016, the Czech koruna did not participate in ERM II. The koruna traded under a flexible exchange rate regime, although since November 2013 this has entailed a commitment by Česká národní banka not to let the koruna appreciate above a level of 27 korunas per euro. The exchange rate of the Czech koruna against the euro exhibited a low degree of volatility over the reference period. On 18 May 2016 the exchange rate stood at 27.022 korunas per euro, i.e. 1.5% stronger than its average level in May 2014. The current account deficit shrank gradually and the balance turned positive from 2014, while the country's net foreign liabilities declined steadily.

Over the reference period from May 2015 to April 2016, long-term interest rates in the Czech Republic were 0.6% on average and thus well below the 4.0% reference value for the interest rate convergence criterion. Long-term interest rates in the Czech Republic have decreased since 2009, with 12-month average rates having declined from almost 5% to below 1%.

Achieving an environment that is conducive to sustainable convergence requires conducting price stability-oriented economic policies, including targeted structural reforms that are geared to ensuring macroeconomic stability. With regard to macroeconomic imbalances, the European Commission did not select the Czech Republic for an in-depth review in its Alert Mechanism Report 2016. Nevertheless, the targeted structural reforms with regard to labour and product market policies, as well as the business environment, need to be stepped up in order to boost potential growth.

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 Croatia

In April 2016 the 12-month average rate of HICP inflation in Croatia was -0.4%, i.e. well below the reference value of 0.7% for the criterion on price stability. Over the past ten years this rate has fluctuated within a relatively wide range, from -0.4% to 6.0%, and the average for that period was moderate, standing at 2.3%. Looking ahead, there are concerns regarding the sustainability of inflation convergence in Croatia over the longer term. The catching-up process is likely to result in positive inflation differentials vis-à-vis 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.

Croatia's general government deficit and debt did not comply with the Maastricht criteria in 2015. Croatia has been subject to the corrective arm of the Stability and Growth Pact since 2014, with the deadline for correcting the excessive deficit being 2016. The European Commission's Spring 2016 Economic Forecast foresees a timely correction of the excessive deficit but points to the risk that Croatia will not comply with the provisions of the Stability and Growth Pact. The Commission's 2015 Fiscal Sustainability Report suggests that Croatia faces a high debt sustainability risk over the medium term. Over the long term, while Croatia appears to be at low risk owing to the projected decrease in age-related spending, the low level of, and projected further decline in, the benefit ratio raise concerns about the adequacy of the pension system. Overall, it is essential that Croatia follows a determined, growth-friendly consolidation strategy that addresses the high risks to medium-term debt sustainability. This will need to be coupled with an overhaul of the fiscal governance framework that is geared towards improving public spending efficiency in order to create the conditions for a lasting improvement in the conduct of fiscal policies.

In the two-year reference period from 19 May 2014 to 18 May 2016, the Croatian kuna did not participate in ERM II, but traded under a flexible exchange rate regime involving a tightly managed floating of the currency's exchange rate. The exchange rate of the Croatian kuna against the euro exhibited, on average, a low degree of volatility over the reference period. On 18 May 2016 the exchange rate stood at 7.488 kuna per euro, i.e. 1.4% stronger than its average level in May 2014.

Croatia's current and capital account has improved over the past decade, while the country's net foreign liabilities remain high.

Over the reference period from May 2015 to April 2016, long-term interest rates in Croatia were 3.7% on average and thus below the 4.0% reference value for the interest rate convergence criterion. Long-term interest rates in Croatia have decreased since 2009, with 12-month average rates having declined from around 8% to below 4%.

Achieving an environment that is conducive to sustainable convergence in Croatia requires stability-oriented economic policies and wide-ranging structural reforms. With regard to macroeconomic imbalances, the European Commission selected Croatia for an in-depth review in its Alert Mechanism Report 2016 and concluded that Croatia is experiencing excessive macroeconomic imbalances. In terms of structural reforms, there is considerable scope and an urgent need for reforms aimed at improving the institutional and business environment, boosting competition in the product markets, reducing mismatches in the labour market and enhancing the efficiency of the public administration and the judicial system. Significant efforts should also be made to ensure that Croatia improves its very weak absorption of EU funds.

Croatian law does not comply with all the requirements for central bank independence. Croatia is an EU Member State with a derogation and must therefore comply with all adaptation requirements under Article 131 of the Treaty.

4.4 Hungary

In April 2016 the 12-month average rate of HICP inflation in Hungary was 0.4%, i.e. below the reference value of 0.7% for the criterion on price stability. Over the past ten years this rate has fluctuated within a relatively wide range, from -0.3% to 7.9%, and the average for that period was elevated, standing at 3.8%. Looking ahead, there are concerns regarding the sustainability of inflation convergence in Hungary over the longer term. The catching-up process is likely to result in positive inflation differentials vis-à-vis 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 2015 Hungary's general government deficit complied with the Maastricht criteria, whereas its debt exceeded the reference value. Hungary has been subject to the preventive arm of the Stability and Growth Pact since 2013. The European Commission's Spring 2016 Economic Forecast points to the high risk of a significant deviation from the adjustment path to the medium-term objective over the 2016-17 period. Hungary is at no risk of fiscal stress over the long term, but medium risk over the medium term. An ageing population poses a challenge to the sustainability of public finances. Determined progress towards the medium-term objective in line with preventive-arm requirements, as well as reform of the fiscal governance framework, are necessary in order to safeguard the sustainability of public finances over the medium term.

In the two-year reference period from 19 May 2014 to 18 May 2016, 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 relatively high degree of volatility over the reference period. On 18 May 2016 the exchange rate stood at 316.05 forints per euro, i.e. 3.8% weaker than its average level in May 2014. Over the past decade Hungary's current and capital account has improved markedly and has contributed to some reduction in the country's net foreign liabilities, which remain high.

Over the reference period from May 2015 to April 2016, long-term interest rates in Hungary were 3.4% on average and thus below the 4.0% reference value for the interest rate convergence criterion. Long-term interest rates in Hungary have decreased since 2009, with 12-month average rates having declined from above 9% to below 4%.

Achieving an environment that is conducive to sustainable convergence in Hungary requires stability-oriented economic policies and wide-ranging structural reforms. With regard to macroeconomic imbalances, the European Commission selected Hungary for an in-depth review in its Alert Mechanism Report 2016 and concluded that Hungary is not experiencing macroeconomic imbalances. However, Hungary would benefit from structural reforms aimed at promoting private sector-led growth, such as improving the governance of institutions, removing red tape and the excessive tax burden, and fostering private credit growth.

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.

4.5 Poland

In April 2016 the 12-month average rate of HICP inflation in Poland was -0.5%, i.e. well below the reference value of 0.7% for the criterion on price stability. Over the past ten years this rate has fluctuated within a relatively wide range, from -0.7% to 4.3%, and the average for that period was moderate, standing at 2.3%. Looking ahead, there are concerns regarding the sustainability of inflation convergence in Poland over the longer term. The catching-up process is likely to result in positive inflation differentials vis-à-vis 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.

Poland's general government deficit and debt complied with the Maastricht criteria in 2015. Poland has been subject to the preventive arm of the Stability and Growth Pact since 2015. The ECOFIN Council decided in June 2015 to abrogate the excessive deficit procedure for Poland, despite the deficit being above the reference value, on the grounds that the debt-to-GDP ratio was below 60% and the excess over the reference value was small and could be explained by the net cost of past pension reforms. The European Commission's Spring 2016 Economic Forecast points to the risk of a significant deviation from the adjustment path towards the medium-term objective. Moreover, in the medium and long run, Poland faces medium risks to fiscal sustainability. Therefore, further progress towards the medium-term objective in line with preventive-arm requirements is essential for ensuring sound public finances over the medium and long term.

In the two-year reference period from 19 May 2014 to 18 May 2016, 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 18 May 2016 the exchange rate stood at 4.3885 zlotys per euro, i.e. 5.0% weaker than its average level in May 2014. Poland's current and capital account has improved over the past decade, while the country's net foreign liabilities remain high.

Over the reference period from May 2015 to April 2016, long-term interest rates in Poland were 2.9% on average and thus below the 4.0% reference value for the interest rate convergence criterion. Long-term interest rates in Poland have decreased since 2009, with 12-month average rates having declined from approximately 6% to below 3%.

Achieving an environment that is conducive to sustainable convergence in Poland requires stability-oriented economic policies, policy measures safeguarding financial stability and targeted structural reforms. With regard to macroeconomic imbalances, the European Commission did not select Poland for an in-depth review in its Alert Mechanism Report 2016. It is essential to preserve the currently strong financial position of the banking sector in order to ensure its sound contribution to economic growth, which should be supported by well targeted structural reforms to enhance competition in product markets and speed up innovation, privatisation and infrastructure modernisation.

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.

4.6 Romania

In April 2016 the 12-month average rate of HICP inflation in Romania was -1.3%, i.e. well below the reference value of 0.7% for the criterion on price stability. Over the past ten years this rate has fluctuated within a relatively wide range, from -1.3% to 8.5%, and the average for that period was elevated, standing at 4.5%. Looking ahead, there are concerns regarding the sustainability of inflation convergence in Romania over the longer term. The catching-up process is likely to result in positive inflation differentials vis-à-vis 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.

Romania's general government deficit and debt complied with the Maastricht criteria in 2015. Romania has been subject to the preventive arm of the Stability and Growth Pact since 2013. According to the European Commission's Spring 2016 Economic Forecast, Romania has complied with its medium-term objective since 2013, but is at risk of a significant deviation in both 2016 and 2017. Furthermore, the expansionary fiscal measures being planned are expected to push the deficit above the 3% of GDP threshold in 2017 and put the debt on an upward path. The Commission's 2015 Fiscal Sustainability Report points to high sustainability risks in the medium term and medium sustainability risks in the long term, partly related to the rising cost of health care and long-term care. Further reforms in these areas and a prudent conduct of fiscal policy, ensuring a rapid return to the medium-term objective, are warranted in order to safeguard the sustainability of public finances.

In the two-year reference period from 19 May 2014 to 18 May 2016, 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 relatively high degree of volatility over the reference period. On 18 May 2016 the exchange rate stood at 4.4990 lei per euro, i.e. 1.7% weaker than its average level in May 2014. Romania's current and capital account has improved substantially over the past decade, while the country's net foreign liabilities, although declining gradually, remain high.

Over the reference period from May 2015 to April 2016, long-term interest rates in Romania were 3.6% on average and thus below the 4.0% reference value for the interest rate convergence criterion. Long-term interest rates in Romania have decreased since 2009, with 12-month average rates having declined from close to 10% to below 4%.

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 2016 and concluded that Romania is not experiencing macroeconomic imbalances. Nevertheless, there is considerable scope and a need for measures aimed at improving the institutional and business environment, boosting investment and competition in product markets, reducing youth and long-term unemployment, and improving both the quality and efficiency of the public administration and the judicial system. Significant efforts should also be made to improve Romania's very weak absorption of EU funds.

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.

4.7 Sweden

In April 2016 the 12-month average rate of HICP inflation in Sweden was 0.9%, i.e. above the reference value of 0.7% for the criterion on price stability. Over the past ten years this rate has fluctuated within a range from 0.2% to 3.4% and the average for that period was subdued, standing at 1.4%. Looking ahead, monetary policy and the stability-oriented institutional framework should continue to support the achievement of price stability in Sweden.

Sweden's general government deficit and debt complied with the Maastricht criteria in 2015. Sweden has been subject to the preventive arm of the Stability and Growth Pact since it came into force in 1998. According to the European Commission's Spring 2016 Economic Forecast, Sweden is expected to comply with its medium-term budgetary objective over the forecast horizon. From a debt sustainability perspective, Sweden faces low and medium risks over the medium and long term respectively, mainly related to the projected increase in long-term care expenditure. Reforms in this area and continued compliance with the medium-term objective over the coming years would ensure that the track record of sound public finances would be enhanced further.

In the two-year reference period from 19 May 2014 to 18 May 2016, 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 relatively high degree of volatility over the reference period. On 18 May 2016 the exchange rate stood at 9.3525 kronor per euro, i.e. 3.6% weaker than its average level in May 2014. Over the past ten years Sweden has recorded large current account surpluses, usually coupled with a relatively small negative net international investment position.

Over the reference period from May 2015 to April 2016, long-term interest rates in Sweden were 0.8% on average and thus well below the 4.0% reference value for the interest rate convergence criterion. Long-term interest rates in Sweden have decreased since 2009, with 12-month average rates having declined from above 3% to below 1%.

Maintaining an environment that is conducive to sustainable convergence in Sweden requires the continuation of stability-oriented economic policies, targeted structural reforms and measures to safeguard financial stability. With regard to macroeconomic imbalances, the European Commission selected Sweden for an in-depth review in its Alert Mechanism Report 2016 and concluded that Sweden is experiencing macroeconomic imbalances. Against this backdrop, decisive efforts are needed to address the risks to macroeconomic stability stemming from the ongoing housing boom and the elevated level of private debt.

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 April 2016 the 12-month average rate of HICP inflation in Bulgaria was -1.0%, i.e. well below the reference value of 0.7% for the criterion on price stability (see Chart 5.1.1). This rate is expected to increase over the coming months.

Over the past ten years the 12-month average rate of HICP inflation has fluctuated within a wide range, from -1.7% to 12.6%, and the average for that period was elevated, standing at 3.6%. Before the onset of the global financial crisis, inflation accelerated significantly on account of adjustments to administered prices, the harmonisation of excise duties with EU levels and a series of supply-side shocks. At the same time, Bulgaria also exhibited growing signs of an overheating economy and an increasingly tight labour market, coupled with large capital inflows. Having peaked at 12% in 2008, inflation then declined rapidly, mainly as a result of lower commodity prices and the contraction in economic activity in an environment of subsiding capital inflows and comprehensive fiscal consolidation measures. Since then economic activity has been subdued (see Table 5.1.1). Between 2009 and 2012 the average annual rate of inflation hovered around 3%, before dropping sharply to a low point of -1.6% in 2014. This fall in inflation was driven by declining commodity prices, an appreciation in the effective exchange rate of the lev and domestic factors, such as cuts in administered prices. In 2015 inflation recovered slightly. Unemployment also moderated, having increased significantly in the wake of the crisis. In recent years growth in nominal wages and unit labour costs has been much lower than before the crisis.

For the first four months of 2016, the average annual rate of HICP inflation stood at -1.5%. During that period inflation was driven down primarily by the drop in energy prices, most notably in fuel prices, given their large share in Bulgaria's HICP basket. Declines in the prices of durable goods, food and services also exerted downward pressure on overall HICP inflation.

Policy choices have played an important role in shaping inflation dynamics in Bulgaria over the past decade, most notably the orientation of monetary policy towards price stability. In 1997 Bulgaria adopted a currency board framework, under which the lev was first fixed to the Deutsche Mark and then to the euro in 1999. During the period 2004-08 monetary conditions under the currency board framework became too expansionary for a catching-up economy, partly due to strong capital inflows.

Inflation is expected to increase in the coming years, albeit remaining subdued; over the longer term there are concerns regarding the sustainability

of inflation convergence in Bulgaria. According to the European Commission's Spring 2016 Economic Forecast, the average annual rate of inflation will increase to -0.7% in 2016 and 0.9% in 2017. Risks to the medium-term inflation outlook are broadly balanced. Upside risks relate to an acceleration in the underlying growth momentum, while downside risks may arise from heightened uncertainty regarding developments in the global economy, which could reduce external price pressures. Looking further ahead, 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.

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 framework, it is imperative that other policy areas provide the economy with the wherewithal to cope with country-specific shocks in order to prevent the reoccurrence of macroeconomic imbalances. Structural reforms to enhance the business and institutional environment are crucial in order to attract foreign direct investment and raise potential growth. These include significantly reducing corruption and ensuring an independent and effective judiciary system. In the context of the high level of long-term unemployment, additional measures to improve the employability of the workforce are required. It is also essential to strengthen national policies aimed at enhancing competition in product markets and to proceed with the liberalisation of regulated sectors. Additional efforts are also needed to ensure that Bulgaria continues to improve its absorption of EU funds. With regard to macroeconomic imbalances, the European Commission selected Bulgaria for an in-depth review in its Alert Mechanism Report 2016 and concluded that Bulgaria is experiencing excessive macroeconomic imbalances.

Financial sector policies should be geared to safeguarding financial stability and ensuring that the financial sector makes a sound contribution to sustainable economic growth. The failure of Corporate Commercial Bank in 2014 revealed imprudent business practices in some credit institutions, coupled with inefficient supervision over them, and fundamental institutional problems. In order to maintain confidence in the financial system, it is essential that the authorities complete the asset quality review and stress tests relating to the banking and non-bank financial sectors. They need to ensure that sufficient resources are in place to follow up on these exercises effectively. Moreover, the process of enhancing the supervisory practices of Българска народна банка (Bulgarian National Bank) should continue in line with the results of the assessment of the implementation of the Basel Core Principles for Effective Banking Supervision in Bulgaria.[112] In order to deal with the high level of non-performing loans, the authorities should encourage the cleaning-up of banks' balance sheets by removing legal and judicial obstacles to the resolution of non-performing loans. Moreover, in order to minimise potential risks

[112] "Bulgaria: Financial Sector Assessment Program – Detailed Assessment of Observance on the Basel Core Principles for Effective Banking Supervision", *Country Report*, No 15/295, IMF, October 2015.

to financial stability associated with the high proportion of foreign currency loans, the recommendations of the ESRB should be taken into account.

5.1.2 Fiscal developments

The deficit and debt complied with the Maastricht criteria in 2015. In the reference year 2015 the general government budget balance recorded a deficit of 2.1% of GDP, i.e. below the 3% reference value. The general government gross debt-to-GDP ratio was 26.7%, well below the 60% reference value (see Table 5.1.2). Compared with the previous year, the deficit declined by 3.4 percentage points of GDP, while there was a smaller decline in the debt ratio (0.3 percentage points). The deficit ratio is forecast by the European Commission to decline slightly to 2.0% in 2016, while the government debt ratio increases moderately to 28.1% of GDP. With regard to other fiscal factors, the deficit ratio did not exceed the ratio of public investment to GDP in 2015, nor is it expected to in 2016.

Bulgaria has been under the preventive arm of the Stability and Growth Pact since 2012. Owing to a rise in the budget deficit above the reference value in 2009, the ECOFIN Council decided on 13 July 2010 that an excessive deficit situation existed in Bulgaria and set 2011 as the deadline for correcting it. Following the correction of the excessive deficit, the ECOFIN Council abrogated the EDP for Bulgaria on 22 June 2012. While general government debt was well below the 60% of GDP reference value in the 2009-15 period, the general government deficit in Bulgaria reached 5.4% of GDP in 2014, i.e. above the reference value, mostly as a result of the one-off capital transfer related to the reclassification of the Deposit Insurance Fund within the government sector (amounting to 3% of GDP), but also sizeable revenue shortfalls and a large increase in public investment. The European Commission's report of 16 November 2015 assessed the exceeding of the reference value to be both exceptional and temporary, and therefore not warranting the opening of an EDP.

Non-cyclical factors have been the main contributors to the deficit dynamics during recent years. The improvement in the deficit ratio between 2010 and 2013, which amounted to 2.8% of GDP, can mainly be explained by an improvement in the structural balance (of 2.2 percentage points of GDP) and, to a lesser extent, by cyclical factors. The 2009 and 2014 deficit increases were almost entirely attributable to non-cyclical factors: revenue shortfalls in 2009 and capital transfers related to the reclassification within the government sector in 2014 (European Commission estimates are presented in Table 5.1.2).

Government debt-to-GDP ratio has remained well below the 60% reference value throughout the crisis, although it has recently increased. The debt ratio increased significantly, from 13.7% in 2009 to 17.1% of GDP in 2013, on the back of primary deficits as well as unfavourable interest-growth differentials. The increase in the debt to 27% of GDP in 2014 was mainly attributable to the financing of the budget deficit, the temporary accumulation of reserves, the loan to the Deposit Insurance Scheme and the provision of liquidity to the banking sector. Over the forecast period, the debt-to-GDP ratio is on an upward trend, reaching 28.7% of GDP in 2017. An increasing debt level and, subsequently, higher interest expenditure could limit the necessary fiscal buffers to stabilise the economy in the event of an adverse shock. Potential risks pertain to possible additional support to the financial sector above that already incorporated in projections by the Bulgarian government, as well as public sector contingent liabilities stemming from state-owned enterprises. The government did not report contingent liabilities related to the financial sector.

In the presence of a credible currency board, the level and structure of public debt allows Bulgaria to manage its debt effectively. The share of government debt with a short-term maturity had been negligible, with only a temporary increase in 2014 (from about 2% to 23% – see Table 5.1.2). Taking into account 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 (79.1% in 2015). However, given that it is mostly denominated in euro, the anchor currency of Bulgaria’s currency board framework, fiscal balances are relatively insensitive to changes in exchange rates other than the EUR/BGN exchange rate, which is fixed under the currency board.

The European Commission's Spring 2016 Economic Forecast points to risks of some deviation from the SGP's preventive arm requirements in 2016 and, under unchanged policies, also in 2017. According to the European Commission's Spring 2016 Economic Forecast, the structural deficit is projected to be 1.8% of GDP in 2016 and 1.4% of GDP in 2017. Deviations from the adjustment path towards the structural balance target, in both 2016 and 2017, point to the need for further consolidation in order to achieve an annual fiscal adjustment of 0.5% of GDP towards the medium-term objective. In contrast, Bulgaria's medium-term fiscal policy, as presented in the 2016 Convergence Programme, projects a structural deficit of 1.7% in 2016 and of 0.5% and 0.2% of GDP in 2017 and 2018 respectively, below the medium-term budgetary objective of 1% of GDP.

In recent years Bulgaria has strengthened its national fiscal governance framework significantly, but there is still scope to further enhance the independence and effective operation of the relevant bodies. After delays in 2013-14, Bulgaria’s fiscal governance framework has recently been modernised through the adoption of the Law on the Fiscal Council and Automatic Correction Mechanisms in 2015. This legislation introduced: (i) an independent advisory body which monitors and analyses the fiscal stance in line with the enhanced EU fiscal governance, and (ii) a set of rules to improve transparency in, and public awareness of, fiscal governance issues. Furthermore, the law defines the mechanisms automatically correcting deviations from the medium-term objective and enforcing the adjustment path towards it. However, the fiscal council was still not operational at the time of the cut-off date for this report. Moreover, a regular and comprehensive risk-based audit of tax compliance and the shadow economy, an increase in the efficiency of public spending and a limit on contingent liabilities related to the state-owned enterprises could help in minimising potential fiscal risks.

Over the long run, Bulgaria faces medium risks to fiscal sustainability, partly as a result of age-related expenditure on health care and long-term care. The European Commission's 2015 Fiscal Sustainability Report does not foresee any significant sustainability risks over the medium term, thanks to the very low starting point of the debt ratio. In the long run, however, Bulgaria appears to be facing medium risks, reflecting an unfavourable initial budget position compounded by age-related costs on health care and long-term care. Despite measures designed to tackle the costs of ageing, Bulgaria, according to the 2015 projections by the European Commission and the EU's Economic Policy Committee,[113] is likely to experience a moderate increase in strictly age-related public expenditure (by 0.5 percentage points of GDP over the period 2013-2060 in the AWG reference scenario). In the AWG risk scenario, however, there is a notable increase in costs, amounting to 3.6 percentage points of GDP, mainly due to long-term care spending (2.5 percentage points of GDP) and health care (1.1 percentage points of GDP). These developments signal the need for further reforms in order to enhance the long-term sustainability of public finances.

Despite the low level of public debt, a prudent fiscal policy and reforms are essential for the medium-term sustainability of the public finances. A prudent and effective fiscal policy will ensure that Bulgaria complies with the preventive arm of the SGP and maintains buffers to alleviate adverse shocks. Further improvements in areas such as tax compliance, the informal economy and spending efficiency, followed by a credible fiscal framework strengthened by the efficient operation of the fiscal council, are essential for achieving medium-term fiscal sustainability. Moreover, there is scope for a more growth and environment-friendly tax system, a shift towards a lower tax wedge for lower-paid labour, an efficient use of property taxes and the cost-effective provision of healthcare services.

5.1.3 Exchange rate developments

In the two-year reference period from 19 May 2014 to 18 May 2016, the Bulgarian lev did not participate in ERM II, but its exchange rate was fixed to the euro at 1.95583 levs per euro within the framework of a currency board (see Chart 5.1.3). This framework, which was adopted in July 1997 to address the repercussions of a financial crisis and hyperinflationary pressures, was based initially on a commitment to maintain a fixed exchange rate to the Deutsche Mark. In January 1999 the reference currency was changed to the euro. Over the reference period the lev did not exhibit any deviation from the rate of 1.95583 levs per euro, which is used as a benchmark for illustrative purposes in the absence of an ERM II 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 and vice versa at the fixed rate. Short-term interest rate differentials against the three-month EURIBOR stood at a low level throughout the reference period.

113 European Commission and Economic Policy Committee, "The 2015 Ageing Report: Economic and budgetary projections for the EU-28 Member States (2013-2060)".

The real effective exchange rate of the Bulgarian lev appreciated overall over the past ten years, although it has depreciated since 2009 (see Chart 5.1.4). However, this indicator should be interpreted with caution, as during this period Bulgaria was subject to a process of economic convergence, which complicates any historical assessment of real exchange rate developments.

Bulgaria's current and capital account has improved over the past decade, while the country's net foreign liabilities remain high (see Table 5.1.3). After recording very large external deficits in 2007 and 2008, the combined current and capital account improved steadily and turned into a surplus from 2011. This improvement primarily reflected a substantial reduction in the goods deficit on account of the export-led recovery and subdued domestic demand following the sharp contraction in activity. The surplus widened to 3.1% of GDP in 2014 and 4.6% of GDP in 2015, amid further improvements in the goods balance and a growing capital account surplus owing to increased transfers to the government from EU institutions. The substantial adjustment in the balance of payments was associated with a significant contraction in net direct investment inflows from more than 20% of GDP in 2006 and 2007 to an average of 2.8% of GDP in the period from 2011 to 2015, while the balance on other investment turned into net outflows. Gross external debt increased substantially from 78.1% of GDP in 2008 to 97.4% in 2014, before declining to 82.9% in 2015. At the same time the country's net international investment position, which had deteriorated substantially from -58.0% of GDP in 2008 to -101.8% in 2009, improved to -74.8% in 2014 and -60.7% in 2015. However, the country's net foreign liabilities are still very high, with foreign direct investment accounting for the largest part of gross foreign liabilities. Fiscal and structural policies therefore continue to be important for supporting external sustainability and the competitiveness of the economy.

The Bulgarian economy is well integrated with the euro area through trade and investment linkages. In 2015 exports of goods and services to the euro area constituted 43.2% of total exports, while the corresponding figure for imports was similar, at 43.6%. The share of the euro area in Bulgaria's stock of direct investment liabilities stood at 63.4% and its share in the country's stock of portfolio investment liabilities was 54.1% in 2015. The share of Bulgaria's stock of foreign assets invested in the euro area amounted to 49.4% in the case of direct investment and 55.3% in the case of portfolio investment in 2015.

5.1.4 Long-term interest rate developments

Over the reference period from May 2015 to April 2016, long-term interest rates in Bulgaria were 2.5% on average and thus below the 4.0% reference value for the interest rate convergence criterion (see Chart 5.1.5).

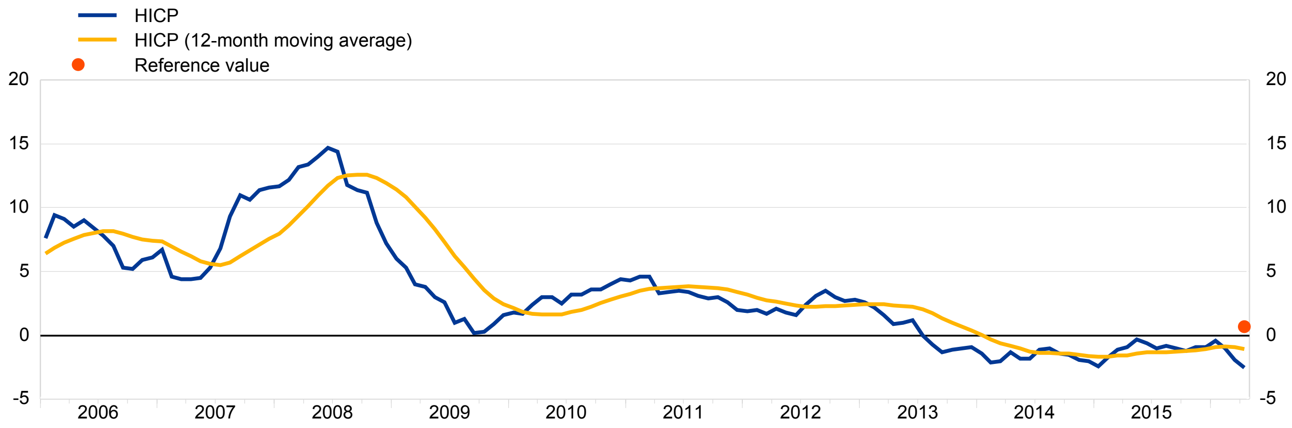
Long-term interest rates in Bulgaria have decreased since 2009, with 12-month average rates having declined from above 7% to below 3%. After an initial steep decline in 2009 and 2010, a second decline could be observed in 2012. Between 2012 and the end of 2014, Bulgarian long-term interest rates remained within a relatively narrow corridor of between 3% and 4%. Since mid-2015 12-month average long-term interest rates have fallen below 3.0%, reaching 2.5% in April 2016 (see Chart 5.1.5). It has to be kept in mind though that liquidity in the benchmark bond remains low. Interest rate developments should, therefore, be interpreted with some caution and over longer time horizons only. The banking sector turbulence throughout 2014 had some impact on longer-term sovereign yields. Furthermore, credit default swap prices have, despite some increase in December 2014, remained well below the levels observed between 2008 and 2012. Long-term interest rates again declined in 2015.

Bulgaria's long-term interest rate differentials vis-à-vis the euro area average closely mirrored developments in the level of long-term interest rates. The interest rate differential, which had increased during the 2008-09 financial crisis, decreased from 2009 onwards (see Chart 5.1.6). The reduction from 2009 onwards in Bulgarian long-term interest rates, coupled with an increase in euro area average rates, had gradually lowered the differential to around zero towards the end of 2012. Since then, the long-term interest rate differential with the euro area average has again increased slightly, to stand at 1.5 percentage points (2.2 percentage points with respect to the AAA euro area yield) at the end of the reference period.

Bulgarian capital markets are much smaller than in the euro area and still underdeveloped (see Table 5.1.4). Overall, there has been no further significant deepening of capital markets since the financial crisis. Stock market capitalisation, as a share of GDP, has declined in recent years, from a peak of 48.2% of GDP in 2007 to 9.9% at the end of 2015. Outstanding debt securities issued by non-financial institutions (a measure of market-based indebtedness) amounted to only 3.1% of GDP in 2015. Integration of the Bulgarian financial sector with the euro area, as measured by the claims of euro area banks on Bulgarian banks, is moderate. Bulgaria's financial sector is largely bank-based, with the degree of financial intermediation low compared with the euro area average, but in line with that of other recent EU Member States. MFI credit to non-government residents stood at 58.1% of GDP in 2015, down by slightly less than 10 percentage points from the peak levels in 2012 and 2013 (see Table 5.1.4). Claims of euro area MFIs on banks in Bulgaria have decreased over recent years. In an environment of ample liquidity and low demand for loans, foreign-owned subsidiaries in Bulgaria have gradually been reducing their dependence on parent group financing, turning instead to local deposits. This notwithstanding, foreign-owned banks continue to play a major role in the Bulgarian financial system.

Bulgaria - Price developments

Chart 5.1.1 HICP inflation and reference value [1)]
(annual percentage changes)



Sources: European Commission (Eurostat) and ECB calculations.
1) The basis of the calculation of the reference value for the period from May 2015 to April 2016 is the unweighted arithmetic average of the annual percentage changes in the HICP for Bulgaria, Slovenia and Spain plus 1.5 percentage points. The reference value is 0.7%.

Table 5.1.1 Measures of inflation and related indicators
(annual percentage changes, unless otherwise indicated)

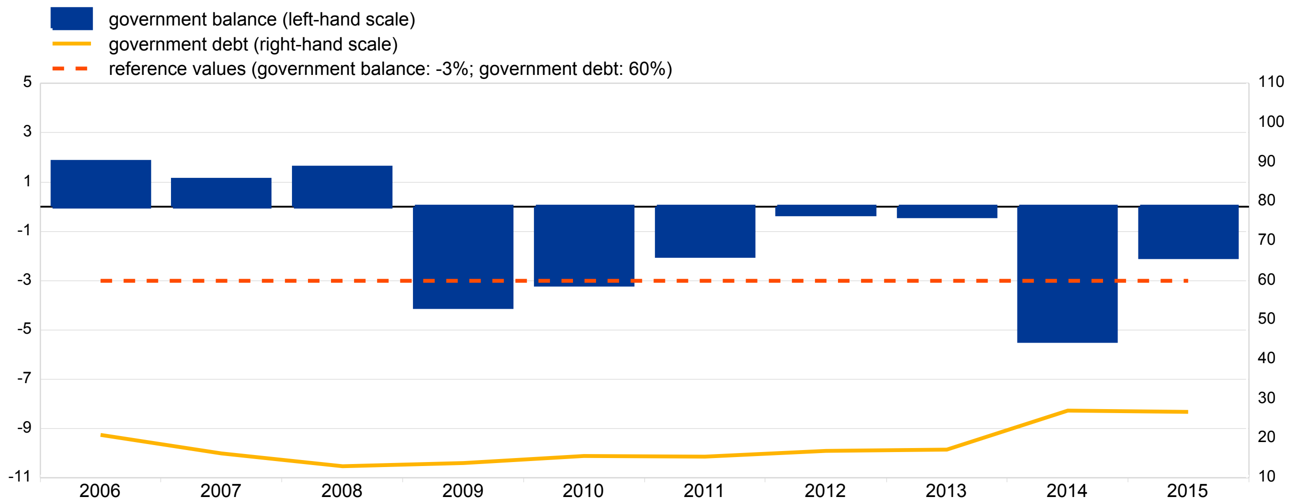
	2006-2015 [1)]	2006-2010 [1)]	2011-2015 [1)]	2011	2012	2013	2014	2015	2016 [2)]	2017 [2)]
Measures of inflation										
HICP	3.5	6.4	0.7	3.4	2.4	0.4	-1.6	-1.1	-0.7	0.9
HICP excluding unprocessed food and energy	3.7	6.9	0.5	2.6	1.2	0.3	-1.3	-0.3	0.6	0.5
HICP at constant tax rates [3)]	3.1	5.5	0.6	3.2	2.4	0.4	-1.6	-1.1	-	-
CPI	3.9	6.6	1.3	4.2	3.0	0.9	-1.4	-0.1	0.5	1.3
Private consumption deflator	2.5	4.1	0.9	4.5	3.6	-2.5	0.0	-0.8	-0.7	0.9
GDP deflator	3.9	6.2	1.7	6.9	1.6	-0.7	0.4	0.3	0.1	1.2
Producer prices [4)]	4.1	6.4	1.9	8.6	5.3	-1.3	-0.9	-1.7	-	-
Related indicators										
Real GDP growth	2.3	3.1	1.5	1.6	0.2	1.3	1.5	3.0	2.0	2.4
GDP per capita in PPS [5)] (euro area = 100)	41.2	40.0	42.7	41.7	42.7	42.8	43.7	.	-	-
Comparative price levels (euro area = 100)	47.5	46.9	48.3	48.7	49.2	48.1	47.2	.	-	-
Output gap [6)]	0.4	1.2	-0.5	-0.4	-0.6	-0.3	-0.7	-0.3	-0.6	-0.5
Unemployment rate (%) [7)]	9.6	7.7	11.4	11.3	12.3	13.0	11.4	9.2	8.6	8.0
Unit labour costs, whole economy	5.8	8.0	3.6	2.8	4.8	7.0	4.4	-0.7	1.9	2.3
Compensation per employee, whole economy	8.4	10.7	6.1	6.8	7.7	8.8	5.6	1.8	3.6	4.3
Labour productivity, whole economy	2.4	2.5	2.4	3.9	2.8	1.7	1.2	2.6	1.7	2.0
Imports of goods and services deflator	3.1	4.9	1.3	8.7	5.1	-2.2	-1.9	-2.5	-2.5	1.6
Nominal effective exchange rate [8)]	0.4	0.4	0.3	1.1	-1.4	2.0	2.0	-2.0	-	-
Money supply (M3) [9)]	12.2	15.4	9.2	12.3	8.7	9.3	7.5	8.2	-	-
Lending from banks [10)]	12.3	23.5	2.0	3.8	3.5	1.1	2.2	-0.3	-	-
Stock prices (SOFIX) [11)]	-44.2	-56.1	27.2	-11.1	7.2	42.3	6.2	-11.7	-	-
Residential property prices [12)]	-2.7	-10.2	-1.1	-5.5	-1.9	-2.2	1.4	2.8	-	-

Sources: European Commission (Eurostat, DG ECFIN), national data for CPI, money supply, lending from banks and residential property prices, and ECB calculations based on Thomson Reuters data for stock prices.
1) Multi-annual averages calculated using the geometric mean, except for GDP per capita in PPS, comparative price levels, output gap and unemployment rate, for which the arithmetic mean is used.
2) Data from the European Commission's Spring 2016 Economic Forecast.
3) The difference between the HICP and the HICP at constant tax rates shows the theoretical impact of changes in indirect taxes (e.g. VAT and excise duties) on the overall rate of inflation. This impact assumes a full and instantaneous pass-through of tax rate changes to the price paid by the consumer.
4) Domestic sales, total industry excluding construction.
5) PPS stands for purchasing power standards.
6) Percentage difference of potential GDP: a positive (negative) sign indicates that actual GDP is above (below) potential GDP.
7) Definition conforms to International Labour Organization guidelines.
8) EER-38 group of trading partners. A positive (negative) sign indicates an appreciation (depreciation).
9) The series includes repurchase agreements with central counterparties.
10) Not adjusted for the derecognition of loans from the MFI statistical balance sheet due to their sale or securitisation.
11) Multi-annual and annual figures represent the percentage change between the end of the given period and the end of the previous period.
12) Data available since 2009.

Bulgaria - Fiscal developments

Chart 5.1.2 General government balance and debt

(as a percentage of GDP)



Sources: European System of Central Banks and European Commission (Eurostat).

Table 5.1.2 Government budgetary developments and projections

(as a percentage of GDP, unless otherwise indicated)

	2006-2015 [1]	2006-2010 [1]	2011-2015 [1]	2011	2012	2013	2014	2015	2016 [2]	2017 [2]	2018	2019
Government balance	**-1.3**	**-0.5**	**-2.0**	**-2.0**	**-0.3**	**-0.4**	**-5.4**	**-2.1**	**-2.0**	**-1.6**	.	.
Total revenue	36.0	36.3	35.7	32.1	34.4	37.2	36.6	38.2	37.0	37.2	.	.
Current revenue	34.3	35.2	33.3	30.9	32.7	35.0	34.0	34.1	35.5	35.5	.	.
Direct taxes	5.3	5.6	5.1	4.6	4.7	5.1	5.4	5.5	5.6	5.5	.	.
Indirect taxes	15.2	15.6	14.9	13.8	14.9	15.4	14.8	15.5	15.7	15.7	.	.
Net social contributions	7.4	7.4	7.4	6.8	6.9	7.5	7.9	8.1	8.2	8.4	.	.
Other current revenue [3]	6.3	6.7	6.0	5.7	6.2	7.1	6.0	5.0	6.1	5.8	.	.
Capital revenue	1.7	1.1	2.4	1.2	1.7	2.2	2.6	4.1	1.4	1.7	.	.
Total expenditure	37.3	36.8	37.7	34.1	34.7	37.6	42.1	40.2	38.9	38.7	.	.
Current expenditure	31.7	31.3	32.2	30.4	30.7	33.3	33.2	33.6	33.3	33.3	.	.
Compensation of employees	9.0	8.9	9.1	8.7	8.7	9.5	9.5	9.3	9.4	9.3	.	.
Social benefits	12.7	11.8	13.7	13.0	13.0	13.9	14.5	14.3	14.7	14.8	.	.
Interest payable	0.9	0.9	0.8	0.7	0.8	0.7	0.9	1.0	1.0	1.0	.	.
Other current expenditure [4]	9.1	9.7	8.5	8.0	8.1	9.2	8.3	9.1	8.1	8.1	.	.
Capital expenditure	5.6	5.6	5.5	3.7	4.0	4.4	8.9	6.6	5.6	5.5	.	.
of which: Investment	4.7	4.9	4.5	3.4	3.4	4.1	5.2	6.2	5.0	4.9	.	.
Cyclically adjusted balance	-1.4	-0.9	-1.9	-1.9	-0.1	-0.3	-5.2	-2.0	-1.8	-1.4	.	.
One-off and temporary measures	.	.	-0.7	0.0	0.0	0.0	-3.2	-0.1	0.0	0.0	.	.
Structural balance [5]	.	.	-1.2	-1.8	-0.1	-0.3	-2.0	-1.9	-1.8	-1.4	.	.
Government debt	**18.2**	**15.9**	**20.6**	**15.3**	**16.8**	**17.1**	**27.0**	**26.7**	**28.1**	**28.7**	.	.
Average residual maturity (in years)	7.0	7.3	6.7	6.6	6.1	6.7	5.6	8.4	.	.	.	.
In foreign currencies (% of total)	77.2	77.1	77.3	74.6	79.0	72.8	80.8	79.1	.	.	.	.
of which: Euro	59.2	53.4	65.1	55.0	62.9	58.8	71.4	77.4	.	.	.	.
Domestic ownership (% of total)	46.8	42.7	50.9	53.6	48.9	52.3	47.8	52.2	.	.	.	.
Medium and long-term maturity (% of total) [6]	96.8	99.4	94.2	97.2	99.9	98.0	76.9	99.2	.	.	.	.
of which: Variable interest rate (% of total)	21.9	27.6	16.2	22.8	21.0	18.6	10.0	8.5	.	.	.	.
Deficit-debt adjustment	**-0.1**	**-1.0**	**0.7**	**-0.9**	**1.4**	**-0.1**	**4.8**	**-1.5**	.	.	.	.
Net acquisitions of main financial assets	-0.2	-0.3	0.0	-1.4	1.9	-1.7	3.7	-2.6	.	.	.	.
Currency and deposits	0.3	0.7	-0.1	-0.9	2.3	-1.3	1.7	-2.1	.	.	.	.
Debt securities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	.	.	.	.
Loans	-0.3	-0.7	0.1	-0.1	-0.1	-0.1	1.0	-0.5	.	.	.	.
Equity and investment fund shares or units	-0.2	-0.3	0.0	-0.4	-0.3	-0.3	1.0	0.0	.	.	.	.
Revaluation effects on debt	0.0	-0.1	0.0	0.1	-0.2	-0.3	0.3	0.2	.	.	.	.
of which: Foreign exchange holding gains/losses	0.0	-0.1	0.0	0.1	-0.1	-0.2	0.3	0.1	.	.	.	.
Other [7]	0.1	-0.6	0.7	0.4	-0.3	1.9	0.9	0.9	.	.	.	.
Convergence programme: government balance	-	-	-	-	-	-	-	-	-1.9	-0.8	-0.4	-0.2
Convergence programme: structural balance	-	-	-	-	-	-	-	-	-1.7	-0.5	-0.2	0.0
Convergence programme: government debt	-	-	-	-	-	-	-	-	31.7	31.2	31.8	30.8

Sources: European System of Central Banks and European Commission (Eurostat, DG ECFIN).

1) Multi-annual averages.

2) Data from the European Commission's Spring 2016 Economic Forecast, except for convergence programme data.

3) Sales and other current revenue.

4) Intermediate consumption, subsidies payable and other current expenditure.

5) Cyclically-adjusted balance excluding one-off and other temporary measures.

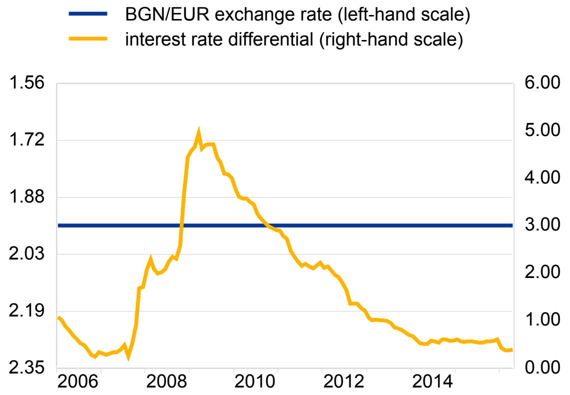
6) Original maturity of more than one year.

7) Time of recording differences and other discrepancies (sector reclassifications and statistical discrepancies).

Bulgaria - Exchange rate and external developments

Chart 5.1.3 Bilateral exchange rate and short-term interest rate differential

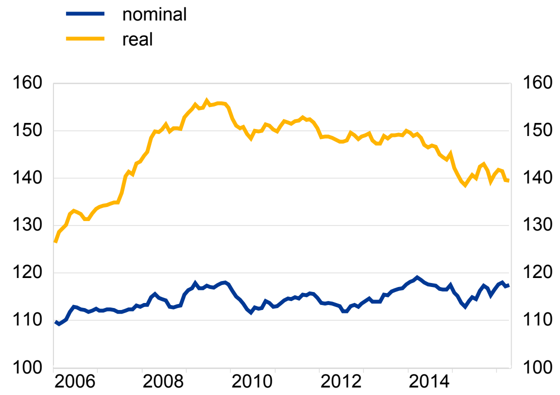
(BGN/EUR exchange rate: monthly averages;
difference between three-month interbank interest rates
and three-month EURIBOR: basis points, monthly values)



Sources: National data and ECB calculations.

Chart 5.1.4 Effective exchange rates [1]

(EER-38 group of trading partners; monthly averages; base index: Q1 1999 = 100)



Source: ECB.
1) The real EER-38 is CPI deflated. An increase (decrease) in the EER indicates an appreciation (depreciation).

Table 5.1.3 External developments

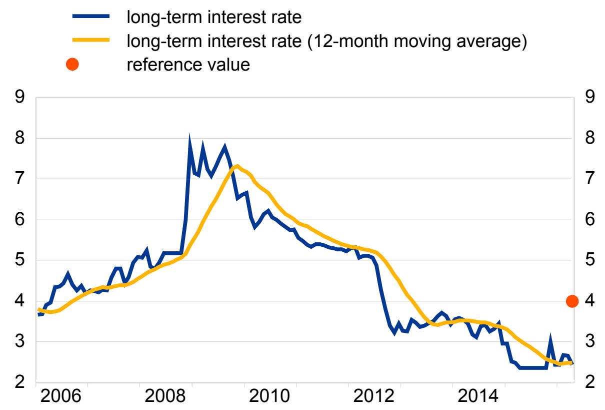
(as a percentage of GDP, unless otherwise indicated)

	2008-2015 [1]	2008-2010 [1]	2011-2015 [1]	2011	2012	2013	2014	2015	2016 [2]	2017 [2]
Balance of payments										
Current account and capital account balance [3]	-2.1	-9.7	2.4	1.6	0.5	2.4	3.1	4.6	3.5	3.8
Current account balance	-3.6	-10.7	0.6	0.3	-0.9	1.3	0.9	1.4	2.3	2.7
Goods	-10.2	-15.8	-6.8	-6.6	-9.6	-7.0	-6.5	-4.3	.	.
Services	6.1	5.7	6.3	6.7	6.2	6.3	5.9	6.1	.	.
Primary income	-3.4	-3.6	-3.3	-3.9	-2.5	-3.8	-2.3	-4.1	.	.
Secondary income	3.9	3.0	4.5	4.1	5.0	5.7	3.8	3.7	.	.
Capital account balance	1.5	0.9	1.8	1.2	1.3	1.1	2.2	3.2	.	.
Combined direct and portfolio investment balance [3]	-4.3	-6.6	-2.9	-2.0	-0.4	-2.7	-4.9	-4.7	.	.
Direct investment	-4.9	-8.4	-2.8	-2.9	-2.6	-3.0	-2.1	-3.4	.	.
Portfolio investment	0.6	1.8	-0.2	0.9	2.1	0.3	-2.8	-1.3	.	.
Other investment balance	-0.3	-4.5	2.1	4.7	-2.4	5.8	0.0	2.6	.	.
Reserve assets	2.0	-0.2	3.4	0.4	5.1	-1.3	4.2	8.4	.	.
Exports of goods and services	58.4	50.2	63.3	59.5	61.1	64.7	64.9	66.4	.	.
Imports of goods and services	62.5	60.3	63.9	59.4	64.5	65.3	65.6	64.6	.	.
Net international investment position [4]	-	-	-74.2	-83.4	-78.4	-73.5	-74.8	-60.7	.	.
Gross external debt [4]	-	-	91.2	91.6	93.2	91.1	97.4	82.9	.	.
Internal trade with the euro area [5]										
Exports of goods and services	.	.	42.4	42.8	41.6	42.0	42.6	43.2	.	.
Imports of goods and services	.	.	42.3	41.9	41.9	41.9	42.4	43.6	.	.
Investment position with the euro area [5]										
Direct investment assets [4]	.	.	52.0	54.7	55.8	51.9	48.4	49.4	.	.
Direct investment liabilities [4]	.	.	65.6	69.1	66.8	64.4	64.6	63.4	.	.
Portfolio investment assets [4]	.	.	47.8	53.8	42.6	43.9	43.5	55.3	.	.
Portfolio investment liabilities [4]	-	-	62.6	65.9	72.4	63.5	56.9	54.1	.	.

Sources: European System of Central Banks and European Commission (Eurostat, DG ECFIN).
Note: Backdata are available from 2008.
1) Multi-annual averages.
2) Data from the European Commission's Spring 2016 Economic Forecast.
3) Differences between totals and sum of their components are due to rounding.
4) End-of-period outstanding amounts.
5) As a percentage of the total.

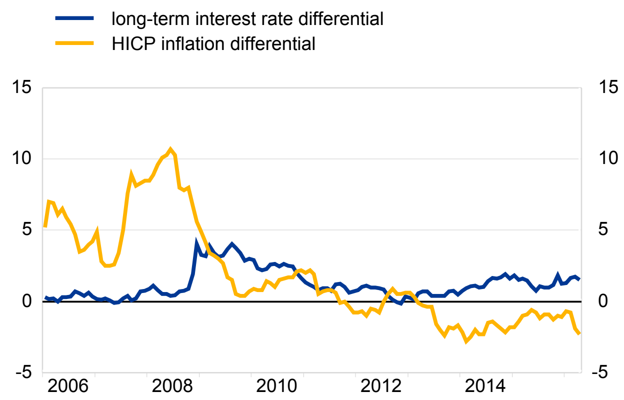
Bulgaria - Long-term interest rate developments

Chart 5.1.5 Long-term interest rate 1)
(monthly averages in percentages)



Sources: European System of Central Banks and ECB calculations.
1) The basis of the calculation of the reference value for the period from May 2015 to April 2016 is the unweighted arithmetic average of the interest rate levels in Bulgaria, Slovenia and Spain plus 2 percentage points. The reference value is 4.0%.

Chart 5.1.6 Long-term interest rate and HICP inflation differentials vis-à-vis the euro area
(monthly averages in percentage points)



Sources: European System of Central Banks, ECB calculations and European Commission (Eurostat).

Table 5.1.4 Long-term interest rates and indicators of financial development and integration
(as a percentage of GDP, unless otherwise indicated)

	2006-2015 [1]	2006-2010 [1]	2011-2015 [1]	2012	2013	2014	2015	May 2015 to Apr. 2016	Memo item: euro area 2015
Long-term interest rates									
Bulgaria [2]	4.6	5.5	3.8	4.5	3.5	3.3	2.5	2.5	-
Euro area [2), 3)]	3.4	4.0	2.9	3.9	3.0	2.0	1.2	1.2	-
Euro area AAA par curve, ten-year residual maturity [2), 3)]	2.8	3.8	1.8	2.1	1.9	1.4	0.6	0.6	-
Indicators of financial development and integration									
Debt securities issued by financial corporations [4]	1.4	1.7	1.0	0.9	1.2	1.2	1.1	-	73.6
Debt securities issued by non-financial corporations [5]	1.9	1.4	2.4	1.3	3.2	3.1	3.1	-	10.8
Stock market capitalisation [6]	18.3	24.4	12.2	12.1	12.1	11.5	9.9	-	60.4
MFI credit to non-government residents [7]	63.2	62.0	64.3	67.7	67.5	61.1	58.1	-	114.7
Claims of euro area MFIs on resident MFIs [8]	12.7	16.2	9.2	11.9	9.7	8.8	4.2	-	27.4

Sources: European System of Central Banks and ECB calculations.
1) Multi-annual averages calculated using the arithmetic average.
2) Average interest rate.
3) Included for information only.
4) Outstanding amount of debt securities issued by resident MFIs and other financial corporations.
5) Outstanding amount of debt securities issued by resident non-financial corporations.
6) Outstanding amount of listed shares issued by residents at the end of the period at market values.
7) MFI (excluding NCB) credit to domestic non-MFI residents other than general government. Credit includes outstanding amounts of loans and debt securities.
8) Outstanding amount of deposits and debt securities issued by domestic MFIs (excluding the NCB) held by euro area MFIs as a percentage of total liabilities of domestic MFIs (excluding the NCB). Total liabilities exclude capital and reserves and remaining liabilities.

5.2 Czech Republic

5.2.1 Price developments

In April 2016 the 12-month average rate of HICP inflation in the Czech Republic was 0.4%, i.e. below the reference value of 0.7% for the criterion on price stability (see Chart 5.2.1). This rate is expected to remain broadly stable over the coming months.

Over the past ten years the 12-month average rate of HICP inflation has fluctuated within a relatively wide range, from 0.3% to 6.6%, and the overall average for that period was moderate, standing at 2.1%. For most of the period under review, growth in compensation per employee exceeded labour productivity growth (see Table 5.2.1). In the years leading up to the global financial crisis, inflation picked up from moderate levels, mainly as a result of higher food and energy prices, and some administrative measures. Having peaked at an average annual rate of 6.3% in 2008, inflation fell sharply as global commodity prices declined and economic activity slowed. Yet, the recession that started in 2009 was relatively modest compared with that in other central and eastern European economies. Over the period 2010-12 the rebound in global commodity prices, as well as hikes in administered prices and the value added tax rate, gradually pushed up inflation. A temporary export-led recovery was accompanied by fiscal restrictions, which ultimately resulted in a further recession in 2012-13. This, along with the developments in global commodity prices, led to a significant fall in inflation between 2012 and 2015. In 2014 growth in import prices picked up, owing partly to the exchange rate floor of 27 korunas per euro set by Česká národní banka as a complementary and temporary instrument for lifting inflation towards its 2% inflation target. In the most recent years the Czech economy has returned to a path of solid growth. However, this robust performance has been exerting pressure on the exchange rate, forcing Česká národní banka since July 2015 to intervene on the foreign exchange market in order to uphold its commitment not to let the koruna appreciate against the euro beyond a level of close to 27.

For the first four months of 2016, the average annual rate of HICP inflation stood at 0.5%. The robust underlying growth momentum exerted upward pressure on consumer prices. At the same time, the decline in global commodity prices in 2015 weighed on headline inflation.

Policy choices have played an important role in shaping inflation dynamics in the Czech Republic over the past decade, most notably the orientation of monetary policy towards price stability. Since April 2001 the inflation target has been defined in terms of CPI inflation, originally as a continuously declining band and since 2006 as a flat point target. The CPI inflation target was set at 3% (±1 percentage point) in 2006 and reduced to 2% (±1 percentage point) on 1 January 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.

Inflation in the Czech Republic is expected to increase in the coming years, albeit remaining at a subdued level. According to the European Commission's Spring 2016 Economic Forecast, the average annual rate of HICP inflation will remain broadly stable in 2016, at around 0.5%, and increase to 1.4% in 2017. Risks to the medium-term inflation outlook are broadly balanced. Upside risks relate to stronger than expected wage increases amid tightening labour market conditions, while downside risks may arise from heightened uncertainty regarding developments in the global economy, which could reduce external price pressures. Looking further ahead, the catching-up process may have a bearing on inflation and/or the nominal exchange rate over the coming years, given that GDP per capita and price levels are still lower in the Czech Republic than in the euro area.

Achieving an environment that is conducive to sustainable convergence in the Czech Republic requires conducting price stability-oriented economic policies, including targeted structural reforms that are geared to ensuring macroeconomic stability. In order to boost potential growth, it is necessary to enhance the functioning of the labour market, for example, by reducing disincentives to work and addressing skill mismatches. It is also essential to strengthen competition in product markets (in particular the electricity, gas and telecommunications markets), to improve the effectiveness of the public administration and to increase investment in infrastructure. Against this background, additional efforts are needed to ensure that the Czech Republic maintains and improves its absorption of EU funds. Priority should also be given to further enhancing the business environment by removing impediments to conducting business and liberalising the regulated professions. Emphasis should continue to be placed on the expansion of the services sector and the fight against corruption in the public sector. As the process of income convergence vis-à-vis the euro area is slow, the implementation of these structural measures should facilitate further changes to the Czech Republic's growth model, which, until recently, has relied mainly on foreign direct investment and exports of manufacturing goods. With regard to macroeconomic imbalances, the European Commission did not select the Czech Republic for an in-depth review in its Alert Mechanism Report 2016.

Financial sector policies should be geared to safeguarding financial stability and ensuring that the financial sector makes a sound contribution to sustainable economic growth. In particular, continued vigilance and a careful monitoring of potential risks and close cross-border cooperation is needed, given the high level of foreign ownership in the financial sector. In June 2015 Česká národní banka issued a set of recommendations aimed at mitigating risks related to loans secured by residential property. The full implementation of these recommendations could help to mitigate the effect of housing credit on residential real estate prices. Furthermore, in December 2015 Česká národní banka decided to set the countercyclical capital buffer rate at 0.5%, applicable as of January 2017.

5.2.2 Fiscal developments

The deficit and debt complied with the Maastricht criteria in 2015. In the reference year 2015 the general government budget balance recorded a deficit of 0.4% of GDP, i.e. well below the 3% reference value and close to a balanced budget. The general government gross debt-to-GDP ratio was 41.1%, i.e. below the 60% reference value (see Table 5.2.2). Compared with the previous year, both the deficit and the debt-to-GDP ratio decreased by 1.5 and 1.6 percentage points of GDP respectively. The deficit ratio is forecast by the European Commission to increase slightly to 0.7% in 2016, while the government debt ratio is projected to increase to 41.3%. With regard to other fiscal factors, the deficit ratio did not exceed the ratio of public investment to GDP in 2015, nor is it expected to in 2016.

The Czech Republic has been subject to the preventive arm of the Stability and Growth Pact since 2014. Against the background of the rise in the budget deficit above the reference value in 2008, the ECOFIN Council decided on 2 December 2009 that an excessive deficit situation existed in the Czech Republic and set 2013 as the deadline for correcting it. The ECOFIN Council abrogated the excessive deficit procedure on 17 June 2014. Since 2014 the Czech Republic has been subject to the preventive arm, having complied with its medium-term objective of a structural deficit of no more than 1% of GDP in 2015. The European Commission's forecast projects the structural deficit to remain below the medium-term objective and, thus, in compliance with the preventive arm’s requirements.

Non-cyclical factors have contributed to the deficit reduction over recent years, which have partly been offset by unfavourable cyclical developments. The deficit ratio reached its peak at 5.5% of GDP in 2009 and declined to 0.4% of GDP in 2015. European Commission estimates (presented in Table 5.2.2) indicate that the structural balance improved by 4.5 percentage points between 2009 and 2015, reflecting the significant consolidation measures adopted by the Czech government, which were partly offset by adverse cyclical factors. Consolidation measures included increases in indirect taxation, property taxes and the social security contribution ceiling on the revenue side, as well as decreases in selected social benefits, reforms of the pension and healthcare systems, and cuts in the government wage bill and employment on the expenditure side.

The debt-to-GDP ratio increased strongly during the crisis, but has recently stabilised at levels below the 60% reference value. The debt ratio increased rapidly, from 28.7% of GDP in 2008 to 45.1% of GDP in 2013, driven by high primary deficits and the recession (see Chart 5.2.2). Since 2013 the debt ratio has been on a downward path on the back of deficit-debt adjustments, a recovery in GDP growth and a favourable contribution from the primary balance. The impact of deficit-debt adjustments over the entire period was volatile, with both debt-increasing and debt-decreasing effects in certain years before 2015 (see Table 5.2.2).

The level and structure of government debt protects the Czech Republic from sudden changes in market conditions. Debt remains long term and denominated in national currency. The share of government debt with a short-term maturity is low (5.2% in 2015 – see Table 5.2.2). Taking into account the level of the debt ratio, fiscal balances are insensitive to changes in interest rates. At the same time, the proportion of foreign currency-denominated government debt is noticeable (13.5% in 2015), most of it being denominated in euro (92% of foreign-denominated debt). Taking the size of the debt as a share of GDP into consideration, this leaves fiscal balances relatively insensitive to changes in exchange rates. Despite some fluctuations, the share of debt denominated in euro and other foreign currency has been on a decreasing path since 2012, pointing to a decline in exchange-rate related vulnerabilities. The Czech Republic has not incurred contingent liabilities resulting from government interventions to support financial institutions or markets during the crisis.

The European Commission's Spring 2016 Economic Forecast points to compliance with the medium-term objective over the forecast horizon. According to the European Commission's forecast, the structural deficit is projected to increase to 0.7% of GDP in 2016 and 0.9% of GDP in 2017 from a level of 0.4% of GDP in 2015. However, the structural deficit level will remain below the medium-term objective (i.e. a structural deficit of 1% of GDP) and, thus, in compliance with preventive arm's requirements. The Czech Republic's medium-term fiscal policy strategy, as presented in the 2016 Convergence Programme update submitted to the European Commission, projects the structural deficit to gradually increase, but to remain at the medium-term objective between 2017 and 2019.

The Czech Republic has strengthened its national fiscal governance framework significantly in recent years, but there is scope for further enhancement. The Czech Republic's fiscal governance framework is in the process of being comprehensively strengthened by: (i) a national budgetary council, which will perform the function of an independent fiscal institution, legislated at constitutional level; (ii) a budgetary planning framework based on realistic and independently assessed macro and fiscal forecasts over the medium term; (iii) a modified numerical (expenditure) fiscal rule, which will encompass the whole public sector and is compatible with the medium-term objective; and (iv) increased transparency and accountability (open data portal, new act on management and financial control in public administration, etc.). However, reform implementation has been slow and the enforcement has been deemed to be weak thus far. In terms of broadening the scope of the current fiscal framework reforms and enforcing the rules more strictly, the Czech Republic would benefit from a streamlining of the tax system and a more efficient tax administration – addressing compliance gaps (especially for VAT) – as well as a comprehensive review of the tax system that is oriented towards reducing the tax wedge on labour and promoting taxation that promotes growth and the environment. The Czech Republic is not among the signatories to the Fiscal Compact. However, the authorities recently signalled their determination to ratify this treaty.

An ageing population poses a significant challenge to the long-term sustainability of public finances. The European Commission's 2015 Fiscal Sustainability Report does not foresee any risks over the short and medium term, and foresees medium risks over the long term. This long-term risk assessment is largely a result of the projected impact of age-related public spending, and is further compounded by the slightly unfavourable initial budgetary position. Regarding the increase in age-related spending, the Czech Republic has taken several measures. Notably, authorities have (i) introduced parametric reforms pertaining to the gradual increase in the statutory retirement age, (ii) proposed changes to the pension indexation scheme, and (iii) abolished the voluntary full-funded pillar scheme established in 2013. Despite some of these measures and an improvement in the demographic outlook in the 2015 projection vintage by the European Commission and the EU's Economic Policy Committee,[114] the AWG report places the Czech Republic among the countries likely to experience a significant increase in strictly age-related public expenditure. This increase is forecast to amount to 3.1 percentage points of GDP between 2013 and 2060 in the AWG reference scenario and 8.4 percentage points of GDP in the AWG risk scenario (of which 5.2 percentage points and 1.7 percentage points of GDP stem from long-term care and health care respectively). These increases in ageing costs would be significantly above the EU average, suggesting that comprehensive pension and healthcare reforms are warranted in order to enhance the long-term sustainability of public finances.

Enhancing the current reforms, strictly enforcing the existing rules and having a prudent fiscal policy are necessary in order to retain the overall sound fiscal position of the Czech Republic. The Czech Republic should ensure compliance with its medium-term objective in 2016 and beyond. The risks to the fiscal sector should be contained through the introduction of reforms that tackle both expenditure (e.g. an anti-corruption plan and governance of the healthcare sector) and revenue (fighting tax evasion and streamlining the tax system). Over the longer term, the risks to medium-term fiscal sustainability are determined by the high and rising mandatory expenditure, combined with relatively large increases in ageing-related spending. Thus, comprehensive and determined structural reforms, focusing on the pension system, health care and improving the efficiency of public administration, are needed.

5.2.3 Exchange rate developments

In the two-year reference period from 19 May 2014 to 18 May 2016, the Czech koruna did not participate in ERM II, but traded under a flexible exchange rate regime involving a commitment by Česká národní banka not to let the currency appreciate beyond a certain level (see Chart 5.2.3). On 7 November 2013 Česká národní banka had announced that it would intervene in foreign exchange markets with the goal of weakening the koruna in order to prevent a long-term undershooting of the inflation target and made a temporary commitment not to let the exchange rate of the koruna against the euro appreciate beyond a level of 27 korunas per euro. This temporary commitment was initially expected to be in place at least until the beginning of 2015 and was later gradually extended until at least 2017. Over the reference period the Czech currency mostly traded close to its May 2014 average exchange rate against the euro of 27.437 korunas per euro, which is used as a

[114] European Commission and Economic Policy Committee, "The 2015 Ageing Report: Economic and budgetary projections for the EU-28 Member States (2013-2060)", prepared by AWG.

benchmark for illustrative purposes in the absence of an ERM II central rate. On 18 May 2016 the exchange rate stood at 27.022 korunas per euro, i.e. 1.5% stronger than its average level in May 2014. Over the reference period the maximum upward deviation from this benchmark was 1.5%, while the maximum downward deviation amounted to 3.5%. Looking back over a longer period the exchange rate of the Czech koruna against the euro has appreciated by 4.4% over the past ten years.

The Czech koruna exhibited a low degree of volatility against the euro over the two-year reference period. After the introduction of a nominal exchange rate floor for the koruna vis-à-vis the euro, the koruna traded at more than 27 koruna per euro from November 2013 to the beginning of 2015. Subsequently, a strong economic performance and speculative capital inflows to the Czech economy, which coincided with monetary policy decisions in the country's key trading partners, added to upward pressures on the currency. Over the period under review Česká národní banka sold domestic currency in exchange for foreign currency to uphold its temporary commitment not to let the exchange rate appreciate beyond 27 korunas per euro. As a result of these interventions, foreign currency reserves increased and reached 39% of GDP in March 2016. Over the reference period short-term interest rate differentials against the three-month EURIBOR were overall small, and stood at 0.5 percentage point in the three-month period ending in March 2016.

The real effective exchange rate of the Czech koruna has appreciated overall over the past ten years, although it has depreciated since mid-2008 (see Chart 5.2.4). However, this indicator should be interpreted with caution, as during this longer period the Czech Republic was subject to a process of economic convergence, which complicates any historical assessment of real exchange rate developments.

The current account deficit gradually shrank and the balance turned positive from 2014, which resulted in a reduction in the country's net foreign liabilities (see Table 5.2.3). The external liabilities predominantly reflected direct investments. Since 2013 a surplus in the combined current and capital account has been recorded, which reached 3.3% of GDP in 2015. The shifts recorded in the Czech Republic's balance of payments over the past few years have also been associated with significant capital inflows. The large net inflows in direct investment of, on average, more than 5% of GDP exceeded the financing needs of the Czech economy up until 2007. However, the pace of net inflows of direct investment has since slowed. Against this background, gross external debt increased gradually to 70.7% of GDP in 2015. At the same time the country's net international investment position deteriorated up to 2012, before improving to reach -31.5% of GDP in 2015.

The Czech economy is well integrated with the euro area through trade and investment linkages. In 2015 exports of goods and services to the euro area constituted 63.1% of total exports, while the corresponding figure for imports was lower, at 52.8%. The share of the euro area in the Czech Republic's stock of inward direct investment stood at 80.3% in 2015, and its share in the country's stock of portfolio investment liabilities was 47.4% in 2015. The share of the Czech Republic's stock of foreign assets invested in the euro area amounted to 79.2% in the case of direct investment and 72.7% in the case of portfolio investment in 2015.

5.2.4 Long-term interest rate developments

Over the reference period from May 2015 to April 2016, long-term interest rates in the Czech Republic were 0.6% on average and thus well below the 4.0% reference value for the interest rate convergence criterion (see Chart 5.2.5).

Long-term interest rates in the Czech Republic have decreased from above 5% in 2009 to 0.4% at the end of the reference period. The fall in long-term interest rates was particularly pronounced in 2012 and 2014, with sovereign credit default swap prices also having decreased substantially in 2012, down from elevated levels during the euro area sovereign debt crisis. A further decrease in sovereign credit default swap prices was observed in 2014 when the Czech Republic returned to positive GDP growth. As with a number of euro area countries, some volatility of long-term rates could be observed in the context of the euro area sovereign debt crisis.

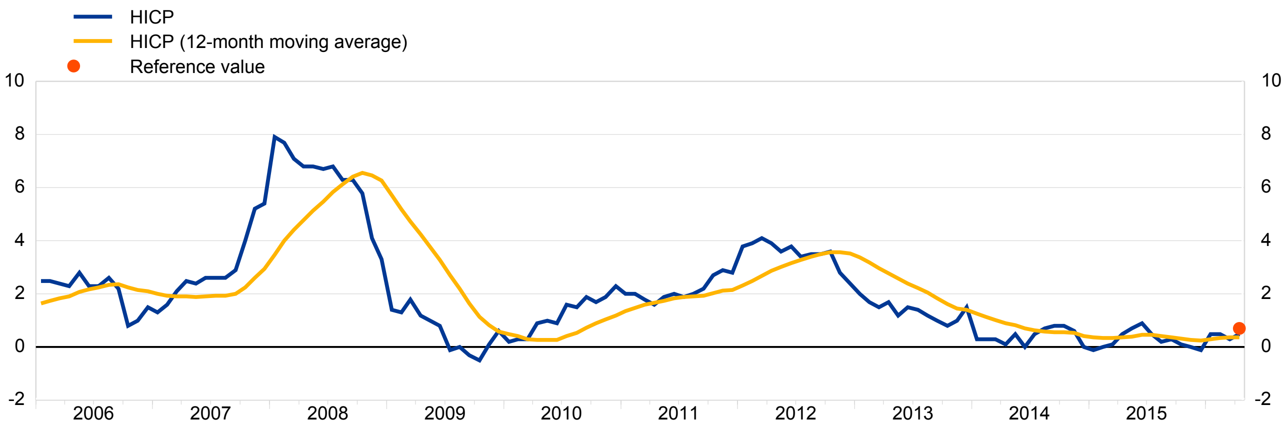
The Czech Republic's long-term interest rate differential vis-à-vis the euro area has remained negative since 2011. The interest rate differential, which had increased into positive territory during the 2008-09 financial crisis and peaked in late 2009, decreased from 2009 onwards and turned negative in late 2010 (see Chart 5.2.6). The long-term interest rate differential reached its low point in August 2012, when it stood at -1.5 percentage points. This marked decline reflected both domestic policy rate cuts and an improvement in euro area financial markets, which led to a decrease in the credit spread. The differential subsequently narrowed in 2013 when rates declined less than they did in the euro area. Since 2014, the long-term interest rate differential has remained between 0 and -1 percentage points, standing at -0.5 percentage points vis-à-vis the euro area average at the end of the reference period, with the Czech Republic's rates being 0.2 percentage points above the euro area AAA yield.

Capital markets in the Czech Republic are smaller and much less developed than those in the euro area (see Table 5.2.4). Stock market capitalisation, as a share of GDP, has declined in recent years, from a peak of close to 25% of GDP before the financial crisis to 14.2% at the end of 2015. Outstanding debt securities issued by non-financial institutions (a measure of market-based indebtedness) amounted to 7.6% of GDP in 2015. In common with most of the Czech Republic's regional peers, the limited development of non-bank capital markets is largely due to the Czech financial system being heavily bank-based, with a small share of assets under management being held by the insurance sector. Integration of the Czech Republic's financial sector with the euro area, as measured by the claims of euro area banks on the Czech Republic's banks, is moderate. The degree of financial intermediation is low compared with the euro area average, but in line with that of other non-euro area EU Member States in central and eastern Europe. MFI credit to non-government residents in 2015 stood at 54.7% of GDP – less than half the euro area average (see Table 5.2.4). Furthermore, claims of euro area MFIs on resident MFIs remain low, at less than half of the euro area average. This notwithstanding, both indicators have increased in recent years and now stand higher than they did prior to the financial crisis.

Czech Republic - Price developments

Chart 5.2.1 HICP inflation and reference value [1)]

(annual percentage changes)



Sources: European Commission (Eurostat) and ECB calculations.

1) The basis of the calculation of the reference value for the period from May 2015 to April 2016 is the unweighted arithmetic average of the annual percentage changes in the HICP for Bulgaria, Slovenia and Spain plus 1.5 percentage points. The reference value is 0.7%.

Table 5.2.1 Measures of inflation and related indicators

(annual percentage changes, unless otherwise indicated)

	2006-2015 [1)]	2006-2010 [1)]	2011-2015 [1)]	2011	2012	2013	2014	2015	2016 [2)]	2017 [2)]
Measures of inflation										
HICP	2.1	2.6	1.5	2.2	3.5	1.4	0.4	0.3	0.5	1.4
HICP excluding unprocessed food and energy	1.7	2.1	1.3	1.4	2.5	1.0	1.1	0.8	0.8	1.5
HICP at constant tax rates [3)]	1.4	1.7	1.0	2.2	2.2	0.4	0.3	0.1	-	-
CPI	2.1	2.8	1.5	1.9	3.3	1.4	0.4	0.3	-	-
Private consumption deflator	1.6	2.2	1.1	1.6	2.2	0.9	0.5	0.1	0.5	1.4
GDP deflator	1.3	1.5	1.2	-0.2	1.4	1.4	2.5	0.7	1.0	1.3
Producer prices [4)]	1.2	1.6	0.9	5.5	2.1	0.8	-0.8	-3.2	-	-
Related indicators										
Real GDP growth	1.9	2.4	1.3	2.0	-0.9	-0.5	2.0	4.2	2.1	2.6
GDP per capita in PPS [5)] (euro area = 100)	76.4	75.6	77.4	76.4	76.2	77.5	79.2	.	-	-
Comparative price levels (euro area = 100)	67.9	67.8	67.9	71.6	70.3	67.1	62.8	.	-	-
Output gap [6)]	0.4	2.3	-1.4	-0.3	-1.6	-2.8	-2.2	0.0	0.2	0.7
Unemployment rate (%) [7)]	6.3	6.2	6.4	6.7	7.0	7.0	6.1	5.1	4.5	4.4
Unit labour costs, whole economy	1.3	1.8	0.7	0.6	3.1	0.6	0.1	-0.5	1.5	1.3
Compensation per employee, whole economy	2.7	3.8	1.6	2.8	1.7	-0.3	1.5	2.4	3.2	3.6
Labour productivity, whole economy	1.4	1.9	0.9	2.2	-1.3	-0.8	1.4	3.0	1.7	2.3
Imports of goods and services deflator	0.4	-0.8	1.5	2.3	3.7	0.5	2.6	-1.5	-1.9	1.4
Nominal effective exchange rate [8)]	0.7	3.4	-1.9	3.3	-4.3	-1.5	-4.8	-2.2	-	-
Money supply (M3) [9)]	7.1	8.7	5.5	2.9	5.3	5.2	5.7	8.3	-	-
Lending from banks [10)]	9.3	13.8	4.9	5.9	3.4	3.8	4.5	7.1	-	-
Stock prices (PX Index) [11)]	-35.1	-16.8	-21.9	-25.6	14.0	-4.8	-4.3	1.0	-	-
Residential property prices [12)]	-0.1	-2.8	1.0	0.0	-1.4	0.0	2.4	4.0	-	-

Sources: European Commission (Eurostat, DG ECFIN), national data for CPI, money supply, lending from banks and residential property prices, and ECB calculations based on Thomson Reuters data for stock prices.

1) Multi-annual averages calculated using the geometric mean, except for GDP per capita in PPS, comparative price levels, output gap and unemployment rate, for which the arithmetic mean is used.

2) Data from the European Commission's Spring 2016 Economic Forecast.

3) The difference between the HICP and the HICP at constant tax rates shows the theoretical impact of changes in indirect taxes (e.g. VAT and excise duties) on the overall rate of inflation. This impact assumes a full and instantaneous pass-through of tax rate changes to the price paid by the consumer.

4) Domestic sales, total industry excluding construction.

5) PPS stands for purchasing power standards.

6) Percentage difference of potential GDP: a positive (negative) sign indicates that actual GDP is above (below) potential GDP.

7) Definition conforms to International Labour Organization guidelines.

8) EER-38 group of trading partners. A positive (negative) sign indicates an appreciation (depreciation).

9) The series includes repurchase agreements with central counterparties.

10) Not adjusted for the derecognition of loans from the MFI statistical balance sheet due to their sale or securitisation.

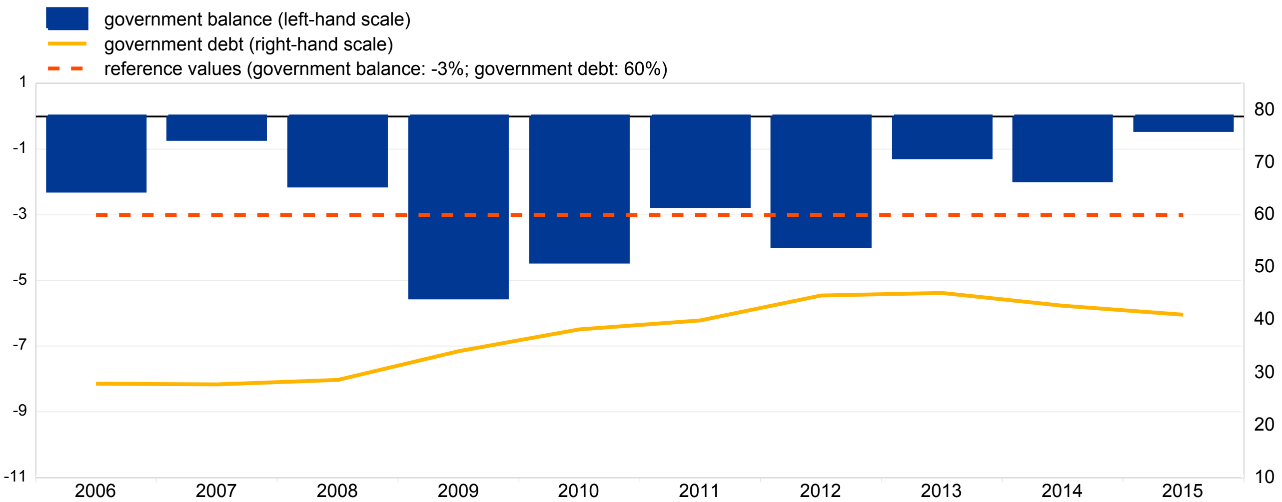
11) Multi-annual and annual figures represent the percentage change between the end of the given period and the end of the previous period.

12) Data available since 2008.

Czech Republic - Fiscal developments

Chart 5.2.2 General government balance and debt

(as a percentage of GDP)



Sources: European System of Central Banks and European Commission (Eurostat).

Table 5.2.2 Government budgetary developments and projections

(as a percentage of GDP, unless otherwise indicated)

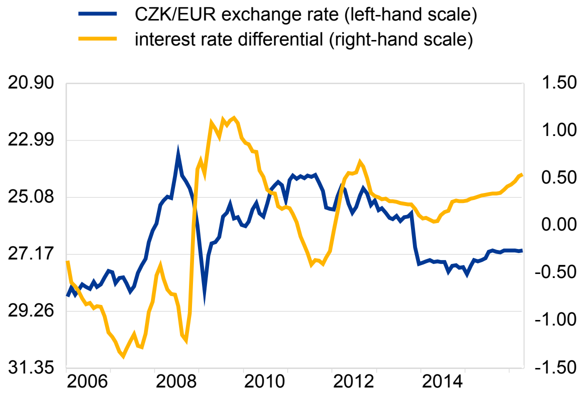
	2006-2015 1)	2006-2010 1)	2011-2015 1)	2011	2012	2013	2014	2015	2016 2)	2017 2)	2018	2019
Government balance	**-2.5**	**-3.0**	**-2.1**	**-2.7**	**-3.9**	**-1.3**	**-1.9**	**-0.4**	**-0.7**	**-0.6**	.	.
Total revenue	39.8	38.5	41.1	40.4	40.7	41.6	40.8	42.2	40.7	40.7	.	.
Current revenue	38.7	37.5	39.8	39.1	39.8	40.6	39.6	40.0	39.8	39.9	.	.
Direct taxes	7.4	7.6	7.2	7.0	7.0	7.2	7.4	7.4	7.3	7.4	.	.
Indirect taxes	11.5	10.6	12.3	12.0	12.4	12.8	12.0	12.5	12.5	12.5	.	.
Net social contributions	14.8	14.8	14.8	14.7	14.9	14.9	14.8	14.8	15.0	15.0	.	.
Other current revenue 3)	5.0	4.5	5.5	5.4	5.5	5.7	5.4	5.4	5.0	5.0	.	.
Capital revenue	1.2	1.0	1.3	1.3	1.0	1.0	1.2	2.2	0.9	0.9	.	.
Total expenditure	42.4	41.5	43.2	43.2	44.7	42.8	42.8	42.6	41.4	41.3	.	.
Current expenditure	36.3	35.1	37.5	37.5	37.6	38.2	37.5	36.7	36.9	36.8	.	.
Compensation of employees	8.0	7.2	8.9	8.7	8.9	9.0	8.9	8.9	9.0	9.1	.	.
Social benefits	16.9	17.5	16.3	16.2	16.4	16.6	16.3	15.9	16.0	15.9	.	.
Interest payable	1.2	1.1	1.3	1.3	1.4	1.3	1.3	1.1	1.0	1.0	.	.
Other current expenditure 4)	10.2	9.3	11.0	11.3	10.8	11.2	10.9	10.8	10.9	10.8	.	.
Capital expenditure	6.0	6.4	5.7	5.6	7.1	4.7	5.3	5.9	4.4	4.6	.	.
of which: Investment	4.6	4.9	4.4	4.5	4.2	3.7	4.2	5.2	3.8	3.9	.	.
Cyclically adjusted balance	-2.7	-4.0	-1.5	-2.6	-3.2	-0.1	-1.0	-0.4	-0.8	-0.9	.	.
One-off and temporary measures	.	.	-0.4	0.0	-1.8	-0.1	-0.2	0.0	0.0	0.0	.	.
Structural balance 5)	.	.	-1.1	-2.6	-1.5	0.0	-0.8	-0.4	-0.7	-0.9	.	.
Government debt	**37.0**	**31.3**	**42.7**	**39.9**	**44.7**	**45.1**	**42.7**	**41.1**	**41.3**	**40.9**	.	.
Average residual maturity (in years)	-	-	-	-	-	-	-	-	.	.	.	.
In foreign currencies (% of total)	15.0	13.6	16.4	16.4	18.6	19.2	14.4	13.5	.	.	.	.
of which: Euro	14.0	12.7	15.3	15.2	17.6	18.2	13.4	12.4	.	.	.	.
Domestic ownership (% of total)	77.4	71.1	83.6	84.1	86.4	84.3	84.5	78.9	.	.	.	.
Medium and long-term maturity (% of total) 6)	92.4	92.4	92.4	90.8	89.8	93.1	93.5	94.8	.	.	.	.
of which: Variable interest rate (% of total)	12.6	8.2	17.0	14.6	14.9	16.8	18.7	19.9	.	.	.	.
Deficit-debt adjustment	**-0.2**	**0.1**	**-0.4**	**-0.3**	**1.0**	**-0.4**	**-2.4**	**0.0**	.	.	.	.
Net acquisitions of main financial assets	0.0	0.1	-0.1	-0.7	3.3	-0.5	-2.5	-0.1	.	.	.	.
Currency and deposits	0.1	0.3	-0.1	-0.9	3.2	-0.6	-2.5	0.1	.	.	.	.
Debt securities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	.	.	.	.
Loans	0.1	0.1	0.1	0.2	0.1	0.2	0.0	-0.1	.	.	.	.
Equity and investment fund shares or units	-0.1	-0.3	0.0	0.0	0.0	0.0	0.0	-0.1	.	.	.	.
Revaluation effects on debt	-0.1	-0.1	-0.1	-0.1	-0.6	0.4	0.0	-0.2	.	.	.	.
of which: Foreign exchange holding gains/losses	0.0	0.0	0.1	0.2	-0.2	0.5	0.1	-0.1	.	.	.	.
Other 7)	-0.1	0.1	-0.2	0.5	-1.7	-0.3	0.1	0.3	.	.	.	.
Convergence programme: government balance	-	-	-	-	-	-	-	-	-0.6	-0.5	-0.5	-0.5
Convergence programme: structural balance	-	-	-	-	-	-	-	-	-0.6	-1.0	-1.0	-1.0
Convergence programme: government debt	-	-	-	-	-	-	-	-	41.1	40.7	40.2	39.3

Sources: European System of Central Banks and European Commission (Eurostat, DG ECFIN).
1) Multi-annual averages.
2) Data from the European Commission's Spring 2016 Economic Forecast, except for convergence programme data.
3) Sales and other current revenue.
4) Intermediate consumption, subsidies payable and other current expenditure.
5) Cyclically-adjusted balance excluding one-off and other temporary measures.
6) Original maturity of more than one year.
7) Time of recording differences and other discrepancies (sector reclassifications and statistical discrepancies).

Czech Republic - Exchange rate and external developments

Chart 5.2.3 Bilateral exchange rate and short-term interest rate differential

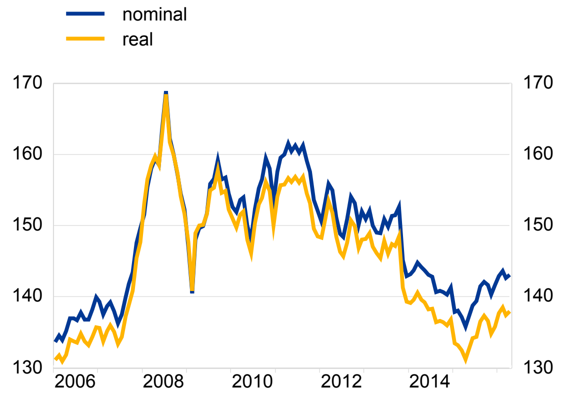
(CZK/EUR exchange rate: monthly averages;
difference between three-month interbank interest rates
and three-month EURIBOR: basis points, monthly values)



Sources: National data and ECB calculations.

Chart 5.2.4 Effective exchange rates [1)]

(EER-38 group of trading partners; monthly averages; base index: Q1 1999 = 100)



Source: ECB.
1) The real EER-38 is CPI deflated. An increase (decrease) in the EER indicates an appreciation (depreciation).

Table 5.2.3 External developments

(as a percentage of GDP, unless otherwise indicated)

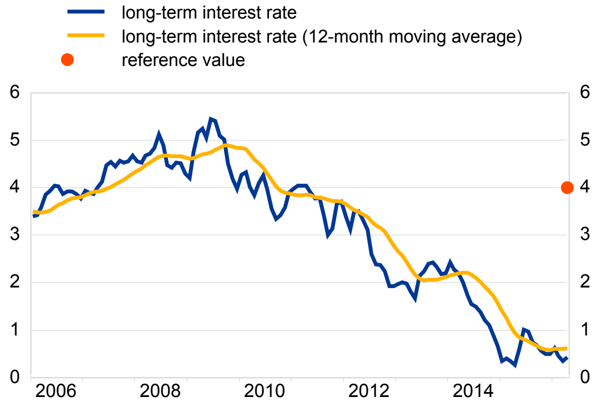
	2008-2015 [1)]	2008-2010 [1)]	2011-2015 [1)]	2011	2012	2013	2014	2015	2016 [2)]	2017 [2)]
Balance of payments										
Current account and capital account balance [3)]	-0.2	-1.6	0.7	-1.8	-0.3	1.5	0.9	3.3	0.3	0.5
Current account balance	-1.4	-2.6	-0.6	-2.1	-1.6	-0.5	0.2	0.9	-1.5	-1.3
Goods	2.7	0.8	3.8	1.9	3.1	4.1	5.2	4.7	.	.
Services	1.9	2.1	1.7	2.0	1.9	1.7	1.3	1.7	.	.
Primary income	-5.6	-5.2	-5.8	-5.6	-5.9	-6.1	-6.1	-5.5	.	.
Secondary income	-0.3	-0.4	-0.3	-0.5	-0.7	-0.3	-0.2	0.0	.	.
Capital account balance	1.2	1.0	1.4	0.3	1.3	2.0	0.8	2.4	.	.
Combined direct and portfolio investment balance [3)]	-2.8	-4.0	-2.1	-1.3	-4.4	-2.1	0.2	-3.1	.	.
Direct investment	-1.2	-1.4	-1.0	-1.1	-3.0	0.2	-1.9	0.6	.	.
Portfolio investment	-1.6	-2.6	-1.1	-0.1	-1.4	-2.3	2.1	-3.7	.	.
Other investment balance	0.4	0.7	0.3	-0.2	2.9	-0.6	-0.3	-0.4	.	.
Reserve assets	2.4	1.2	3.1	-0.4	2.0	4.5	1.7	7.9	.	.
Exports of goods and services	72.7	62.7	78.7	71.6	76.7	77.3	83.6	84.6	.	.
Imports of goods and services	68.2	59.7	73.2	67.7	71.7	71.4	77.1	78.2	.	.
Net international investment position [4)]	-40.4	-41.9	-39.4	-43.2	-46.1	-39.4	-36.8	-31.5	.	.
Gross external debt [4)]	58.2	49.3	63.6	54.8	60.2	63.5	68.6	70.7	.	.
Internal trade with the euro area [5)]										
Exports of goods and services	63.6	65.0	62.8	64.2	62.2	62.3	62.3	63.1	.	.
Imports of goods and services	52.3	52.5	52.2	51.7	51.6	51.8	52.9	52.8	.	.
Investment position with the euro area [5)]										
Direct investment assets [4)]	78.5	78.0	78.7	80.4	79.1	78.8	76.2	79.2	.	.
Direct investment liabilities [4)]	81.4	82.8	80.6	81.1	81.2	80.8	79.5	80.3	.	.
Portfolio investment assets [4)]	75.2	76.5	74.5	75.9	75.9	73.8	73.9	72.7	.	.
Portfolio investment liabilities [4)]	48.2	49.8	47.3	46.9	50.4	48.4	43.1	47.4	.	.

Sources: European System of Central Banks and European Commission (Eurostat, DG ECFIN).
Note: Backdata are available from 2008.
1) Multi-annual averages.
2) Data from the European Commission's Spring 2016 Economic Forecast.
3) Differences between totals and sum of their components are due to rounding.
4) End-of-period outstanding amounts.
5) As a percentage of the total.

Czech Republic - Long-term interest rate developments

Chart 5.2.5 Long-term interest rate 1)

(monthly averages in percentages)

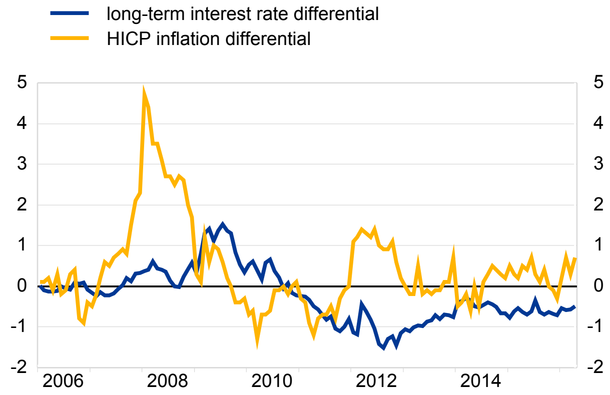


Sources: European System of Central Banks and ECB calculations.

1) The basis of the calculation of the reference value for the period from May 2015 to April 2016 is the unweighted arithmetic average of the interest rate levels in Bulgaria, Slovenia and Spain plus 2 percentage points. The reference value is 4.0%.

Chart 5.2.6 Long-term interest rate and HICP inflation differentials vis-à-vis the euro area

(monthly averages in percentage points)



Sources: European System of Central Banks, ECB calculations and European Commission (Eurostat).

Table 5.2.4 Long-term interest rates and indicators of financial development and integration

(as a percentage of GDP, unless otherwise indicated)

	2006-2015 1)	2006-2010 1)	2011-2015 1)	2012	2013	2014	2015	May 2015 to Apr. 2016	Memo item: euro area 2015
Long-term interest rates									
Czech Republic 2)	3.2	4.3	2.2	2.8	2.1	1.6	0.6	0.6	-
Euro area 2), 3)	3.4	4.0	2.9	3.9	3.0	2.0	1.2	1.2	-
Euro area AAA par curve, ten-year residual maturity 2), 3)	2.8	3.8	1.8	2.1	1.9	1.4	0.6	0.6	-
Indicators of financial development and integration									
Debt securities issued by financial corporations 4)	17.9	15.8	20.0	19.5	23.9	19.6	19.0	-	73.6
Debt securities issued by non-financial corporations 5)	5.2	2.8	7.0	6.9	7.6	8.0	7.6	-	10.8
Stock market capitalisation 6)	20.4	24.8	16.1	17.7	14.8	14.8	14.2	-	60.4
MFI credit to non-government residents 7)	49.3	45.1	53.4	52.8	54.3	53.8	54.7	-	114.7
Claims of euro area MFIs on resident MFIs 8)	7.1	6.3	7.9	4.9	7.3	7.9	12.8	-	27.4

Sources: European System of Central Banks and ECB calculations.
1) Multi-annual averages calculated using the arithmetic average.
2) Average interest rate.
3) Included for information only.
4) Outstanding amount of debt securities issued by resident MFIs and other financial corporations.
5) Outstanding amount of debt securities issued by resident non-financial corporations.
6) Outstanding amount of listed shares issued by residents at the end of the period at market values.
7) MFI (excluding NCB) credit to domestic non-MFI residents other than general government. Credit includes outstanding amounts of loans and debt securities.
8) Outstanding amount of deposits and debt securities issued by domestic MFIs (excluding the NCB) held by euro area MFIs as a percentage of total liabilities of domestic MFIs (excluding the NCB). Total liabilities exclude capital and reserves and remaining liabilities.

5.3 Croatia

5.3.1 Price developments

In April 2016 the 12-month average rate of HICP inflation in Croatia was -0.4%, i.e. well below the reference value of 0.7% for the criterion on price stability (see Chart 5.3.1). This rate is expected to remain broadly unchanged over the coming months.

Over the past ten years the 12-month average rate of HICP inflation has fluctuated within a relatively wide range, from -0.4% to 6.0%, and the average for that period was moderate, standing at 2.3%. Towards the end of 2007 this rate of inflation accelerated significantly, peaking at levels close to 6% in 2008. This mainly reflected a surge in food, energy and administered prices, alongside a build-up of domestic price pressures during a period of robust economic expansion. Rapid credit growth, fuelled partly by cross-border lending by foreign parent banks, led to a significant accumulation of private sector debt. The boom in domestic demand was accompanied by soaring trade deficits and accelerating growth in unit labour costs. The global financial crisis led to an unwinding of the credit and housing boom. Inflation decreased rapidly as the economy moved into recession and global commodity prices declined. Following a cumulative decline in real GDP of more than 12% over the period 2009-14, economic activity started to recover in 2015 (see Table 5.3.1). Owing to increases in energy and food prices, inflation picked up in 2011 and 2012, before falling to historically low levels in 2014 and 2015 on the back of lower commodity prices in conjunction with weak internal demand. The unemployment rate, which rose sharply during the recession, decreased slightly in 2015, albeit remaining at a high level. Growth in unit labour costs has been very weak or even negative over the past few years.

For the first four months of 2016, the average annual rate of HICP inflation stood at -0.6%. This negative inflation rate mainly reflected declines in the prices of crude oil and food, as well as a reduction in administered gas prices for households.

Policy choices have played an important role in shaping inflation dynamics in Croatia over the past decade, most notably the orientation of monetary policy towards price stability. Hrvatska narodna banka aims to achieve price stability through a tightly managed floating exchange rate regime vis-à-vis the euro. During the period of robust economic expansion, Croatia's monetary policy was constrained by the tightly managed floating exchange rate regime, and the overall policy stance (including fiscal policy) was not tight enough to counter the build-up of macroeconomic imbalances. Owing to the growing financial vulnerabilities and macroeconomic imbalances prior to the economic downturn, Hrvatska narodna banka introduced a series of administrative and prudential measures to curb credit growth funded by banks' borrowing abroad. However, several of these measures were later abolished or loosened under counter-cyclical policies. In addition, the government introduced a number of growth-enhancing credit schemes, but domestic credit growth to the private sector remained fairly weak. At the same time, corporations with access to international markets partly made up for the reduction in their borrowing from domestic credit institutions by obtaining funding from other sources, primarily those abroad. At the beginning of 2016 Hrvatska narodna banka introduced a structural repo operation allowing banks to increase lending in local currency at more favourable financing conditions. This welcome move, aimed at fostering the use of the kuna in the banking system, was facilitated by favourable balance of payments developments and the stronger external positions of banks.

Inflation is expected to increase in the coming years, albeit remaining at a moderate level; over the longer term there are concerns regarding the sustainability of inflation convergence in Croatia. According to the European Commission's Spring 2016 Economic Forecast, average annual HICP inflation will remain in negative territory, at -0.6%, in 2016, before increasing to 0.7% in 2017. Inflationary pressures are expected to be contained given the weak economic growth. Risks to the inflation outlook are broadly balanced. On the upside, the risks relate to developments in administered prices, while on the downside, they relate to the heightened uncertainty regarding developments in the global economy, which could reduce external price pressures. 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 significantly lower in Croatia 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 Croatia requires stability-oriented economic policies and wide-ranging structural reforms. Given monetary policy's limited room for manoeuvre owing to the tightly managed floating exchange rate regime and the high level of euroisation, it is imperative that other policy areas provide the economy with the wherewithal to cope with country-specific shocks in order to ensure the correction of macroeconomic imbalances and to prevent their recurrence in the future. More specifically, structural reforms are needed to increase overall productivity and raise the potential growth of the economy, to enhance the quantity and quality of the labour supply, and to align the education system with the needs of the market. This is particularly important in view of the high levels of structural and youth unemployment. Notwithstanding the labour market reforms in 2013 and 2014 that have significantly reduced the gap with other EU economies in terms of employment protection legislation, and the recent measures in support of youth employment, there is scope and a need for further measures. In particular, further progress is required in the review of social benefits in order to push up the very low participation rate. It is also crucial to achieve sufficient flexibility in wages, strengthen national policies aimed at enhancing competition in product markets and proceed with the liberalisation of regulated sectors. Priority should be given to improving the quality of the business and regulatory environment, with a particular focus on fighting corruption. In addition, it is essential to improve the effectiveness of the public administration and the judicial system. Modernising the country's infrastructure (in particular its rail network) would boost potential output and support a more efficient allocation of resources. Against this background, significant efforts should be made to ensure that Croatia improves its very weak absorption of EU funds. Recent government intervention in existing loan agreements to allow the conversion of loans denominated in, or linked to, Swiss francs into loans denominated in, or linked to, euro, highlights the need for a more predictable legal system. Moreover, when the recent Swiss franc loan conversion was designed, due consideration should have been given to fair burden sharing among all stakeholders in order to avoid moral hazard.[115] With regard to macroeconomic imbalances, the European Commission selected Croatia for an in-depth review in its Alert Mechanism Report 2016 and concluded that Croatia is experiencing excessive macroeconomic imbalances.

Financial sector policies should be geared to safeguarding financial stability and ensuring that the financial sector makes a sound contribution to sustainable economic growth. In view of the high level of private sector debt, it is important to ensure that the necessary conditions are in place for an orderly deleveraging process. The resolution framework for non-performing loans should be further strengthened, particularly in order to improve the efficiency of court practice. Given that the legislative changes allowing the conversion of loans denominated in Swiss francs had a negative impact on banks' profitability, it is important to preserve the resilience of the banking system and its ability to support the real economy. In order to minimise the potential risks to financial stability associated with a high proportion of foreign currency loans, Croatia should continue to apply the Recommendation of the European Systemic Risk Board of 21 September 2011 on lending in foreign currencies (ESRB/2011/1). Close cooperation between the home and host country supervisory authorities is important to ensure the effective implementation of these measures.

5.3.2 Fiscal developments

The deficit and debt do not comply with the Maastricht criteria. In 2015 the general government budget balance of Croatia recorded a deficit of 3.2% of GDP, i.e. above the 3% reference value. The general government gross debt-to-GDP ratio was 86.7%, well above the 60% reference value (see Table 5.3.2). Compared with the previous year, the deficit ratio decreased by 2.3 percentage points, while the debt ratio increased by 0.2 percentage points of GDP. The deficit ratio is forecast by the European Commission to decline to 2.7% in 2016, while the government debt ratio is projected to increase to 87.6% of GDP. With regard to other fiscal factors, the deficit ratio exceeded the ratio of public investment to GDP over the 2011-14 interval and is expected to do so again in 2015.

Croatia has been subject to the corrective arm of the Stability and Growth Pact since 2014. The European Council, following Croatia's accession to the EU in June 2013 and taking into account the level of the 2013 deficit, as well as the planned 2014 deficit – both of which breach the 3% deficit reference value – decided on 21 January 2014 to open an excessive deficit procedure (EDP), with the deadline for

[115] See Opinion of the European Central Bank of 18 September 2015 on the conversion of Swiss franc loans (CON/2015/32).

correcting the excessive deficit being 2016. The European Commission's Spring 2016 Economic Forecast, while projecting a budget balance below the 3% reference value in 2016, also points to risks of deviation from the structural balance adjustment requirements.

Both cyclical and non-cyclical factors have contributed to the deficit changes over recent years. The deficit peaked in 2011 at 7.8% of GDP, driven by non-cyclical factors (presented in Table 5.3.2). In 2012 the deficit improved markedly (by 2.5 percentage points of GDP) on account of a large structural adjustment, which was partly offset by unfavourable cyclical factors. On average, during 2012-15, the deficit remained high, standing well above the 3% reference value, owing to positive structural and negative cyclical factors.

The debt-to-GDP ratio, currently well above the 60% reference value, has almost doubled since the 2009 crisis as a result of unfavourable economic conditions and large primary deficits. The debt ratio increased rapidly and continuously from 49% of GDP in 2009 to 86.7% of GDP in 2015. This sharp increase was driven by persistently high primary deficits, rising interest growth differentials due to unfavourable economic conditions, and significant deficit-debt adjustments (see Chart 5.3.2). The particularly strong deficit-debt adjustment in 2013 mainly reflected pre-financing for the first half of 2014. The government did not report contingent liabilities related to the financial sector.

The level and structure of government debt protects Croatia, to some extent, from interest rate shocks while the high share of foreign currency-denominated debt implies that the fiscal balances would be highly sensitive to the exchange rate movements. The share of government debt with a short-term maturity is low (6.7% in 2015 – see Table 5.3.2). Taking into account the fact that long-term debt is entirely based on fixed rates, fiscal balances are relatively insensitive to interest rate changes. However, a high share of public debt is denominated in foreign currency (78.6% in 2015), mainly euro (74.4% of the total debt). Taking the government debt share of GDP into account, this implies that the fiscal balances are highly sensitive to exchange rate changes. The tightly managed float (designed to reduce the exchange rate's volatility against the euro) followed by Hrvatska narodna banka means that the high sensitivity of fiscal balances to the euro-kuna exchange rate changes should be somewhat mitigated. Both the foreign currency-denominated part of public debt and long-term maturity debt are close to their medium-term trends, although the euro share is on a slightly upward trend.

The European Commission's Spring 2016 Economic Forecast foresees a timely correction of the excessive deficit but points to a risk that Croatia will not comply with the Stability and Growth Pact. According to the European Commission's latest forecast, the headline deficit is projected to return to below the 3% reference value by the 2016 EDP deadline. The improvement in the structural balance in 2017 (under the assumption of unchanged policies) is expected to fall short of the fiscal requirements with respect to both the medium-term objective and the debt reduction benchmark. In contrast, the medium-term fiscal policy strategy of Croatia, as presented in the 2016 Convergence Programme, forecasts the structural deficit to be 1.2% of GDP in 2016, 1.1% of GDP in 2017 and 0.8% of GDP in 2018, thus already below the minimum medium-term objective (1.75% of GDP structural deficit from 2017 onwards). Therefore, there is scope for additional measures to ensure compliance with the Stability and Growth Pact in 2017.

Croatia needs to improve its national fiscal framework. The fiscal strategy has to focus on compositional issues so that public spending becomes more growth and employment-friendly. Only modest progress has been made in implementing the 2014 country-specific recommendations on fiscal governance, as the measures announced have not been adopted. Challenges in the Croatian fiscal framework relate to the operationalisation and independence of the Fiscal Policy Commission and the revision of the Fiscal Responsibility Act. Moreover, the full adoption of numerical fiscal rules, control of expenditure by means of spending reviews and effective budgetary planning are essential for the improvement of the Croatian fiscal framework.

The Commission's 2015 Fiscal Sustainability Report suggests that Croatia faces a high debt sustainability risk over the medium term. The European Commission's 2015 Fiscal Sustainability Report foresees no significant short-term risks of fiscal stress, although some variables (namely the primary deficit; the net international investment position; and the level of, and change in, the share of non-performing loans) point to significant short-term challenges. Over the medium term, the risk level is high, underpinned by the high stock of debt and high sensitivity of the projections to macro shocks. Over the long term, while Croatia appears to be at low risk because of the projected decrease in age-related spending, the low level of, and projected further decline in, the benefit ratio raise concerns about the adequacy of the pension system. Croatia has taken steps to tackle ageing costs, including (i) streamlining social benefits, (ii) tightening the regime for special pensions, and (iii) increasing penalties for early retirement. The projected decrease in public expenditure is largely the result of the low valorisation of pension rights and the anticipated decrease in the level of new public pensions. This, in turn, would entail a reduced level of current and future spending on public pensions. This largely explains the projected savings in demography-sensitive public expenditure and, thus, the low fiscal stress in the long term. These projected developments also imply a risk regarding the future adequacy of the pension system in the form of the upcoming increased social payments that may be needed to support the elderly population that will be below the poverty line or socially excluded. According to the 2015 projections by the European Commission and the EU's Economic Policy Committee[116], Croatia is likely to experience a decrease in age-related public expenditure amounting to 2.5 percentage points of GDP by 2060 in the AWG reference scenario from a level of 20.7% of GDP in 2013. In the AWG risk scenario, the reduction in the cost of ageing is 0.4 percentage points. This is mainly due to significant savings in gross pensions, which are projected to fall from 10.8% of GDP to 6.9% of GDP for the period 2013-60, while healthcare and long-term care spending are expected to increase by 2.7% and 1.1% of GDP respectively during the same period.

[116] European Commission and Economic Policy Committee, "The 2015 Ageing Report: Economic and budgetary projections for the EU-28 Member States (2013-2060)", prepared by the AWG.

A prudent and credible fiscal policy based on further fiscal consolidation, along with renewed determination in pursuing fiscal reforms, are needed for public finances to return to a more sustainable footing over the medium term. Despite the fact that the budget balance is projected to be below the 3% reference value in 2016, possible fiscal risks in 2016 and additional required adjustment in 2017 may point to additional consolidation measures. These need to be implemented in a growth-friendly framework in order to mitigate the effect on economic conditions, which remain weak. In the light of the significant medium-term risks to debt sustainability, Croatia needs to set up a credible medium-term consolidation plan. Moreover, fiscal risks related to the inefficiency of public spending and of state-owned enterprises need to be addressed. The Croatian fiscal governance framework needs to be strengthened further, particularly as regards the independence of the Fiscal Policy Commission, the revision of the Fiscal Responsibility Act, the improvement to numerical fiscal rules, the introduction of effective expenditure control and budgetary planning.

5.3.3 Exchange rate developments

In the two-year reference period from 19 May 2014 to 18 May 2016, the Croatian kuna did not participate in ERM II, but traded under a flexible exchange rate regime involving a tightly managed floating of the currency's exchange rate. The Croatian kuna was stable over the reference period and traded close to its May 2014 average exchange rate against the euro of 7.595 kuna per euro, which is used as a benchmark for illustrative purposes in the absence of an ERM II central rate (see Chart 5.3.3). On 18 May 2016 the exchange rate stood at 7.488 kuna per euro, i.e. 1.4% stronger than its average level in May 2014. Over the reference period the maximum upward deviation from this benchmark was 1.7%, while the maximum downward deviation amounted to 1.7%. Looking back over a longer period the exchange rate of the Croatian kuna against the euro has depreciated by 3.0% over the past ten years.

The exchange rate of the Croatian kuna against the euro exhibited, on average, a low degree of volatility over the reference period. This reflected the strategy of Hrvatska narodna banka to limit exchange rate fluctuations by means of occasional market interventions. Hrvatska narodna banka conducted two foreign exchange interventions at the beginning of 2015 by selling euro for domestic currency. The purpose was to alleviate depreciation pressures caused by banks adjusting their foreign exchange position against the background of the government's decision to freeze the exchange rate vis-à-vis the Swiss franc for loan repayments at the exchange rate level applicable before the decision of the Swiss National Bank to discontinue its minimum exchange rate target vis-à-vis the euro. Moreover, as of September 2015 Hrvatska narodna banka undertook a series of measures to alleviate the pressures on the foreign exchange and money markets caused by legislative changes regulating the conversion of loans in Swiss francs. Over the reference period short-term interest rate differentials against the three-month EURIBOR stood, on average, at a low level. The spreads increased late in the third quarter of 2015 amid the above-mentioned legislative changes and decreased thereafter as the measures by Hrvatska narodna banka reduced the pressures on money markets.

The real effective exchange rate of the Croatian kuna has depreciated overall over the past ten years (see Chart 5.3.4). However, this indicator should be interpreted with caution, as during this period Croatia was subject to a process of economic convergence, which complicates any historical assessment of real exchange rate developments.

Croatia's current and capital account has improved over the past decade, while the country's net foreign liabilities remain high (see Table 5.3.3). After a progressive increase in the external deficit in the period up to 2008, the combined current and capital account improved steadily and turned into a small surplus in 2012, stabilising at around 1% in 2013 and 2014. This improvement primarily reflected a sharp decline in the goods deficit, driven largely by the contraction in domestic demand. The surplus widened notably in 2015 to 5.6% of GDP, mainly reflecting a temporary reduction in the deficit of the balance of primary income owing to foreign-owned banks' losses following the regulatory amendments allowing for the conversion of loans in Swiss francs, as well as improvements in the balance on trade in services owing to an exceptionally good tourist season. In addition, the balance of secondary income and capital accounts improved as a result of the intensified allocation of EU funds to end-beneficiaries. Gross external debt increased substantially from 73.9% of GDP in 2006 to 105.6% in 2013 and 108.4% in 2014. At the same time the country's net international investment position, which had deteriorated substantially from -76.1% of GDP in 2006 to -95.9% in 2010, improved to reach -88.0% in 2014 and -78.7% in 2015. However, the country's net foreign liabilities are still very high. Fiscal and structural policies therefore continue to be important for supporting external sustainability and the competitiveness of the economy.

The Croatian economy is well integrated with the euro area through trade linkages.[117] In 2015 exports of goods and services to the euro area constituted 58.9% of total exports, while the corresponding figure for imports was higher, at 59.3%.

5.3.4 Long-term interest rate developments

Over the reference period from May 2015 to April 2016, long-term interest rates in Croatia were 3.7% on average and thus below the 4.0% reference value for the interest rate convergence criterion (see Chart 5.3.5).

Long-term interest rates in Croatia have decreased from above 8% in 2009 to 3.6% in 2016, with the reduction having been interrupted by three episodes of long-term rate rises. The first rise could be observed in 2011 and lasted until 2012,

117 Data on Croatia's investment position with the euro area are available only for portfolio investment liabilities.

with long-term interest rates increasing from around 6% to close to 8%. A second period of rate rises could be observed in 2013 on the back of credit ratings being downgraded. Since early 2014 long-term interest rates have continued to decline, interrupted by an increase in yields in 2015. This rise can partly be attributed to the weak economic environment and legislative changes concerning the conversion of Swiss franc loans, as well as heightened political uncertainty following the election. Rating agencies gave Croatia a negative credit rating outlook in the course of 2014 and 2015.

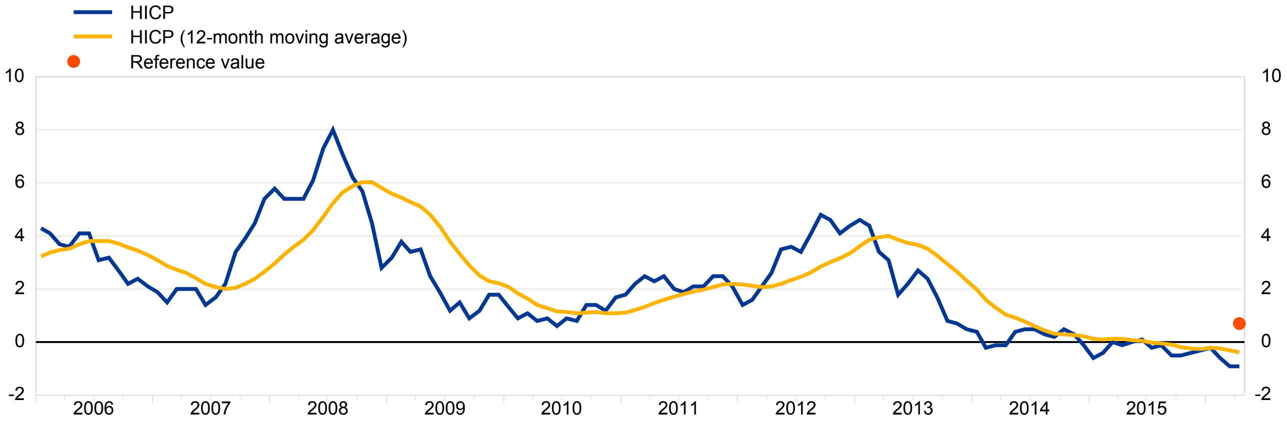
Croatia's long-term interest rate differential vis-à-vis the euro area has widened since the start of 2013, to stand at 2.7 percentage points at the end of the review period. The interest rate differential, which had increased during the 2008-09 financial crisis, decreased from 2009 onwards. The latest widening was in excess of what could be observed in the euro area, and largely reflected long-term structural issues and weak economic growth, despite a relatively resilient financial sector (see Chart 5.3.6). The long-term interest rate differential vis-à-vis the AAA euro area yield stood at 3.4 percentage points at the end of the review period.

Capital markets in Croatia are smaller and much less developed than those in the euro area (see Table 5.3.4), but among the most developed in central and eastern Europe. The non-banking financial sector is relatively large compared with those of peer countries, with non-banking institutions also playing a more important role in financial intermediation. Since the financial crisis, pension funds in particular have gained importance. Stock market capitalisation as a share of GDP is higher than for many peer countries and stood at 38.7% in 2015. Contrary to overall developments in the euro area, stock market capitalisation has remained more or less constant over the last decade. Despite this, the share of debt securities issued by financial and non-financial institutions as a percentage of GDP remains very low, at 0.4% and 5.3% respectively at the end of 2015. Integration of Croatia's financial sector with the euro area, as measured by the claims of euro area banks on Croatian banks, has reached a considerable level. The Croatian financial sector is largely bank-based, with its banking sector being largely foreign-owned and highly integrated with the EU financial sector. The degree of financial intermediation is somewhat lower than the euro area average. During the recession of the last few years, which followed a period of strong credit expansion prior to the crisis, the claims of euro area MFIs on resident MFIs decreased from 16.4% in 2012 to 8.2% in 2015, while MFI credit to non-government residents in 2015 stood at 66.8% of GDP – slightly below pre-crisis levels (see Table 5.3.4). The share of foreign currency-denominated loans remains high, with most loans denominated in euro, whereas the share of loans denominated in Swiss francs dropped to very low levels after the recent Swiss franc loan conversion.

Croatia - Price developments

Chart 5.3.1 HICP inflation and reference value [1]

(annual percentage changes)



Sources: European Commission (Eurostat) and ECB calculations.

1) The basis of the calculation of the reference value for the period from May 2015 to April 2016 is the unweighted arithmetic average of the annual percentage changes in the HICP for Bulgaria, Slovenia and Spain plus 1.5 percentage points. The reference value is 0.7%.

Table 5.3.1 Measures of inflation and related indicators

(annual percentage changes, unless otherwise indicated)

	2006-2015 [1]	2006-2010 [1]	2011-2015 [1]	2011	2012	2013	2014	2015	2016 [2]	2017 [2]
Measures of inflation										
HICP	2.3	3.0	1.6	2.2	3.4	2.3	0.2	-0.3	-0.6	0.7
HICP excluding unprocessed food and energy	2.1	3.0	1.3	1.5	1.6	2.1	0.6	0.8	0.1	0.8
HICP at constant tax rates [3]	1.9	2.8	1.1	2.1	2.5	1.9	-0.6	-0.6	-	-
CPI	2.3	3.1	1.4	2.3	3.4	2.2	-0.2	-0.5	-	-
Private consumption deflator	2.3	3.3	1.3	2.4	3.3	1.9	-0.4	-0.5	-0.5	0.7
GDP deflator	2.1	3.5	0.8	1.7	1.6	0.8	0.0	0.1	0.3	1.0
Producer prices [4]	2.5	3.6	1.3	6.4	7.0	0.4	-2.7	-3.8	-	-
Related indicators										
Real GDP growth	0.0	0.5	-0.5	-0.3	-2.2	-1.1	-0.4	1.6	1.8	2.1
GDP per capita in PPS [5] (euro area = 100)	55.6	55.9	55.3	55.0	55.8	55.3	55.0	.	-	-
Comparative price levels (euro area = 100)	70.1	72.1	67.6	70.5	67.6	67.0	65.2	.	-	-
Output gap [6]	0.1	3.2	-3.0	-1.3	-2.8	-3.7	-4.0	-2.9	-1.7	-0.3
Unemployment rate (%) [7]	13.2	10.2	16.1	13.7	16.0	17.3	17.3	16.3	15.5	14.7
Unit labour costs, whole economy	2.1	5.5	-1.2	0.6	-1.3	-2.2	-2.4	-0.5	0.4	0.9
Compensation per employee, whole economy	1.5	3.5	-0.4	4.3	0.2	-0.7	-5.3	-0.3	1.1	1.6
Labour productivity, whole economy	-0.6	-1.9	0.8	3.7	1.5	1.6	-3.0	0.1	0.7	0.7
Imports of goods and services deflator	1.7	1.9	1.4	5.9	3.0	0.2	-0.7	-1.2	-0.7	0.4
Nominal effective exchange rate [8]	-0.5	0.2	-1.3	-1.6	-3.3	1.2	0.6	-3.1	-	-
Money supply (M3) [9]	2.7	6.8	1.3	1.0	2.9	2.8	0.1	4.2	-	-
Lending from banks [10]	-2.6	-	-2.6	4.4	-6.2	-0.1	-1.7	-2.4	-	-
Stock prices (CROBEX) [11]	-15.4	5.7	-20.0	-17.6	0.0	3.1	-2.7	-3.2	-	-
Residential property prices [12]	-3.0	-5.7	-2.0	0.2	-1.6	-4.0	-1.6	-2.9	-	-

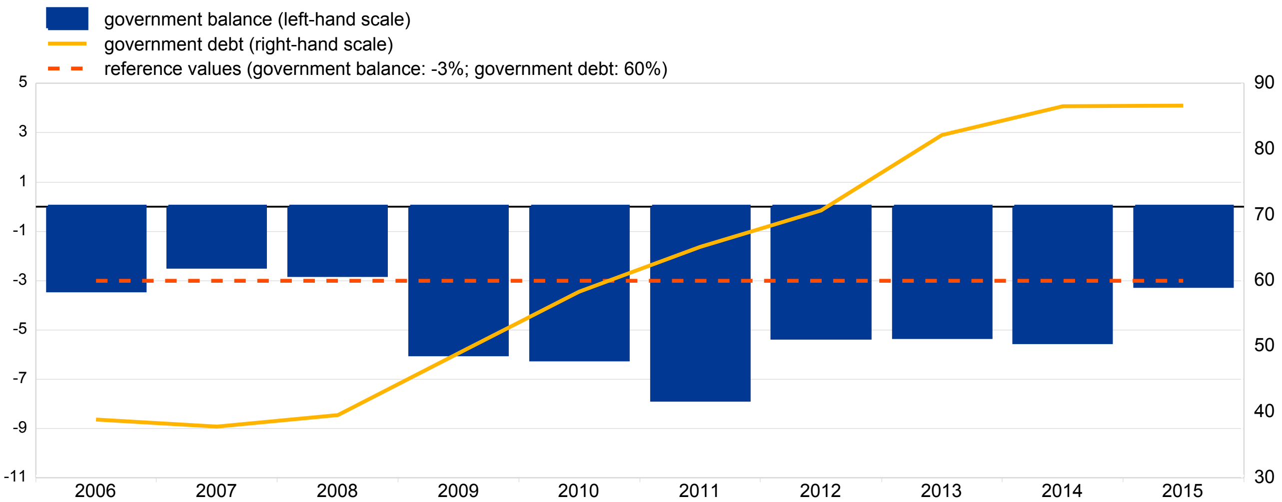
Sources: European Commission (Eurostat, DG ECFIN), national data for CPI, money supply, lending from banks and residential property prices, and ECB calculations based on Thomson Reuters data for stock prices.

1) Multi-annual averages calculated using the geometric mean, except for GDP per capita in PPS, comparative price levels, output gap and unemployment rate, for which the arithmetic mean is used.
2) Data from the European Commission’s Spring 2016 Economic Forecast.
3) The difference between the HICP and the HICP at constant tax rates shows the theoretical impact of changes in indirect taxes (e.g. VAT and excise duties) on the overall rate of inflation. This impact assumes a full and instantaneous pass-through of tax rate changes to the price paid by the consumer.
4) Domestic sales, total industry excluding construction.
5) PPS stands for purchasing power standards.
6) Percentage difference of potential GDP: a positive (negative) sign indicates that actual GDP is above (below) potential GDP.
7) Definition conforms to International Labour Organization guidelines.
8) EER-38 group of trading partners. A positive (negative) sign indicates an appreciation (depreciation).
9) The series includes repurchase agreements with central counterparties.
10) Data available since 2011. Not adjusted for the derecognition of loans from the MFI statistical balance sheet due to their sale or securitisation.
11) Multi-annual and annual figures represent the percentage change between the end of the given period and the end of the previous period.
12) Data available since 2008.

Croatia - Fiscal developments

Chart 5.3.2 General government balance and debt

(as a percentage of GDP)



Sources: European System of Central Banks and European Commission (Eurostat).

Table 5.3.2 Government budgetary developments and projections

(as a percentage of GDP, unless otherwise indicated)

	2006-2015 1)	2006-2010 1)	2011-2015 1)	2011	2012	2013	2014	2015	2016 2)	2017 2)	2018	2019
Government balance	**-4.8**	**-4.2**	**-5.4**	**-7.8**	**-5.3**	**-5.3**	**-5.5**	**-3.2**	**-2.7**	**-2.3**	.	.
Total revenue	42.1	41.8	42.3	41.0	41.7	42.5	42.6	43.7	44.1	44.4	.	.
Current revenue	41.8	41.7	41.8	40.6	40.9	42.2	42.3	43.0	43.3	43.5	.	.
Direct taxes	6.5	6.9	6.1	6.2	6.1	6.3	6.1	5.9	5.8	6.1	.	.
Indirect taxes	18.3	18.0	18.6	17.5	18.3	19.0	18.7	19.5	19.5	19.5	.	.
Net social contributions	11.7	11.7	11.6	11.6	11.5	11.3	11.8	11.9	11.9	12.0	.	.
Other current revenue 3)	5.3	5.1	5.5	5.4	4.9	5.7	5.7	5.7	5.9	6.0	.	.
Capital revenue	0.3	0.1	0.5	0.3	0.9	0.3	0.3	0.7	0.8	0.9	.	.
Total expenditure	46.9	46.0	47.7	48.8	47.0	47.8	48.1	46.9	46.8	46.6	.	.
Current expenditure	40.9	39.1	42.7	42.1	42.2	42.9	43.1	43.1	42.8	42.4	.	.
Compensation of employees	11.8	11.6	12.0	12.4	12.3	12.1	11.8	11.4	11.4	11.3	.	.
Social benefits	15.7	15.1	16.2	16.1	16.3	15.9	16.6	16.4	16.3	16.1	.	.
Interest payable	2.8	2.1	3.4	3.0	3.4	3.5	3.5	3.6	3.6	3.6	.	.
Other current expenditure 4)	10.6	10.2	11.0	10.6	10.3	11.4	11.3	11.7	11.5	11.5	.	.
Capital expenditure	6.0	6.9	5.0	6.7	4.8	4.9	5.0	3.9	4.0	4.2	.	.
of which: Investment	4.4	5.4	3.5	3.6	3.5	3.7	3.7	2.8	3.1	3.3	.	.
Cyclically adjusted balance	-4.8	-5.6	-4.0	-7.3	-4.0	-3.6	-3.6	-1.8	-1.9	-2.1	.	.
One-off and temporary measures	.	.	-0.1	0.0	0.0	-0.2	-0.1	-0.1	0.0	0.0	.	.
Structural balance 5)	.	.	-4.0	-7.3	-4.0	-3.3	-3.5	-1.7	-1.9	-2.1	.	.
Government debt	**61.5**	**44.7**	**78.2**	**65.2**	**70.7**	**82.2**	**86.5**	**86.7**	**87.6**	**87.3**	.	.
Average residual maturity (in years)	-	-	5.3	5.8	5.3	5.1	5.0	5.3	.	.	.	.
In foreign currencies (% of total)	-	-	77.8	77.3	76.4	78.0	78.8	78.6	.	.	.	.
of which: Euro	-	-	73.2	71.5	71.3	74.1	74.7	74.4	.	.	.	.
Domestic ownership (% of total)	55.8	53.0	58.5	58.9	58.5	57.7	58.4	59.2	.	.	.	.
Medium and long-term maturity (% of total) 6)	89.4	88.0	90.9	89.7	90.4	90.2	90.8	93.3	.	.	.	.
of which: Variable interest rate (% of total)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	.	.	.	.
Deficit-debt adjustment	**0.6**	**0.7**	**0.5**	**-0.2**	**-0.2**	**6.0**	**-1.4**	**-1.6**	.	.	.	.
Net acquisitions of main financial assets	0.4	0.6	0.2	-1.4	0.6	3.8	-0.5	-1.5	.	.	.	.
Currency and deposits	0.4	0.9	-0.1	-1.5	0.3	3.2	-0.7	-1.7	.	.	.	.
Debt securities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.1	.	.	.	.
Loans	0.2	0.1	0.3	0.2	0.2	0.5	0.3	0.2	.	.	.	.
Equity and investment fund shares or units	-0.2	-0.4	0.0	0.0	0.1	0.1	-0.1	0.0	.	.	.	.
Revaluation effects on debt	0.6	0.4	0.7	1.1	0.5	1.0	0.7	0.4	.	.	.	.
of which: Foreign exchange holding gains/losses	0.3	0.1	0.5	0.8	0.1	0.6	0.6	0.1	.	.	.	.
Other 7)	-0.4	-0.3	-0.4	0.1	-1.3	1.3	-1.6	-0.5	.	.	.	.
Convergence programme: government balance	-	-	-	-	-	-	-	-	-2.6	-2.0	-1.6	-1.0
Convergence programme: structural balance	-	-	-	-	-	-	-	-	-1.5	-1.7	-1.8	-1.7
Convergence programme: government debt	-	-	-	-	-	-	-	-	85.9	84.7	82.8	80.0

Sources: European System of Central Banks and European Commission (Eurostat, DG ECFIN).

1) Multi-annual averages.

2) Data from the European Commission's Spring 2016 Economic Forecast, except for convergence programme data.

3) Sales and other current revenue.

4) Intermediate consumption, subsidies payable and other current expenditure.

5) Cyclically-adjusted balance excluding one-off and other temporary measures.

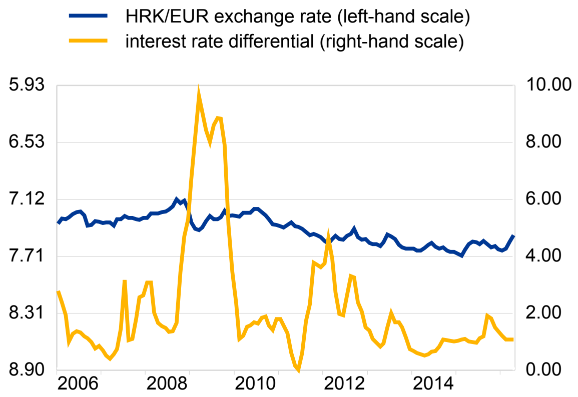
6) Original maturity of more than one year.

7) Time of recording differences and other discrepancies (sector reclassifications and statistical discrepancies).

Croatia - Exchange rate and external developments

Chart 5.3.3 Bilateral exchange rate and short-term interest rate differential

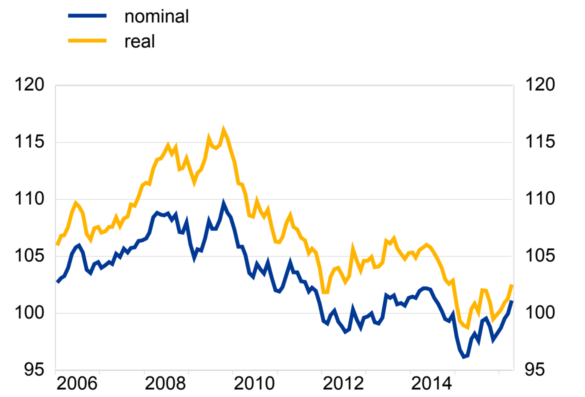
(HRK/EUR exchange rate: monthly averages;
difference between three-month interbank interest rates
and three-month EURIBOR: basis points, monthly values)



Sources: National data and ECB calculations.

Chart 5.3.4 Effective exchange rates [1)]

(EER-38 group of trading partners; monthly averages; base index: Q1 1999 = 100)



Source: ECB.
1) The real EER-38 is CPI deflated. An increase (decrease) in the EER indicates an appreciation (depreciation).

Table 5.3.3 External developments

(as a percentage of GDP, unless otherwise indicated)

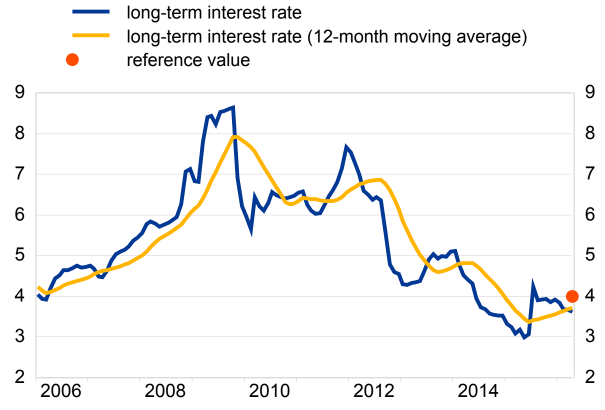
	2008-2015 [1)]	2008-2010 [1)]	2011-2015 [1)]	2011	2012	2013	2014	2015	2016 [2)]	2017 [2)]
Balance of payments										
Current account and capital account balance [3)]	-1.0	-4.9	1.4	-0.7	0.0	1.1	1.0	5.6	5.0	4.7
Current account balance	-1.1	-5.0	1.2	-0.8	-0.1	1.0	0.8	5.2	4.4	4.0
Goods	.	.	-14.7	-14.3	-14.3	-15.1	-14.8	-15.1	.	.
Services	.	.	15.8	13.8	14.8	15.5	16.8	17.9	.	.
Primary income	.	.	-2.5	-3.0	-3.4	-2.0	-3.3	-0.7	.	.
Secondary income	2.5	2.3	2.6	2.7	2.8	2.6	2.1	3.1	.	.
Capital account balance	0.2	0.1	0.2	0.1	0.1	0.1	0.2	0.4	.	.
Combined direct and portfolio investment balance [3)]	-3.7	-3.6	-3.8	-4.0	-6.7	-6.3	-1.4	-0.5	.	.
Direct investment	-2.6	-3.5	-2.1	-2.5	-2.7	-1.9	-3.1	-0.3	.	.
Portfolio investment	-1.1	-0.1	-1.7	-1.5	-4.0	-4.4	1.7	-0.2	.	.
Other investment balance	-0.2	-4.7	2.5	-0.3	5.8	1.1	2.3	3.4	.	.
Reserve assets	1.0	0.7	1.1	0.9	0.1	4.2	-1.2	1.7	.	.
Exports of goods and services	41.6	36.9	44.3	40.5	41.7	43.1	46.4	50.1	.	.
Imports of goods and services	42.4	40.9	43.3	40.9	41.2	42.6	44.4	47.3	.	.
Net international investment position [4)]	-86.5	-85.3	-87.3	-90.6	-90.5	-88.7	-88.0	-78.7	.	.
Gross external debt [4)]	.	.	.	103.7	103.0	105.6	108.4	.	.	.
Internal trade with the euro area [5)]										
Exports of goods and services	.	.	55.7	51.9	52.5	57.2	58.0	58.9	.	.
Imports of goods and services	.	.	53.5	46.0	47.4	56.2	58.8	59.3	.	.
Investment position with the euro area [5)]										
Direct investment assets [4)]	.	.	.	.	.	.	.	.	.	.
Direct investment liabilities [4)]	.	.	.	.	.	.	.	.	.	.
Portfolio investment assets [4)]	.	.	.	.	.	.	.	.	.	.
Portfolio investment liabilities [4)]	49.2	55.2	45.6	41.6	45.3	44.2	48.9	48.2	.	.

Sources: European System of Central Banks and European Commission (Eurostat, DG ECFIN).
Note: Backdata are available from 2008.
1) Multi-annual averages.
2) Data from the European Commission's Spring 2016 Economic Forecast.
3) Differences between totals and sum of their components are due to rounding.
4) End-of-period outstanding amounts.
5) As a percentage of the total.

Croatia - Long-term interest rate developments

Chart 5.3.5 Long-term interest rate 1)

(monthly averages in percentages)

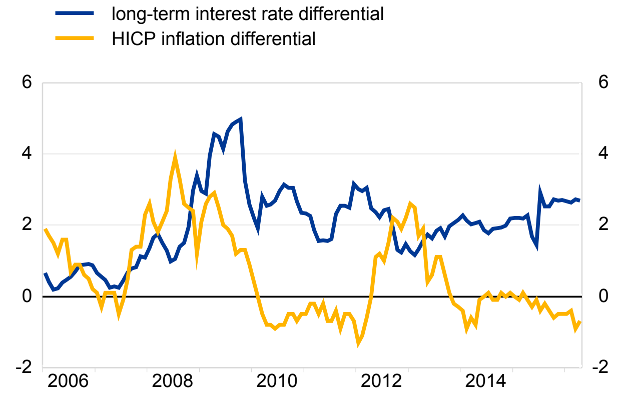


Sources: European System of Central Banks and ECB calculations.

1) The basis of the calculation of the reference value for the period from May 2015 to April 2016 is the unweighted arithmetic average of the interest rate levels in Bulgaria, Slovenia and Spain plus 2 percentage points. The reference value is 4.0%.

Chart 5.3.6 Long-term interest rate and HICP inflation differentials vis-à-vis the euro area

(monthly averages in percentage points)



Sources: European System of Central Banks, ECB calculations and European Commission (Eurostat).

Table 5.3.4 Long-term interest rates and indicators of financial development and integration

(as a percentage of GDP, unless otherwise indicated)

	2006-2015 1)	2006-2010 1)	2011-2015 1)	2012	2013	2014	2015	May 2015 to Apr. 2016	Memo item: euro area 2015
Long-term interest rates									
Croatia 2)	5.4	5.9	5.0	6.1	4.7	4.1	3.6	3.7	-
Euro area 2), 3)	3.4	4.0	2.9	3.9	3.0	2.0	1.2	1.2	-
Euro area AAA par curve, ten-year residual maturity 2), 3)	2.8	3.8	1.8	2.1	1.9	1.4	0.6	0.6	-
Indicators of financial development and integration									
Debt securities issued by financial corporations 4)	0.4	-	0.4	-	0.4	0.4	0.4	-	73.6
Debt securities issued by non-financial corporations 5)	5.3	-	5.3	-	5.9	4.8	5.3	-	10.8
Stock market capitalisation 6)	38.0	-	38.0	-	36.5	38.9	38.7	-	60.4
MFI credit to non-government residents 7)	66.2	-	71.0	71.5	71.0	70.1	66.8	-	114.7
Claims of euro area MFIs on resident MFIs 8)	15.5	-	14.7	16.4	15.3	12.5	8.2	-	27.4

Sources: European System of Central Banks and ECB calculations.

1) Multi-annual averages calculated using the arithmetic average.

2) Average interest rate.

3) Included for information only.

4) Outstanding amount of debt securities issued by resident MFIs and other financial corporations. Data available since 2013.

5) Outstanding amount of debt securities issued by resident non-financial corporations. Data available since 2013.

6) Outstanding amount of listed shares issued by residents at the end of the period at market values. Data available since 2013.

7) MFI (excluding NCB) credit to domestic non-MFI residents other than general government. Credit includes outstanding amounts of loans and debt securities. Data available since 2011.

8) Outstanding amount of deposits and debt securities issued by domestic MFIs (excluding the NCB) held by euro area MFIs as a percentage of total liabilities of domestic MFIs (excluding the NCB). Total liabilities exclude capital and reserves and remaining liabilities. Data available since 2011.

5.4 Hungary

5.4.1 Price developments

In April 2016 the 12-month average rate of HICP inflation in Hungary was 0.4%, i.e. below the reference value of 0.7% for the criterion on price stability (see Chart 5.4.1). This rate is expected to increase over the coming months.

Over the past ten years the 12-month average rate of HICP inflation has fluctuated within a relatively wide range, from -0.3% to 7.9%, and the average for that period was elevated, standing at 3.8%. In 2007 the average annual rate of HICP inflation accelerated to 7.9%, owing partly to hikes in administered prices and indirect taxes. As a result of the sharp economic slowdown that started in 2007, inflation receded gradually, but successive commodity price shocks and frequent changes to indirect taxes and administered prices meant that consumer price inflation in Hungary was relatively volatile during the period under review. In 2010 and 2011 Hungary experienced a weak economic recovery driven by external demand (see Table 5.4.1). While domestic demand remained subdued amid wage restraint, hikes in indirect taxes and the depreciation of the forint kept consumer price inflation at an elevated level. In 2012 economic activity declined again, while inflation increased as a result of, among other things, a hike in the value added tax rate. The ensuing economic recovery was to a large extent supported by government intervention in an environment characterised by a contraction in bank lending to the private sector. In recent years inflation expectations have become increasingly better anchored. As inflation receded, the Magyar Nemzeti Bank continued to loosen its monetary policy stance. In 2014 and 2015 the average annual rate of HICP inflation was close to zero owing to a combination of factors, including global commodity price developments, utility price cuts, relatively muted wage growth and subdued external price pressures. The delayed recovery in residential house prices can partly be explained by the high share of non-performing loans in the household sector and the ongoing contraction in lending.

For the first four months of 2016, the average annual rate of HICP inflation stood at 0.3%. Strong domestic demand, supported by a sharply declining unemployment rate, robust wage growth and an accommodative monetary policy stance, made an increasing contribution to domestically generated inflation. However, this was partly offset by developments in global commodity prices and subdued inflation in Hungary's key trading partners.

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. The Magyar Nemzeti Bank defines its inflation target as an annual rate of consumer price inflation of 3%. This was adopted in August 2005. In addition, in March 2015 the Magyar Nemzeti Bank adopted an ex-ante tolerance band of ±1 percentage point around this inflation target. Successive cuts in administrative prices, which constitute a large share of Hungary's HICP basket of goods and services (17% in 2016), helped to contain consumer price inflation. In late

2008 Hungary's large external financing needs necessitated an EU-IMF financial assistance programme, which, owing to a change of government, went off track in June 2010. In November 2011 Hungary requested further precautionary financial assistance from the EU and the IMF, but negotiations were limited to one official round in July 2012, as Hungary did not request any further assistance.

Inflation is expected to increase in the coming years; over the longer term there are concerns regarding the sustainability of inflation convergence in Hungary. According to the European Commission's Spring 2016 Economic Forecast, the rate of inflation will accelerate in 2016 and reach 2.3% in 2017. The inflation outlook is based on expectations of moderate economic growth, with robust job creation and dynamic compensation per employee growth projected to contribute to pushing up inflation. The risks to the inflation outlook are broadly balanced. The main upside risks relate to further depreciation pressure being exerted on the forint, owing to the heightened uncertainty regarding domestic policy. A key downside risk relates to the greater uncertainty about developments in the global economy, which could reduce external price pressures. Looking further ahead, 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 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. More specifically, economic policies promoting private sector-led growth in order to drive up the currently low level of potential growth are essential. Improving the quality of public institutions and ensuring that they are free from undue political intervention are prerequisites for private sector-led economic growth. The red tape for businesses should be reduced further and the excessive tax burden on the private sector, specifically related to special taxes and levies at the sectoral level, needs to be reconsidered. 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. With regard to macroeconomic imbalances, the European Commission selected Hungary for an in-depth review in its Alert Mechanism Report 2016 and concluded that Hungary is not experiencing macroeconomic imbalances.

Financial sector policies should be geared to safeguarding financial stability and ensuring that the financial sector makes a sound contribution to sustainable economic growth. Policies should aim at reviving lending to the private sector in a sustainable manner. The reduction in the banking tax should be implemented as originally envisaged in the Memorandum of Understanding between the Government of Hungary and the European Bank for Reconstruction and Development. The resolution framework for non-performing loans should be further strengthened and the existing bottlenecks in the collateral enforcement process need to be removed.

5.4.2 Fiscal developments

The deficit-to-GDP ratio complies with the Maastricht criteria, whereas the debt-to-GDP ratio exceeds the reference value. In the reference year 2015 the general government budget balance recorded a deficit of 2.0% of GDP, i.e. below the 3% reference value. The general government gross debt-to-GDP ratio was 75.3%, i.e. above the 60% reference value (see Table 5.4.2). Compared with the previous year, the deficit and debt ratios decreased by 0.3 and 0.9 percentage points of GDP respectively. The deficit ratio is forecast by the European Commission to remain at 2.0% in 2016, while the government debt ratio is projected to decrease further to 74.3%. With regard to other fiscal factors, the deficit ratio did not exceed the ratio of public investment to GDP in 2015, nor is it expected to do so in 2016.

Hungary has been subject to the preventive arm of the Stability and Growth Pact since 2013. It had recorded deficits in excess of 3% of GDP each year up to 2012. Hungary's excessive deficit procedure ended on 21 June 2013, nine years after the European Council first assessed that it had an excessive deficit. Hungary is currently subject to the debt rule, as well as the preventive arm of the Stability and Growth Pact. The European Commission's Spring 2016 Economic Forecast projects the structural deficit to be above the medium-term objective, pointing to a high risk of a significant deviation from the preventive arm’s requirements in both 2016 and 2017, unless further measures are taken.

Cyclical factors explain most of the deficit reduction over recent years. The deficit ratio reached its peak in 2006 at 9.3% of GDP and has been on a downward trend ever since, with a subsequent peak in 2011, when it was 5.5% of GDP. European Commission estimates (presented in Table 5.4.2) indicate that cyclical factors improved the budget balance by about 1.7 percentage points of GDP between 2010 and 2015, while the structural balance did so by almost the same amount (1.6 percentage points of GDP). The structural deficit path also points to periods of consolidation efforts (e.g. between 2006 and 2009, as well as in 2012 and, to a lesser extent, 2015), but also to intervals of fiscal loosening (e.g. between 2009 and 2011, and between 2012 and 2014).

The debt-to-GDP ratio increased sharply during the crisis, but has been on a downward path since 2011, albeit at levels above the 60% reference value. The debt ratio increased rapidly, from 65.6% of GDP in 2007 to 80.8% of GDP in 2011, driven by an unfavourable interest growth differential and high deficit-debt adjustments (see Chart 5.4.2), which were partly related to the support granted to the financial sector and partly to the debt revaluation effects stemming from exchange rate dynamics. Since 2012 the debt ratio has been on a downward path, underpinned by primary surpluses, favourable deficit-debt adjustments and an almost neutral effect of the interest-growth differential (see Table 5.4.2). These favourable deficit-debt adjustments stem from the sizeable capital transfer that resulted from the state takeover of mandatory second-pillar private pension assets. Hungary has not incurred contingent liabilities resulting from government interventions to support financial institutions or markets during the crisis.

The level and structure of government debt indicate a high sensitivity with respect to exchange rate movements and fiscal balances that are relatively sensitive to interest rate variations. The share of government debt with a short-term maturity is noticeable (15.1% in 2015 – see Table 5.4.2). Taking into account the level of the debt ratio, fiscal balances are relatively sensitive to changes in interest rates. At the same time, the proportion of foreign currency-denominated government debt, mainly in euro, is high (35.3% in 2015). This leaves fiscal balances sensitive to changes in the exchange rate vis-à-vis the euro. Despite some fluctuations, the share of debt denominated in euro and other foreign currency has been on a decreasing path since 2011, pointing to a decline in debt-related vulnerabilities.

The European Commission's Spring 2016 Economic Forecast points to a high risk of a significant deviation from the adjustment path towards the medium-term objective over the forecast horizon. According to the European Commission's latest forecast, the structural deficit is projected to increase from a level of 2.0% of GDP in 2015 to 2.9% of GDP in 2016, returning to 2.5% of GDP in 2017, thereby deviating from the medium-term objective of -1.7% of GDP (and of -1.5% of GDP from 2017 onwards) and pointing to a high risk of a significant deviation from the preventive arm's provisions. Hungary's medium-term fiscal policy strategy, as presented in the 2016 Convergence Programme update, although indicating compliance with the preventive's arm requirements in 2015, points to partial compliance over the forecast horizon, with the structural deficit projections deviating from the target over 2016-2018 (a widening deviation in 2017 also as a result of the new, tighter medium-term objective) and a return to compliance with the revised medium-term objective as of 2019.

The national fiscal governance framework has recently been strengthened, but there is scope for further improvement. Hungary began the process of reforming its national fiscal governance framework in 2010 (also establishing a strong constitutional basis for the new set-up) and subsequently implemented several changes, ranging from allocating optional tasks and resources to the fiscal council to assigning veto competence to the council over the annual budget bill. However, the fiscal council's analytical capacities and competencies should be improved and its independence needs to be strengthened in order to match its uniquely strong veto powers. Moreover, positive provisions, such as the government's obligation to fully justify the differences between the medium-term budgetary framework and the actual draft budgetary plan by factors outside the government influence have not been implemented. This suggests that the current framework has still not passed an effectiveness test. There is scope for improving the fiscal governance framework with (i) a better medium-term budget programming process, (ii) an enhanced fiscal council with a broader mandatory remit that will further increase the transparency of public finances, (iii) a more growth and environmentally-friendly taxation system and less reliance on sector-specific distortionary taxation, and (iv) further improvements in the efficiency of tax administration that will address the existing compliance gaps. This could be complemented by (v) tackling the high expenditure ratio and (vi) recognising existing contingent liabilities at the level of state-owned enterprises. Implementing these fiscal framework improvements should increase the efficiency, transparency and credibility of the fiscal sector, thus fostering a sustainable adjustment towards an already favourable medium-term objective.

Hungary is at no risk of fiscal stress over the long term, but medium risk over the medium term and an ageing population pose a challenge to public finances. In the 2015 Fiscal Sustainability Report published by the European Commission, the assessment for Hungary points to no risk over the short and long term and medium risk over the medium term. This medium-term risk is underpinned by the high stock of debt, the sensitivity to possible shocks to nominal growth, interest rates and the government primary balance. It is partly mitigated by the low adjustment implied by the cost of ageing in the baseline scenario. Hungary has taken steps to tackle the costs of ageing. Notably, the authorities have made successive parametric changes to the existing pension system pertaining to: (i) the level of the benefit (including changes in indexation) and (ii) the number of recipients (raising the retirement age and the effective retirement age), (iii) changes to the tax system to incentivise favourable demographic developments and (iv) labour market reforms aimed at increasing the participation rate in the workforce. These reforms imply a reduced level of current and future spending on public pensions which, in turn, largely explains the projected savings in demography-sensitive public expenditure. However, such developments raise concerns regarding the future adequacy of the pension system in Hungary. In the 2015 Ageing Report[118] projections, Hungary is likely to experience an increase in strictly age-related public expenditure of 0.9 percentage points of GDP by 2060 in the AWG reference scenario, rising from a level of 20.5% of GDP in 2013. In the same time span, Hungary is projected to incur higher ageing costs amounting to 5.4 percentage points of GDP (mostly from increases of 4.2% and 1.5% of GDP in long-term care and health care respectively) in the AWG risk scenario, significantly above the EU average. All these factors suggest that further pension reform is needed in order to enhance the long-term sustainability of public finances.

Further reforms of the fiscal governance framework and a prudent fiscal policy are necessary in order to safeguard the sustainability of public finances over the medium term. Hungary should take the necessary measures to ensure compliance with its medium-term objective in 2016 and beyond. Fiscal risks related to low tax compliance, contingent liabilities stemming from state-owned enterprises and deficiencies in the medium-term budget programming process need to be addressed. Determined progress towards the medium-term objective in line with preventive-arm requirements, as well as reforms of the fiscal governance framework, are necessary in order to safeguard the sustainability of public finances over the medium term.

[118] European Commission and Economic Policy Committee, "The 2015 Ageing Report: Economic and budgetary projections for the EU-28 Member States (2013-2060)", prepared by the AWG.

5.4.3 Exchange rate developments

Over the reference period from 19 May 2014 to 18 May 2016, 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 traded close to its May 2014 average exchange rate against the euro of 304.58 forints per euro, which is used as a benchmark for illustrative purposes in the absence of an ERM II central rate (see Chart 5.4.3). On 18 May 2016 the exchange rate stood at 316.05 forints per euro, i.e. 3.8% weaker than its average level in May 2014. Over the reference period the maximum upward deviation from this benchmark was 2.6%, while the maximum downward deviation amounted to 5.8%. Looking back over a longer period the exchange rate of the Hungarian forint against the euro has depreciated by 20.5% over the past ten years.

The exchange rate of the Hungarian forint against the euro exhibited, on average, a relatively high degree of volatility over the reference period. It is likely that the existing macroeconomic vulnerabilities in Hungary, albeit declining, together with a non-investment sovereign credit rating and a gradually declining short-term interest rate differential against the three-month EURIBOR, have made the forint susceptible to relatively high volatility. Between November 2014 and January 2015 the Hungarian forint depreciated against the euro amid a deteriorating outlook in the country's key trading partners and elevated geopolitical risks. This period was followed by a rather dynamic appreciation between January 2015 and April 2015, which coincided with monetary policy decisions in the country's key trading partners and their subsequent impact on financial markets. By July 2015 the Hungarian forint had depreciated markedly again, erasing most of the gains it had recorded against the euro during the previous period. Since then the forint exchange rate volatility has declined somewhat.

The real effective exchange rate of the Hungarian forint has been subject to some volatility over the past ten years (see Chart 5.4.4). However, this indicator should be interpreted with caution, as during this period Hungary was subject to a process of economic convergence, which complicates any historical assessment of real exchange rate developments.

Over the past decade Hungary's current and capital account has improved markedly and contributed to a reduction in the country's net foreign liabilities, which remain high (see Table 5.4.3). After reporting a large deficit of, on average, 6.3% of GDP between 2006 and 2008, the combined current and capital account balance turned into a slight surplus in 2009, which widened gradually thereafter to 5.7% in 2014 and 8.7% in 2015. This is largely explained by a substantial adjustment in the goods and services balance owing to robust export growth supported by expanded capacities of export-oriented sectors and, until recently, to relatively subdued domestic demand. An increasing capital account surplus reflecting larger transfers from the EU budget to Hungary also contributed to this rebalancing in the more recent past. The sharp adjustment in Hungary's external position was coupled with a significant reshuffling of its financing capital flows. While the portfolio investment balance turned into net outflows, which were later reversed, the balance on other investment continued to record net outflows until recently. Moreover, Hungary has been, on average, a recipient of net inflows of foreign direct investment. Against this background, gross external debt decreased from 161.5% in 2011 to 145.0% of GDP in 2014 and 133.8% of GDP in 2015. Hungary's net international investment position improved somewhat less dynamically, from -94.5% of GDP in 2011 to -73.9% of GDP in 2014 and -68.6% of GDP in 2015. However, the country's net foreign liabilities are still very high. Fiscal and structural policies therefore continue to be important for supporting external sustainability and the competitiveness of the economy.

The Hungarian economy is well integrated with the euro area through trade and investment linkages. In 2015 exports of goods and services to the euro area constituted 55.6% of total exports, while the corresponding figure for imports was similar, at 57.8%. The share of the euro area in Hungary's stock of inward direct investment stood at 59.0% in 2015 and its share in the country's stock of portfolio investment liabilities was 38.1% in 2015. The share of Hungary's stock of foreign assets invested in the euro area amounted to 32.7% in the case of direct investment and 65.2% in the case of portfolio investment in 2015.

5.4.4 Long-term interest rate developments

Over the reference period from May 2015 to April 2016, long-term interest rates in Hungary were 3.4% on average and thus below the 4.0% reference value for the interest rate convergence criterion (see Chart 5.4.5).

Long-term interest rates in Hungary have decreased since 2009. After an initial steep decline in 2009, there was a temporary increase in long-term interest rates in 2011-12, which was accompanied by a significant increase in credit default swap prices to levels above those observed during the financial crisis. The reasons for the temporary increase in long-term interest rates included uncertainty related to the prospects of a possible IMF/EU programme, contracting economic activity in the midst of increasing inflation and the rise in global risk aversion due to the euro area debt crisis. In 2013 the long-term interest rate hovered around 6%, before falling to below 4% at the end of 2014 (see Chart 5.4.5). A decrease in global risk aversion, coupled with an improvement in the country-specific risk perception, and a number of consecutive monetary policy rate cuts may all have contributed to this decline in bond yields. During the reference period interest rates remained below 4% and the increase in euro area sovereign yields during the summer of 2015 was also evident in Hungarian sovereign yield developments.

Hungary's long-term interest rate differential vis-à-vis the euro area average has narrowed over recent years to stand at 2.1 percentage points at the end of the reference period. The interest rate differential, which had increased during the 2008-09 financial crisis, decreased from 2009 onwards, with the exception of some widening in 2011 and 2012 (see Chart 5.4.6). Since 2012 gradual but continuous reductions of the base rate (measured by the three-month fixed rate deposit since 23 September 2015, replacing the two-week central bank deposit rate), from 7%

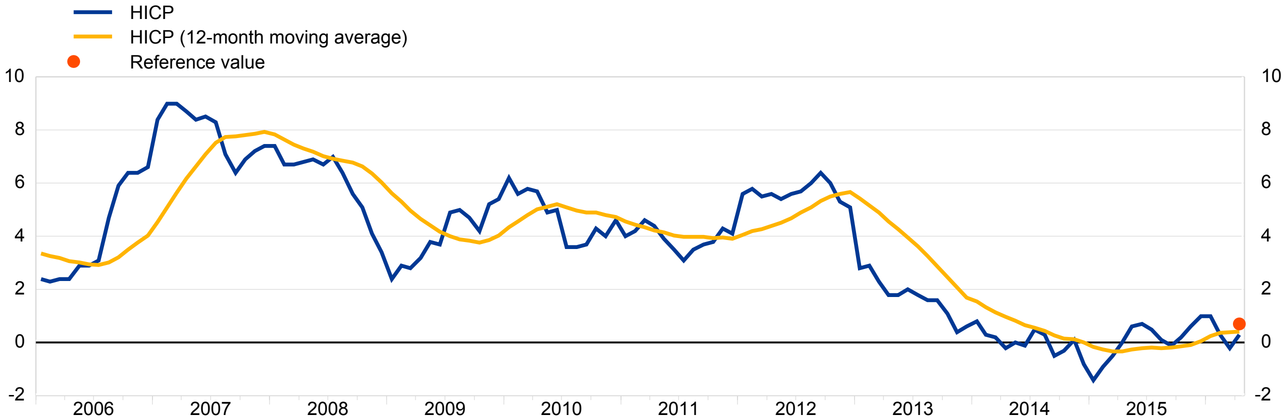
down to currently 1.05%, have contributed to the decline in the differential. As a result of this and given improving euro area financial market confidence since mid-2012, the long-term interest rate differential with respect to the AAA euro area yield stood at 2.8 percentage points at the end of the reference period.

Hungarian capital markets are much smaller than in the euro area and still underdeveloped (see Table 5.4.4). Stock market capitalisation, as a share of GDP, has declined in recent years, from above 20% of GDP before the crisis to 15% in 2015. Overall, equities do not play an important role in the financing of the Hungarian economy. Outstanding debt securities issued by non-financial institutions (a measure of market-based indebtedness) amounted to only 1.1% of GDP in 2015. The decline in debt securities issued by financial corporations also reflects continued deleveraging efforts in an environment characterised by a still relatively high level of non-performing loans. Integration of Hungary's financial sector with the euro area, as measured by the claims of euro area banks on Hungarian banks, is moderate, particularly following the deleveraging observed since 2008. However, the share of foreign ownership of the Hungarian banking system is significant. In addition, foreign participation in the Budapest Stock Exchange remains high. The degree of financial intermediation is low compared with the euro area average, despite Hungary's financial sector being well developed in comparison with its peers. A significant rebound in the financial intermediation capacity of Hungarian banks is being hampered by continued deleveraging and a number of policy measures weighing on banks' profits. MFI credit to non-government residents in 2015 stood at 39.0% of GDP, approximately 15 percentage points down from its 2012 level (see Table 5.4.4). The level of claims of euro area MFIs on resident MFIs has also decreased significantly, standing at 5.7% in 2015 compared with a euro area average of 27.4%.

Hungary - Price developments

Chart 5.4.1 HICP inflation and reference value 1)

(annual percentage changes)



Sources: European Commission (Eurostat) and ECB calculations.

1) The basis of the calculation of the reference value for the period from May 2015 to April 2016 is the unweighted arithmetic average of the annual percentage changes in the HICP for Bulgaria, Slovenia and Spain plus 1.5 percentage points. The reference value is 0.7%.

Table 5.4.1 Measures of inflation and related indicators

(annual percentage changes, unless otherwise indicated)

	2006-2015 1)	2006-2010 1)	2011-2015 1)	2011	2012	2013	2014	2015	2016 2)	2017 2)
Measures of inflation										
HICP	3.8	5.3	2.3	3.9	5.7	1.7	0.0	0.1	0.4	2.3
HICP excluding unprocessed food and energy	3.5	4.3	2.8	3.0	5.0	3.0	1.6	1.3	1.5	2.4
HICP at constant tax rates 3)	3.1	4.5	1.6	3.7	3.5	1.2	0.0	0.0	-	-
CPI	3.8	5.4	2.2	3.9	5.7	1.7	-0.2	-0.1	0.4	2.3
Private consumption deflator	3.6	4.7	2.6	3.7	6.3	2.1	1.0	0.1	0.8	2.3
GDP deflator	3.4	4.0	2.8	2.2	3.5	3.1	3.2	1.8	2.4	2.5
Producer prices 4)	4.0	7.0	1.1	6.1	5.3	-0.5	-2.1	-3.0	-	-
Related indicators										
Real GDP growth	0.7	-0.2	1.7	1.8	-1.7	1.9	3.7	2.9	2.5	2.8
GDP per capita in PPS 5) (euro area = 100)	59.6	58.1	61.6	60.4	60.2	62.0	63.7	.	-	-
Comparative price levels (euro area = 100)	61.1	62.9	58.8	60.0	59.9	58.5	56.7	.	-	-
Output gap 6)	-0.6	0.4	-1.5	-1.5	-3.3	-2.4	-0.7	0.1	0.5	1.0
Unemployment rate (%) 7)	9.1	8.8	9.4	11.0	11.0	10.2	7.7	6.8	6.4	6.1
Unit labour costs, whole economy	2.4	2.6	2.3	1.4	4.0	0.9	2.0	3.2	2.9	1.5
Compensation per employee, whole economy	2.7	3.3	2.2	3.1	2.1	1.8	0.9	3.3	4.6	4.3
Labour productivity, whole economy	0.3	0.6	0.0	1.7	-1.8	0.9	-1.1	0.1	1.6	2.7
Imports of goods and services deflator	1.6	1.7	1.5	4.9	4.1	-0.5	0.3	-1.0	-0.5	0.3
Nominal effective exchange rate 8)	-2.4	-2.0	-2.8	-0.8	-5.8	-0.8	-2.7	-3.7	-	-
Money supply (M3) 9)	5.5	7.5	3.6	2.1	0.1	6.2	2.9	6.8	-	-
Lending from banks 10)	-0.5	6.4	-6.9	-13.1	-5.5	-4.1	-3.5	-8.1	-	-
Stock prices (BUX) 11)	15.1	2.6	12.2	-20.4	7.1	2.2	-10.4	43.8	-	-
Residential property prices 12)	0.0	-1.8	1.0	-3.4	-3.8	-2.6	4.3	11.5	-	-

Sources: European Commission (Eurostat, DG ECFIN), national data for CPI, money supply, lending from banks and residential property prices, and ECB calculations based on Thomson Reuters data for stock prices.

1) Multi-annual averages calculated using the geometric mean, except for GDP per capita in PPS, comparative price levels, output gap and unemployment rate, for which the arithmetic mean is used.

2) Data from the European Commission's Spring 2016 Economic Forecast.

3) The difference between the HICP and the HICP at constant tax rates shows the theoretical impact of changes in indirect taxes (e.g. VAT and excise duties) on the overall rate of inflation. This impact assumes a full and instantaneous pass-through of tax rate changes to the price paid by the consumer.

4) Domestic sales, total industry excluding construction.

5) PPS stands for purchasing power standards.

6) Percentage difference of potential GDP: a positive (negative) sign indicates that actual GDP is above (below) potential GDP.

7) Definition conforms to International Labour Organization guidelines.

8) EER-38 group of trading partners. A positive (negative) sign indicates an appreciation (depreciation).

9) The series includes repurchase agreements with central counterparties.

10) Not adjusted for the derecognition of loans from the MFI statistical balance sheet due to their sale or securitisation.

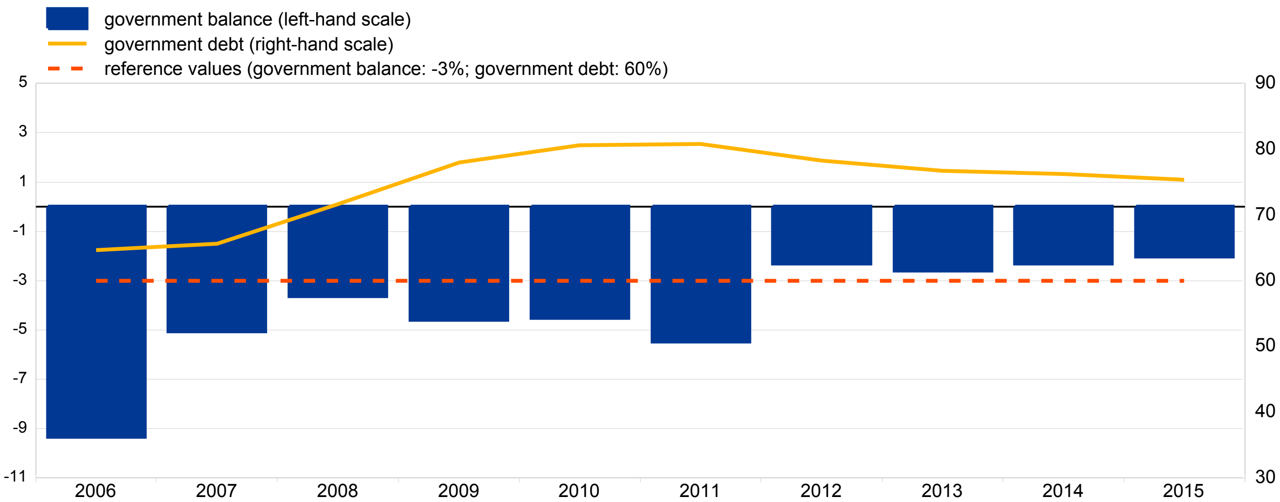
11) Multi-annual and annual figures represent the percentage change between the end of the given period and the end of the previous period.

12) Data available since 2007.

Hungary - Fiscal developments

Chart 5.4.2 General government balance and debt

(as a percentage of GDP)



Sources: European System of Central Banks and European Commission (Eurostat).

Table 5.4.2 Government budgetary developments and projections

(as a percentage of GDP, unless otherwise indicated)

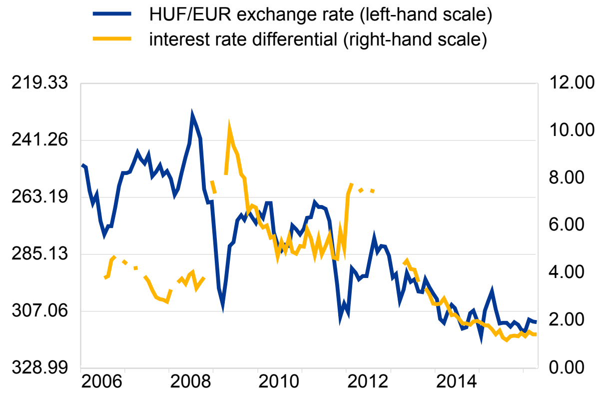
	2006-2015 1)	2006-2010 1)	2011-2015 1)	2011	2012	2013	2014	2015	2016 2)	2017 2)	2018	2019
Government balance	**-4.2**	**-5.4**	**-2.9**	**-5.5**	**-2.3**	**-2.6**	**-2.3**	**-2.0**	**-2.0**	**-2.0**	.	.
Total revenue	45.8	44.7	46.8	44.3	46.3	47.0	47.5	48.7	46.4	46.1	.	.
Current revenue	43.8	43.6	44.0	42.1	44.2	44.4	44.6	44.7	44.3	43.9	.	.
Direct taxes	8.1	9.4	6.7	6.3	6.8	6.6	6.8	6.9	7.2	7.0	.	.
Indirect taxes	17.2	16.0	18.4	17.3	18.6	18.5	18.5	19.0	18.1	17.8	.	.
Net social contributions	13.0	12.9	13.1	13.1	13.0	13.0	13.1	13.3	13.4	13.4	.	.
Other current revenue 3)	5.5	5.3	5.8	5.3	5.8	6.4	6.1	5.5	5.6	5.6	.	.
Capital revenue	2.0	1.1	2.8	2.2	2.1	2.6	3.0	4.0	2.1	2.2	.	.
Total expenditure	49.9	50.2	49.7	49.7	48.6	49.6	49.8	50.7	48.4	48.1	.	.
Current expenditure	43.8	44.7	43.0	43.5	43.3	43.8	42.9	41.3	41.3	40.5	.	.
Compensation of employees	10.8	11.4	10.3	10.2	10.0	10.1	10.4	10.7	11.0	10.9	.	.
Social benefits	18.5	19.2	17.8	19.0	18.5	18.2	17.1	16.4	14.8	14.3	.	.
Interest payable	4.2	4.1	4.2	4.2	4.6	4.5	4.0	3.6	3.1	3.0	.	.
Other current expenditure 4)	10.3	9.9	10.7	10.2	10.3	11.0	11.4	10.6	12.4	12.4	.	.
Capital expenditure	6.1	5.5	6.7	6.3	5.3	5.9	6.9	9.4	7.1	7.5	.	.
of which: Investment	4.3	4.0	4.7	3.4	3.7	4.4	5.5	6.7	5.5	5.3	.	.
Cyclically adjusted balance	-3.9	-5.6	-2.2	-4.7	-0.7	-1.4	-1.9	-2.1	-2.2	-2.5	.	.
One-off and temporary measures	.	.	0.2	-0.2	0.7	0.1	0.3	0.0	0.7	0.0	.	.
Structural balance 5)	.	.	-2.3	-4.5	-1.4	-1.5	-2.2	-2.0	-2.9	-2.5	.	.
Government debt	**74.8**	**72.1**	**77.5**	**80.8**	**78.3**	**76.8**	**76.2**	**75.3**	**74.3**	**73.0**	.	.
Average residual maturity (in years)	4.6	4.6	4.5	4.9	4.5	4.6	4.5	4.2	.	.	.	.
In foreign currencies (% of total)	40.7	38.8	42.5	51.8	43.4	42.1	39.8	35.3	.	.	.	.
of which: Euro	39.4	37.2	41.6	49.7	41.7	41.5	39.8	35.3	.	.	.	.
Domestic ownership (% of total)	45.3	48.1	42.5	34.9	38.2	42.4	45.5	51.6	.	.	.	.
Medium and long-term maturity (% of total) 6)	87.0	87.6	86.5	89.4	86.3	85.3	86.3	84.9	.	.	.	.
of which: Variable interest rate (% of total)	5.8	4.0	7.7	4.5	4.4	5.5	11.6	12.4	.	.	.	.
Deficit-debt adjustment	**0.1**	**0.9**	**-0.6**	**-2.2**	**-3.4**	**-0.4**	**2.2**	**0.6**	.	.	.	.
Net acquisitions of main financial assets	0.4	0.4	0.5	4.4	-0.7	-1.6	0.8	-0.6	.	.	.	.
Currency and deposits	0.3	0.7	-0.2	0.5	0.4	-1.4	0.7	-0.9	.	.	.	.
Debt securities	0.0	0.0	0.0	0.2	0.1	0.3	-0.4	0.0	.	.	.	.
Loans	-0.1	0.1	-0.2	-0.5	-0.4	0.0	0.0	0.0	.	.	.	.
Equity and investment fund shares or units	0.2	-0.4	0.8	4.3	-0.7	-0.4	0.4	0.3	.	.	.	.
Revaluation effects on debt	0.7	0.5	0.9	4.8	-2.4	0.7	1.3	0.2	.	.	.	.
of which: Foreign exchange holding gains/losses	0.8	0.5	1.0	4.8	-2.4	0.7	1.6	0.3	.	.	.	.
Other 7)	-1.0	0.0	-2.0	-11.4	-0.3	0.5	0.1	1.0	.	.	.	.
Convergence programme: government balance	-	-	-	-	-	-	-	-	-1.9	-2.4	-1.8	-1.5
Convergence programme: structural balance	-	-	-	-	-	-	-	-	-2.1	-2.1	-1.7	-1.5
Convergence programme: government debt	-	-	-	-	-	-	-	-	74.5	73.6	72.4	68.4

Sources: European System of Central Banks and European Commission (Eurostat, DG ECFIN).
1) Multi-annual averages.
2) Data from the European Commission's Spring 2016 Economic Forecast, except for convergence programme data.
3) Sales and other current revenue.
4) Intermediate consumption, subsidies payable and other current expenditure.
5) Cyclically-adjusted balance excluding one-off and other temporary measures.
6) Original maturity of more than one year.
7) Time of recording differences and other discrepancies (sector reclassifications and statistical discrepancies).

Hungary - Exchange rate and external developments

Chart 5.4.3 Bilateral exchange rate and short-term interest rate differential

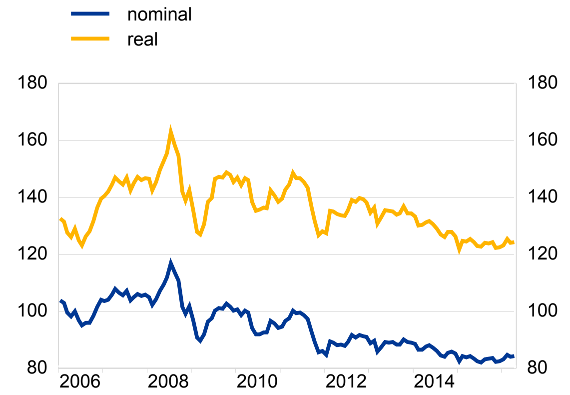
(HUF/EUR exchange rate: monthly averages; difference between three-month interbank interest rates and three-month EURIBOR: basis points, monthly values)



Sources: National data and ECB calculations.

Chart 5.4.4 Effective exchange rates [1)]

(EER-38 group of trading partners; monthly averages; base index: Q1 1999 = 100)



Source: ECB.
1) The real EER-38 is CPI deflated. An increase (decrease) in the EER indicates an appreciation (depreciation).

Table 5.4.3 External developments

(as a percentage of GDP, unless otherwise indicated)

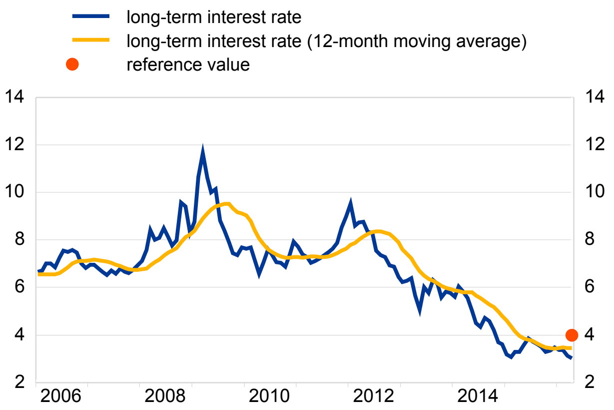
	2008-2015 [1)]	2008-2010 [1)]	2011-2015 [1)]	2011	2012	2013	2014	2015	2016 [2)]	2017 [2)]
Balance of payments										
Current account and capital account balance [3)]	3.3	-0.9	5.9	3.1	4.3	7.6	5.7	8.7	7.7	7.7
Current account balance	0.6	-2.5	2.5	0.8	1.7	3.9	2.0	4.2	5.0	4.5
Goods	2.5	1.5	3.1	2.9	2.9	3.4	2.4	3.9	.	.
Services	3.2	1.7	4.1	3.3	3.8	3.9	4.7	4.7	.	.
Primary income	-4.4	-5.1	-4.0	-4.8	-4.2	-2.8	-4.5	-3.7	.	.
Secondary income	-0.7	-0.6	-0.7	-0.6	-0.8	-0.5	-0.7	-0.7	.	.
Capital account balance	2.7	1.6	3.3	2.3	2.5	3.6	3.7	4.5	.	.
Combined direct and portfolio investment balance [3)]	-1.0	0.7	-2.0	-7.7	-3.7	-3.0	0.2	4.2	.	.
Direct investment	-1.5	-1.5	-1.5	-1.4	-2.2	-0.1	-2.8	-1.0	.	.
Portfolio investment	0.5	2.2	-0.5	-6.3	-1.5	-3.0	3.0	5.2	.	.
Other investment balance	1.3	-8.6	7.3	3.7	12.1	8.7	3.4	8.4	.	.
Reserve assets	-	-	-0.4	3.9	-3.3	1.1	0.7	-4.5	.	.
Exports of goods and services	85.0	78.9	88.7	87.3	86.7	88.0	89.5	92.1	.	.
Imports of goods and services	79.3	75.6	81.5	81.1	80.0	80.7	82.3	83.5	.	.
Net international investment position [4)]	-92.2	-108.0	-82.7	-94.5	-93.0	-83.5	-73.9	-68.6	.	.
Gross external debt [4)]	153.8	162.3	148.8	161.5	158.0	145.5	145.0	133.8	.	.
Internal trade with the euro area [5)]										
Exports of goods and services	56.4	57.0	56.0	55.9	56.3	55.8	56.5	55.6	.	.
Imports of goods and services	55.3	53.7	56.2	54.1	55.8	55.7	57.8	57.8	.	.
Investment position with the euro area [5)]										
Direct investment assets [4)]	39.3	46.1	35.2	39.6	35.0	36.1	32.9	32.7	.	.
Direct investment liabilities [4)]	56.0	55.7	56.1	55.1	54.4	56.3	55.7	59.0	.	.
Portfolio investment assets [4)]	65.5	63.8	66.6	64.6	64.3	67.5	71.2	65.2	.	.
Portfolio investment liabilities [4)]	48.8	56.4	44.2	50.4	45.3	45.2	41.9	38.1	.	.

Sources: European System of Central Banks and European Commission (Eurostat, DG ECFIN).
Note: Backdata are available from 2008.
1) Multi-annual averages.
2) Data from the European Commission's Spring 2016 Economic Forecast.
3) Differences between totals and sum of their components are due to rounding.
4) End-of-period outstanding amounts.
5) As a percentage of the total.

Hungary - Long-term interest rate developments

Chart 5.4.5 Long-term interest rate 1)

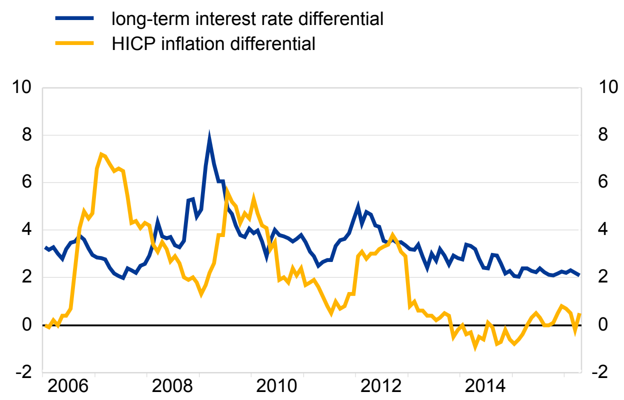
(monthly averages in percentages)



Sources: European System of Central Banks and ECB calculations.
1) The basis of the calculation of the reference value for the period from May 2015 to April 2016 is the unweighted arithmetic average of the interest rate levels in Bulgaria, Slovenia and Spain plus 2 percentage points. The reference value is 4.0%.

Chart 5.4.6 Long-term interest rate and HICP inflation differentials vis-à-vis the euro area

(monthly averages in percentage points)



Sources: European System of Central Banks, ECB calculations and European Commission (Eurostat).

Table 5.4.4 Long-term interest rates and indicators of financial development and integration

(as a percentage of GDP, unless otherwise indicated)

	2006-2015 1)	2006-2010 1)	2011-2015 1)	2012	2013	2014	2015	May 2015 to Apr. 2016	Memo item: euro area 2015
Long-term interest rates									
Hungary 2)	6.8	7.7	5.9	7.9	5.9	4.8	3.4	3.4	-
Euro area 2), 3)	3.4	4.0	2.9	3.9	3.0	2.0	1.2	1.2	-
Euro area AAA par curve, ten-year residual maturity 2), 3)	2.8	3.8	1.8	2.1	1.9	1.4	0.6	0.6	-
Indicators of financial development and integration									
Debt securities issued by financial corporations 4)	19.0	19.0	19.0	24.0	27.3	9.3	9.7	-	73.6
Debt securities issued by non-financial corporations 5)	1.7	1.5	1.9	2.2	2.0	2.0	1.1	-	10.8
Stock market capitalisation 6)	19.3	24.1	14.6	16.0	14.2	11.8	15.0	-	60.4
MFI credit to non-government residents 7)	56.4	62.5	50.2	54.2	48.8	45.1	39.0	-	114.7
Claims of euro area MFIs on resident MFIs 8)	17.2	22.6	11.8	13.5	11.6	8.0	5.7	-	27.4

Sources: European System of Central Banks and ECB calculations.
1) Multi-annual averages calculated using the arithmetic average.
2) Average interest rate.
3) Included for information only.
4) Outstanding amount of debt securities issued by resident MFIs and other financial corporations.
5) Outstanding amount of debt securities issued by resident non-financial corporations.
6) Outstanding amount of listed shares issued by residents at the end of the period at market values.
7) MFI (excluding NCB) credit to domestic non-MFI residents other than general government. Credit includes outstanding amounts of loans and debt securities.
8) Outstanding amount of deposits and debt securities issued by domestic MFIs (excluding the NCB) held by euro area MFIs as a percentage of total liabilities of domestic MFIs (excluding the NCB). Total liabilities exclude capital and reserves and remaining liabilities.

5.5 Poland

5.5.1 Price developments

In April 2016 the 12-month average rate of HICP inflation in Poland was -0.5%, i.e. well below the reference value of 0.7% for the criterion on price stability (see Chart 5.5.1). This rate is expected to increase over the coming months.

Over the past ten years the 12-month average rate of HICP inflation has fluctuated within a relatively wide range, from -0.7% to 4.3%, and the average for that period was moderate, standing at 2.3%. During the period 2006-08 HICP inflation followed an upward trend, reaching levels of over 4%. To a large extent, this was due to stronger growth in unit labour costs and changes to administered prices, as well as the global food and energy price shock. In 2006 and 2007 real GDP expanded at an annual rate of well above 6% and the unemployment rate declined to historically low levels. A relatively short-lived economic slowdown – Poland was the only EU Member State that avoided a decline in output in 2009 – and lower global commodity prices resulted in a temporary fall in annual HICP inflation, to levels slightly below 2% in the summer of 2010. Thereafter, inflationary pressures re-emerged, supported by the robust recovery in economic activity and a hike in the value added tax rate in 2011. As a result, Narodowy Bank Polski had to increase interest rates over the period from 2011 to mid-2012. In 2012 the Polish economy slowed on account of weak domestic demand and unfavourable external conditions. The weakening of domestic economic activity, along with a significant fall in global commodity prices, contributed to a sharp decline in inflation over the period 2013-15. In 2015 the average annual rate of HICP inflation stood at -0.7% (see Table 5.5.1), despite the stronger growth in real GDP growth since mid-2013 and notwithstanding the fact that Narodowy Bank Polski cut its main policy rate to a historical low of 1.50%.

For the first four months of 2016, the average annual rate of HICP inflation stood at -0.4%. This historically low level of inflation largely reflects the decline in global commodity prices over the past year. At the same time, however, domestic price pressures remained subdued. This is reflected in the very low levels of HICP inflation excluding unprocessed food and energy.

Policy choices have played an important role in shaping inflation dynamics 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 since 1999 has had an inflation-targeting monetary policy framework in place. The medium-term CPI inflation target has been 2.5% (±1 percentage point) since 2004. Inflation developments have been broadly supported by a number of reforms designed to strengthen financial market stability, increase labour market flexibility and enhance product market competition.

Inflation is expected to increase in the coming years, albeit remaining at a moderate level; over the longer term, there are concerns regarding the

sustainability of inflation convergence in Poland. According to the European Commission's Spring 2016 Economic Forecast, average annual inflation is projected to increase, reaching 1.6% in 2017. Relatively strong real GDP growth and further declines in the unemployment rate are likely to support a gradual pick-up in inflation towards the lower bound of the range of the central bank's inflation target. Risks to the inflation outlook are broadly balanced. Downside risks relate to the heightened uncertainty regarding developments in the global economy, which could reduce external price pressures, while upside risks may arise from stronger than expected wage pressures on the back of tightening labour market conditions. 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. 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 financial crisis comparatively well, a number of structural issues remain unresolved. In order to enhance potential growth and resource allocation, efforts are needed to boost competition in product markets and speed up innovation, privatisation and infrastructure modernisation. Improvements in the business environment could help to attract private investment. In the labour market, a number of structural weaknesses need to be addressed, for example, by strengthening vocational education and reducing labour market mismatches, as well as by boosting the labour force participation rate. It is also essential that structural reforms are carried out to tackle disincentives to work, particularly those resulting from income taxation and pension schemes. With regard to macroeconomic imbalances, the European Commission did not select Poland for an in-depth review in its Alert Mechanism Report 2016.

Financial sector policies should be geared to safeguarding financial stability and ensuring that the financial sector makes a sound contribution to economic growth. In view of the tax on financial institutions' assets that was introduced in February 2016 and the possible regulation on the conversion of foreign exchange-denominated mortgage loans, it is essential to preserve the currently strong financial position of the banking sector. This would ensure the supply of credit to the real economy. Improvements are needed in terms of the completion of the legislation on recovery and resolution mechanisms.

5.5.2 Fiscal developments

Poland's government deficit and debt complied with the Maastricht criteria in 2015. In the reference year 2015 the general government budget balance recorded a deficit of 2.6% of GDP, i.e. below the 3% reference value. The general government gross debt-to-GDP ratio was 51.3%, i.e. below the 60% reference value (see Table 5.5.2). Compared with the previous year, the deficit ratio fell by 0.7 percentage point of GDP. By contrast, the debt ratio increased by 0.8 percentage point. The deficit ratio is forecast by the European Commission to remain at the same level in 2016, before edging up to 3.1% in 2017 on the basis of unchanged policies. The debt-to-GDP ratio is projected to continue to increase, reaching 52.7% in 2017. With regard to other fiscal factors, the deficit ratio did not exceed the ratio of public investment to GDP in 2015, nor is it expected to do so in 2016.

Poland has been subject to the preventive arm of the Stability and Growth Pact since 2015. Against the background of the rise in the budget deficit in excess of the reference value in 2008, the ECOFIN Council decided on 7 July 2009 that an excessive deficit situation existed in Poland and set 2012 as the deadline for correcting it. This was extended to 2014 on 21 June 2013 and by a further year, to 2015, on 10 December 2013. It was noted that Poland had not taken effective action in response to the Council's 21 June 2013 recommendation. The ECOFIN Council abrogated the excessive deficit procedure on 19 June 2015, one year earlier than the extended deadline. While the deficit amounted to 3.3% of GDP in 2014, i.e. above the 3% of GDP reference value, the Council found Poland to be eligible for specific provisions under the excessive deficit procedure that deal with systemic pension reforms. The European Commission’s Spring 2016 Economic Forecast points to risks of a significant deviation from the adjustment path towards the medium-term objective both in 2016 and, under unchanged policies, in 2017.

The reduction in the deficit in recent years is attributable to the improvement in the structural position. The deficit ratio declined from its peak of 7.5% of GDP in 2010 to 2.6% of GDP in 2015. The structural balance according to European Commission estimates (presented in Table 5.5.2) improved even further, while the cyclical component of the deficit deteriorated slightly. The improvement in the structural balance reflects substantial expenditure-based consolidation, driven by broad-based restraint in current spending and a reduction in public investment towards its historical average. Some fiscal measures on the revenue side, such as VAT and social security contribution rate increases, as well as modifications to the pension system with a positive budgetary impact, supported the improvement. In addition, the fiscal adjustment benefited from a considerable reduction in the interest payment bill in relation to GDP.

The debt-to-GDP ratio increased to a limited degree during the early years of the crisis to move closer to the 60% reference value, but decreased more recently. The debt ratio increased by about 5 percentage points in 2010-11, reaching around 55% of GDP. This was attributable to sizeable primary deficits recorded on the back of relatively high capital expenditure related to the absorption of EU structural funds. The debt ratio fell markedly (by more than 5 percentage points) in 2014 on account of a negative deficit-debt adjustment. This reflected the impact of the changes to the pension system, which involved a one-off transfer of government debt from private pension funds to the public sector, partly reversing previous pension reforms. The government has not reported any contingent liabilities related to the financial sector.

The structure of government debt exposes Poland to changes in interest rates and exchange rate fluctuations to some extent. The share of short-term maturity debt in total government debt is negligible (0.8% in 2015 – see Table 5.5.2). A proportion of long-term debt (around 20% in 2015) is subject to a variable interest rate. Overall, taking both characteristics and the level of the debt-to-GDP ratio into consideration, the budget balance remains relatively sensitive to changes in interest rates. The share of foreign currency-denominated government debt is significant (35% in 2015), with around 75% denominated in euro. As a result, and accounting for the debt-to-GDP ratio, the fiscal balance is relatively sensitive to exchange rate fluctuations.

The European Commission’s Spring 2016 Economic Forecast points to the risk of a significant deviation from the adjustment path towards the medium-term objective. The European Commission's Spring 2016 Economic Forecast points to a deterioration in the structural balance of 0.7 percentage point of GDP in 2016. This represents a significant deviation from the improvement of 0.5 percentage point of GDP that is required under the preventive arm. Moreover, the deficit ratio projected for 2017 exceeds the reference value of 3%. The Polish government's plans that were presented in the 2016 Convergence Programme update assume that the deficit ratio will remain below 3%. However, the structural adjustment will be in line with the requirements only in the later years (i.e. 2018-19). Furthermore, according to the government's projections, Poland is not expected to achieve by 2019 its medium-term objective of a structural balance amounting to -1.0% of GDP. The fiscal strategy is not yet fully underpinned by specific measures.

The Polish fiscal framework has strong features, but its effectiveness would benefit from stronger implementation in practice. The constitutional debt rule with triggers for corrective action provides a legal safeguard against exceeding the 60% reference value. Medium-term budgetary planning is based on the Multiannual State Financial Plan, which covers four years and constitutes the basis for annual budget preparation. In addition, a permanent expenditure rule came into force in 2015. This rule limits the growth of public spending to trend GDP growth, or below if government debt is above pre-specified thresholds. However, its effectiveness remains to be seen, especially in view of recent amendments allowing a less restrictive fiscal policy in an environment of low inflation. Unlike most EU countries, Poland does not have an independent fiscal council. However, in line with the provisions of the Fiscal Compact, Poland should, before joining the euro area, put in place the role and independence of the institutions responsible at national level for monitoring compliance with EU fiscal rules.

Over the medium and long term, Poland faces medium risks to fiscal sustainability. The analysis laid out in the European Commission's 2015 Fiscal Sustainability Report points to medium risk over the medium and long term. This stems largely from an unfavourable initial budgetary position and the necessity to meet future increases in strictly age-related costs. The latter, according to the 2015 Ageing Report,[119] are projected to rise moderately (by 1.3 percentage points) by 2060 in the AWG reference scenario, increasing from a level of 20.7% of GDP in

[119] European Commission and Economic Policy Committee, “The 2015 Ageing Report: Economic and budgetary projections for the EU-28 Member States (2013-2060)”.

2013. In the AWG risk scenario, the ageing costs increase significantly in the same time interval (by 3.3 percentage points of GDP), albeit by less than the EU average increase of 3.8 percentage points. The expected increase is entirely driven by healthcare and long-term care spending, whereas pension expenditure and education spending act as mitigating factors. These developments signal the need for reforms in order to address the expected spending pressures.

The favourable medium-term macroeconomic outlook should be used to build up fiscal buffers and introduce the necessary reforms. Poland should ensure compliance with the provisions of the preventive arm of the Pact and make adequate progress towards the medium-term objective. The role and independence of the national institutions that monitor compliance with the EU fiscal rules should be improved. There is significant room for broadening tax bases and boosting tax compliance. On the spending side, the strategy should focus on improving expenditure efficiency through spending reviews and better-targeted benefits. Finally, there is a need for reform to curb projected increases in healthcare and long-term care spending.

5.5.3 Exchange rate developments

In the two-year reference period from 19 May 2014 to 18 May 2016, the Polish zloty did not participate in ERM II, but traded under a flexible exchange rate regime. Over the reference period the Polish zloty at times traded below its May 2014 average exchange rate against the euro of 4.1800 zlotys per euro, which is used as a benchmark for illustrative purposes in the absence of an ERM II central rate (see Chart 5.5.3). On 18 May 2016 the exchange rate stood at 4.3885 zlotys per euro, i.e. 5.0% weaker than its average level in May 2014. Over the reference period the maximum upward deviation from this benchmark was 5.1%, while the maximum downward deviation amounted to 7.5%. Looking back over a longer period the exchange rate of the Polish zloty against the euro has depreciated by 12.7% over the past ten years.

The exchange rate of the Polish zloty against the euro exhibited, on average, a relatively high degree of volatility over the reference period. Volatility increased at the beginning of 2015, which coincided with monetary policy decisions in the country's key trading partners and their subsequent impact on financial markets, and it remained elevated in the first half of 2015. The Polish zloty appreciated against the euro rapidly up to mid-April 2015, a trend that was fully reversed during the following two months. Overall, since mid-2015, the Polish zloty weakened gradually against the euro, partly as the positive interest rate differential vis-à-vis euro area assets declined. The Polish currency may also have been affected by rising global financial market volatility, concerns regarding developments in emerging market economies and the increase in interest rates by the Federal Reserve System at the end of 2015. This has been in contrast to a relatively strong and resilient macroeconomic performance by the Polish economy over this period. Over the reference period short-term interest rate differentials against the three-month EURIBOR remained at relatively wide levels, on average, on account of higher monetary policy rates in

Poland than in the euro area. However, the spreads decreased from 2.4 percentage points in the three-month period ending in September 2014 to 1.9 percentage points in the three-month period ending in March 2016 amid two interest rate cuts by Narodowy Bank Polski. A Flexible Credit Line (FCL) arrangement by the IMF, which can be obtained by countries with very strong economic fundamentals and a good policy track record, has been in place since mid-2009. The latest two-year FCL arrangement was approved in January 2015 for an amount of SDR 15.51 billion, which was confirmed in January 2016, but for a lower amount of SDR 13 billion, as a way of providing adequate insurance against external risks, while sending a signal of their intention to gradually exit the FCL as conditions allow. Poland has not received any disbursements since its establishment. As this arrangement helped to reduce risks related to financial vulnerabilities, it might also have contributed to reducing the risk of exchange rate pressures.

The real effective exchange rate of the Polish zloty has depreciated overall over the past ten years (see Chart 5.5.4). However, this indicator should be interpreted with caution, as during this period Poland was subject to a process of economic convergence, which complicates any historical assessment of real exchange rate developments.

Poland's current and capital account has improved over the past decade, while the country's net foreign liabilities remain high (see Table 5.5.3). Following relatively large deficits over the period 2008-12, the current and capital account subsequently recorded a small surplus. This mostly reflected improvement in the goods and services balance on account of strengthening exports. On the financing side, Poland received net inflows in direct and portfolio investment from 2008 to 2015. Against this background, gross external debt increased over this period, reaching 70.3% of GDP in 2015. At the same time Poland's net international investment position deteriorated substantially to a very high level of -60.7% of GDP in 2015. Fiscal and structural policies therefore continue to be important for supporting external sustainability and the competitiveness of the economy.

The Polish economy is well integrated with the euro area through trade and investment linkages. In 2015 exports of goods and services to the euro area constituted 56.5% of total exports, while the corresponding figure for imports was slightly higher, at 58.2%. The share of the euro area in Poland's stock of inward direct investment stood at 77.5% in 2015 and its share in the country's stock of portfolio investment liabilities was 37.2% in 2015. The share of Poland's stock of foreign assets invested in the euro area amounted to 67.5% in the case of direct investment and 58.2% in the case of portfolio investment in 2015.

5.5.4 Long-term interest rate developments

Over the reference period from May 2015 to April 2016, long-term interest rates in Poland were 2.9% on average and thus below the 4.0% reference value for the interest rate convergence criterion (see Chart 5.5.5).

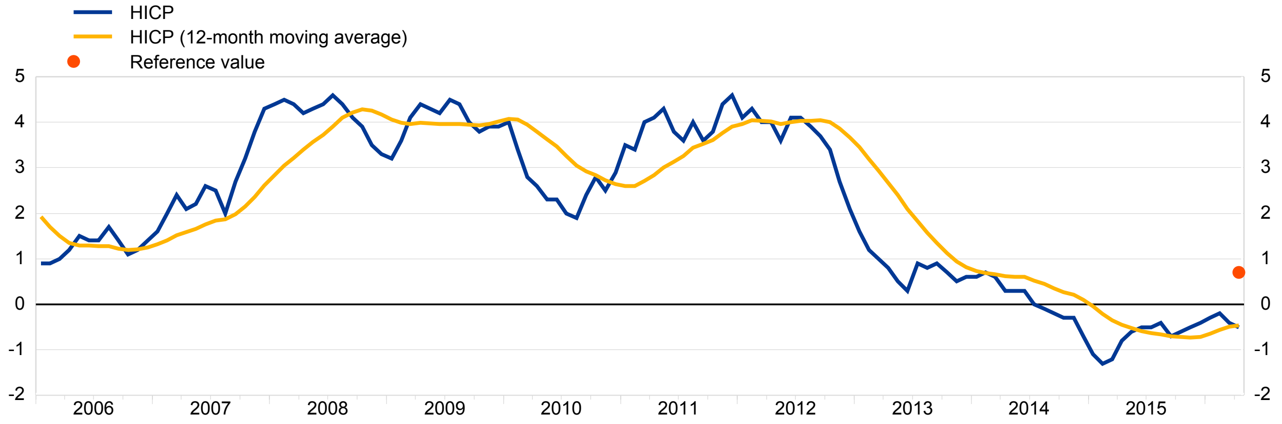
Long-term interest rates in Poland have been on a declining trend since 2011 as 12-month moving average rates more than halved from approximately 6% to under 3% at the end of the reference period. After hovering around 6% in the years between 2008 and 2011 (see Chart 5.5.5), Polish long-term interest rates declined in an environment where rates globally were also falling. In addition, in 2011 and 2012, the relative resilience of the Polish economy and a stable credit rating at the time may have contributed to the fall in Polish interest rates.

Poland's long-term interest rate differential vis-à-vis the euro area has exhibited a high degree of stability over the past decade. In fact, the rate differential has moved within a band of between approximately 1 and 2 percentage points for most of the period since 2006 (see Chart 5.5.6). It was only in 2009 and 2010 that the differential with the euro area consistently exceeded 2 percentage points, peaking at about 2.6 percentage points towards the end of 2009. With the subsequent reductions in Poland's long-term interest rates between 2011 and 2013 being somewhat more pronounced than in the euro area, the interest rate differential reached a low point of 0.6 percentage points in the spring of 2013. It has increased since then, following the end of the previous easing cycle amid expectations of a gradual economic recovery. However, at 2.0 percentage points, the differential continues to be at levels comparable to those observed over the past ten years (for comparison, the differential vis-à-vis the euro area AAA yield stood at 2.7 percentage points).

At the end of 2015 Poland's capital market was smaller and much less developed than the euro area average. While both corporate debt and equity markets were smaller relative to GDP than in the euro area, bond issuance by financial corporations was particularly low at 7.7% of GDP compared with more than 70% in the euro area (see Table 5.5.4). At the same time, the gap vis-à-vis the euro area in terms of equity market capitalisation was less pronounced (28.5% in Poland compared with 60.4% in the euro area). Integration of the Polish financial sector with the euro area, as measured by the claims of euro area banks on Polish banks, is limited. Claims of euro area MFIs accounted for 5.4% of Polish banks' liabilities at the end of 2015 (see Table 5.5.4). Poland's banking sector is smaller and less developed than that of the euro area but, at the same time, is well integrated into the EU financial system. MFIs had extended the equivalent of 57.2% of GDP in credit to the private sector by the end of 2015 (compared with 114.7% in the euro area), with European banks accounting for a major part of those loans.

Poland - Price developments

Chart 5.5.1 HICP inflation and reference value [1]
(annual percentage changes)



Sources: European Commission (Eurostat) and ECB calculations.
1) The basis of the calculation of the reference value for the period from May 2015 to April 2016 is the unweighted arithmetic average of the annual percentage changes in the HICP for Bulgaria, Slovenia and Spain plus 1.5 percentage points. The reference value is 0.7%.

Table 5.5.1 Measures of inflation and related indicators
(annual percentage changes, unless otherwise indicated)

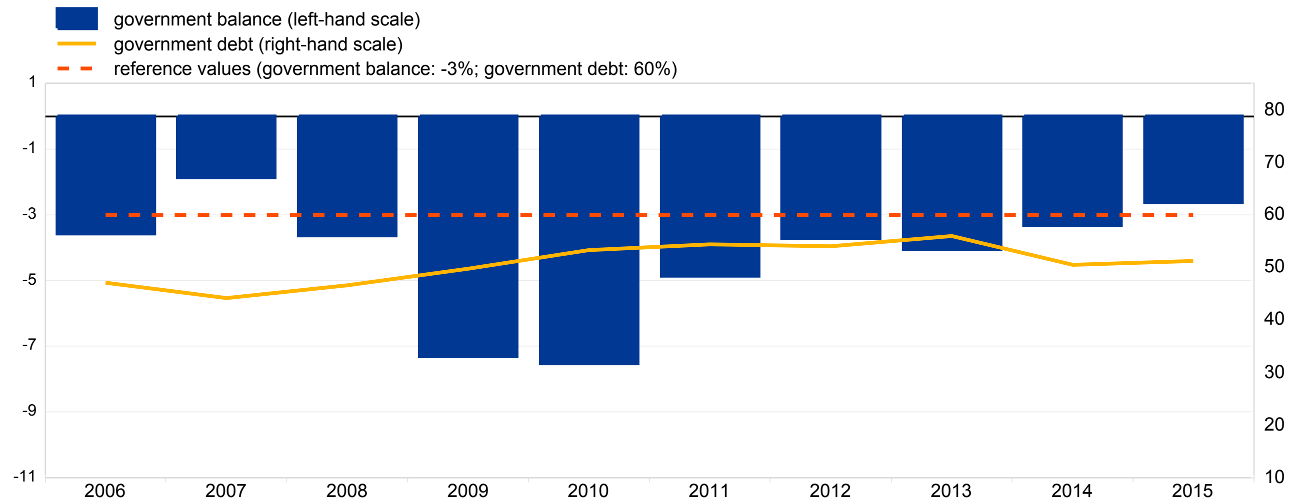
	2006-2015 [1]	2006-2010 [1]	2011-2015 [1]	2011	2012	2013	2014	2015	2016 [2]	2017 [2]
Measures of inflation										
HICP	2.2	2.9	1.5	3.9	3.7	0.8	0.1	-0.7	0.0	1.6
HICP excluding unprocessed food and energy	1.9	2.3	1.5	3.1	2.8	1.0	0.6	0.3	0.6	1.6
HICP at constant tax rates [3]	1.8	2.5	1.2	3.1	3.4	0.5	-0.3	-0.7	-	-
CPI	2.3	2.9	1.7	4.3	3.7	0.9	0.0	-0.9	0.0	1.6
Private consumption deflator	2.1	2.7	1.4	4.9	3.4	0.4	-0.2	-1.2	0.0	1.6
GDP deflator	2.2	3.1	1.4	3.2	2.4	0.4	0.5	0.4	0.2	1.3
Producer prices [4]	2.5	3.8	1.2	7.6	3.6	-1.2	-1.4	-2.4	-	-
Related indicators										
Real GDP growth	3.8	4.7	2.9	5.0	1.6	1.3	3.3	3.6	3.7	3.6
GDP per capita in PPS [5] (euro area = 100)	56.0	51.5	61.8	59.5	61.9	62.4	63.4	.	-	-
Comparative price levels (euro area = 100)	58.4	60.8	55.5	56.9	55.2	54.8	55.0	.	-	-
Output gap [6]	0.9	1.8	0.0	2.3	0.4	-1.2	-1.0	-0.5	0.0	0.4
Unemployment rate (%) [7]	9.5	9.7	9.3	9.7	10.1	10.3	9.0	7.5	6.8	6.3
Unit labour costs, whole economy	1.6	2.9	0.3	0.9	2.1	0.3	0.1	-1.8	0.8	1.3
Compensation per employee, whole economy	4.2	5.9	2.5	5.3	3.6	1.7	1.6	0.4	3.8	4.3
Labour productivity, whole economy	2.5	2.9	2.2	4.4	1.4	1.3	1.5	2.2	3.0	3.0
Imports of goods and services deflator	2.3	2.9	1.8	8.5	5.1	-1.1	-1.9	-1.3	0.0	1.9
Nominal effective exchange rate [8]	-0.5	0.3	-1.2	-2.7	-3.8	1.5	1.7	-2.5	-	-
Money supply (M3) [9]	10.4	13.1	7.9	10.8	5.6	6.2	7.8	8.9	-	-
Lending from banks [10]	12.5	19.8	5.7	5.9	7.3	4.0	5.4	5.8	-	-
Stock prices (Warsaw General Index) [11]	30.5	33.4	-2.2	-20.8	26.2	8.1	0.3	-9.6	-	-
Residential property prices [12]	-1.1	-	-1.1	0.1	-3.5	-4.4	1.0	1.5	-	-

Sources: European Commission (Eurostat, DG ECFIN), national data for CPI, money supply, lending from banks and residential property prices, and ECB calculations based on Thomson Reuters data for stock prices.
1) Multi-annual averages calculated using the geometric mean, except for GDP per capita in PPS, comparative price levels, output gap and unemployment rate, for which the arithmetic mean is used.
2) Data from the European Commission's Spring 2016 Economic Forecast.
3) The difference between the HICP and the HICP at constant tax rates shows the theoretical impact of changes in indirect taxes (e.g. VAT and excise duties) on the overall rate of inflation. This impact assumes a full and instantaneous pass-through of tax rate changes to the price paid by the consumer.
4) Domestic sales, total industry excluding construction.
5) PPS stands for purchasing power standards.
6) Percentage difference of potential GDP: a positive (negative) sign indicates that actual GDP is above (below) potential GDP.
7) Definition conforms to International Labour Organization guidelines.
8) EER-38 group of trading partners. A positive (negative) sign indicates an appreciation (depreciation).
9) The series includes repurchase agreements with central counterparties.
10) Not adjusted for the derecognition of loans from the MFI statistical balance sheet due to their sale or securitisation.
11) Multi-annual and annual figures represent the percentage change between the end of the given period and the end of the previous period.
12) Data available since 2010.

Poland - Fiscal developments

Chart 5.5.2 General government balance and debt

(as a percentage of GDP)



Sources: European System of Central Banks and European Commission (Eurostat).

Table 5.5.2 Government budgetary developments and projections

(as a percentage of GDP, unless otherwise indicated)

	2006-2015 [1]	2006-2010 [1]	2011-2015 [1]	2011	2012	2013	2014	2015	2016 [2]	2017 [2]	2018	2019
Government balance	**-4.2**	**-4.8**	**-3.7**	**-4.9**	**-3.7**	**-4.0**	**-3.3**	**-2.6**	**-2.6**	**-3.1**	.	.
Total revenue	39.3	39.9	38.7	38.8	38.9	38.4	38.9	38.9	39.1	39.1	.	.
Current revenue	38.4	39.2	37.5	37.0	37.6	37.4	37.7	37.8	38.1	37.8	.	.
Direct taxes	7.2	7.6	6.9	6.7	6.9	6.8	6.9	6.9	7.1	7.2	.	.
Indirect taxes	13.5	13.9	13.0	13.7	12.9	12.8	12.8	12.9	13.0	12.7	.	.
Net social contributions	12.7	12.4	13.0	12.1	12.9	13.3	13.2	13.6	13.7	13.7	.	.
Other current revenue [3]	5.0	5.3	4.6	4.6	4.8	4.6	4.7	4.4	4.4	4.3	.	.
Capital revenue	1.0	0.7	1.3	1.7	1.3	1.0	1.2	1.1	1.0	1.3	.	.
Total expenditure	43.6	44.7	42.4	43.6	42.6	42.4	42.2	41.5	41.7	42.2	.	.
Current expenditure	38.3	39.1	37.5	37.3	37.6	38.1	37.4	36.8	37.6	37.4	.	.
Compensation of employees	10.6	10.8	10.4	10.5	10.3	10.4	10.4	10.2	10.1	10.1	.	.
Social benefits	16.2	16.4	16.0	15.5	15.8	16.3	16.2	16.3	17.1	17.2	.	.
Interest payable	2.3	2.3	2.3	2.5	2.7	2.5	1.9	1.8	1.7	1.5	.	.
Other current expenditure [4]	9.1	9.5	8.8	8.7	8.8	8.9	8.9	8.5	8.6	8.5	.	.
Capital expenditure	5.3	5.6	5.0	6.3	5.0	4.3	4.7	4.7	4.1	4.8	.	.
of which: Investment	4.8	4.8	4.7	5.8	4.7	4.1	4.5	4.4	4.3	4.5	.	.
Cyclically adjusted balance	-4.7	-5.7	-3.7	-6.0	-3.9	-3.4	-2.8	-2.4	-2.6	-3.3	.	.
One-off and temporary measures	.	.	0.0	0.0	0.1	0.0	-0.2	0.0	0.4	0.0	.	.
Structural balance [5]	.	.	-3.7	-6.0	-4.0	-3.4	-2.6	-2.3	-3.0	-3.3	.	.
Government debt	**50.7**	**48.2**	**53.2**	**54.4**	**54.0**	**56.0**	**50.5**	**51.3**	**52.0**	**52.7**	.	.
Average residual maturity (in years)	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	.	.	.	.
In foreign currencies (% of total)	29.2	26.1	32.3	31.1	30.7	29.6	35.1	35.0	.	.	.	.
of which: Euro	21.2	19.0	23.5	21.5	21.9	21.7	25.9	26.5	.	.	.	.
Domestic ownership (% of total)	54.0	61.5	46.5	51.2	47.5	49.5	42.3	42.0	.	.	.	.
Medium and long-term maturity (% of total) [6]	96.8	94.3	99.3	98.5	99.3	99.9	99.7	99.2	.	.	.	.
of which: Variable interest rate (% of total)	14.4	12.0	16.8	11.3	15.4	17.6	18.8	21.0	.	.	.	.
Deficit-debt adjustment	**-0.9**	**0.0**	**-1.9**	**0.3**	**-2.0**	**-1.1**	**-6.8**	**0.2**	.	.	.	.
Net acquisitions of main financial assets	-0.4	0.0	-0.7	-1.8	-0.3	-1.5	0.9	-0.9	.	.	.	.
Currency and deposits	0.1	0.4	-0.2	-0.6	0.8	-1.0	0.6	-0.9	.	.	.	.
Debt securities	0.0	0.0	0.0	0.0	0.0	0.1	-0.1	0.0	.	.	.	.
Loans	0.1	0.1	0.0	0.1	0.0	0.0	0.2	0.0	.	.	.	.
Equity and investment fund shares or units	-0.5	-0.5	-0.5	-1.3	-1.0	-0.6	0.2	0.0	.	.	.	.
Revaluation effects on debt	0.3	0.2	0.4	1.9	-1.5	0.0	1.2	0.5	.	.	.	.
of which: Foreign exchange holding gains/losses	0.2	0.1	0.4	1.9	-1.4	-0.1	0.9	0.5	.	.	.	.
Other [7]	-0.9	-0.2	-1.6	0.3	-0.2	0.3	-8.8	0.6	.	.	.	.
Convergence programme: government balance	-	-	-	-	-	-	-	-	-2.6	-2.9	-2.0	-1.3
Convergence programme: structural balance	-	-	-	-	-	-	-	-	-3.1	-2.8	-2.1	-1.3
Convergence programme: government debt	-	-	-	-	-	-	-	-	52.0	52.5	52.0	50.4

Sources: European System of Central Banks and European Commission (Eurostat, DG ECFIN).

1) Multi-annual averages.

2) Data from the European Commission's Spring 2016 Economic Forecast, except for convergence programme data.

3) Sales and other current revenue.

4) Intermediate consumption, subsidies payable and other current expenditure.

5) Cyclically-adjusted balance excluding one-off and other temporary measures.

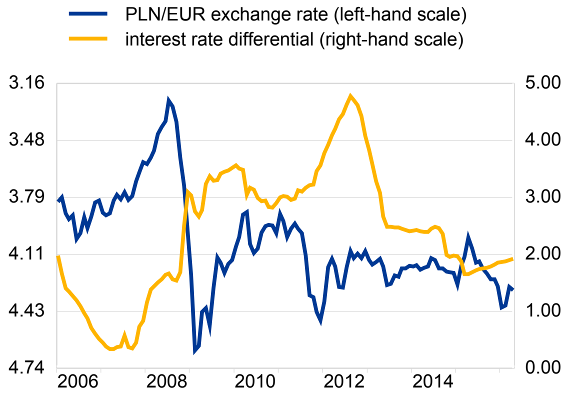
6) Original maturity of more than one year.

7) Time of recording differences and other discrepancies (sector reclassifications and statistical discrepancies).

Poland - Exchange rate and external developments

Chart 5.5.3 Bilateral exchange rate and short-term interest rate differential

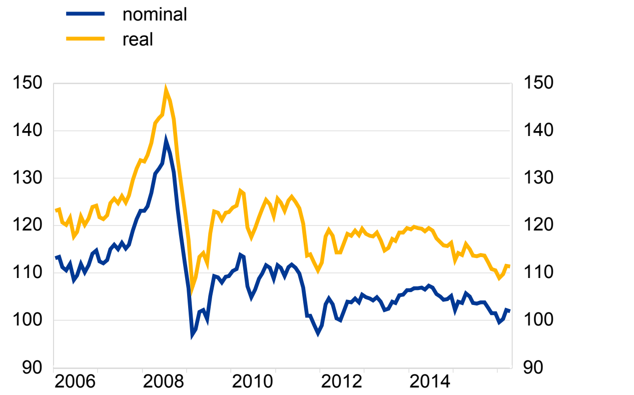
(PLN/EUR exchange rate: monthly averages;
difference between three-month interbank interest rates
and three-month EURIBOR: basis points, monthly values)



Sources: National data and ECB calculations.

Chart 5.5.4 Effective exchange rates [1)]

(EER-38 group of trading partners; monthly averages; base index: Q1 1999 = 100)



Source: ECB.
1) The real EER-38 is CPI deflated. An increase (decrease) in the EER indicates an appreciation (depreciation).

Table 5.5.3 External developments

(as a percentage of GDP, unless otherwise indicated)

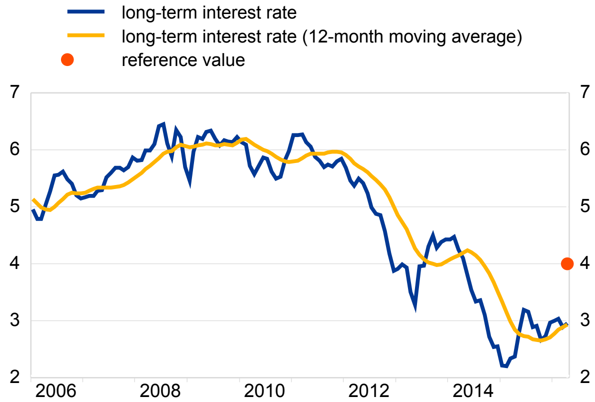
	2008-2015 [1)]	2008-2010 [1)]	2011-2015 [1)]	2011	2012	2013	2014	2015	2016 [2)]	2017 [2)]
Balance of payments										
Current account and capital account balance [3)]	-1.6	-3.9	-0.2	-3.3	-1.5	1.0	0.4	2.1	0.9	0.4
Current account balance	-3.6	-5.4	-2.5	-5.2	-3.7	-1.3	-2.0	-0.2	-0.3	-0.9
Goods	-2.2	-4.0	-1.2	-3.5	-2.1	-0.1	-0.8	0.5	.	.
Services	1.6	1.3	1.8	1.4	1.5	1.9	2.1	2.3	.	.
Primary income	-2.9	-2.7	-3.1	-3.2	-3.1	-3.0	-3.2	-2.8	.	.
Secondary income	0.0	0.0	0.0	0.2	0.0	-0.1	-0.1	-0.2	.	.
Capital account balance	2.0	1.5	2.2	1.9	2.2	2.3	2.4	2.4	.	.
Combined direct and portfolio investment balance [3)]	-3.5	-4.8	-2.7	-5.8	-5.1	-0.8	-1.6	0.0	.	.
Direct investment	-1.6	-1.8	-1.5	-2.6	-1.2	-0.8	-2.0	-0.7	.	.
Portfolio investment	-1.9	-2.9	-1.2	-3.2	-3.9	0.0	0.4	0.7	.	.
Other investment balance	-1.0	-3.7	0.5	-0.6	1.2	-0.4	0.7	1.8	.	.
Reserve assets	1.2	1.9	0.8	1.2	2.2	0.2	0.1	0.2	.	.
Exports of goods and services	43.2	38.5	46.0	42.6	44.4	46.3	47.5	49.4	.	.
Imports of goods and services	43.8	41.2	45.4	44.7	44.9	44.4	46.2	46.6	.	.
Net international investment position [4)]	-62.0	-57.8	-64.5	-57.8	-67.1	-69.7	-67.1	-60.7	.	.
Gross external debt [4)]	65.6	58.5	69.9	65.5	72.1	70.6	71.1	70.3	.	.
Internal trade with the euro area [5)]										
Exports of goods and services	.	.	55.2	56.1	54.3	53.8	55.4	56.5	.	.
Imports of goods and services	.	.	57.3	57.5	56.1	57.1	57.4	58.2	.	.
Investment position with the euro area [5)]										
Direct investment assets [4)]	.	.	64.1	59.6	62.5	65.6	65.0	67.5	.	.
Direct investment liabilities [4)]	.	.	76.8	75.0	75.5	77.4	78.5	77.5	.	.
Portfolio investment assets [4)]	.	.	56.2	53.7	50.9	59.3	58.8	58.2	.	.
Portfolio investment liabilities [4)]	43.7	47.4	41.5	44.4	42.8	42.6	40.4	37.2	.	.

Sources: European System of Central Banks and European Commission (Eurostat, DG ECFIN).
Note: Backdata are available from 2008.
1) Multi-annual averages.
2) Data from the European Commission's Spring 2016 Economic Forecast.
3) Differences between totals and sum of their components are due to rounding.
4) End-of-period outstanding amounts.
5) As a percentage of the total.

Poland - Long-term interest rate developments

Chart 5.5.5 Long-term interest rate 1)

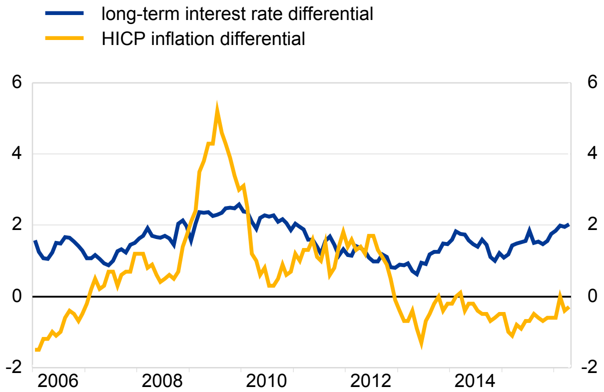
(monthly averages in percentages)



Sources: European System of Central Banks and ECB calculations.
1) The basis of the calculation of the reference value for the period from May 2015 to April 2016 is the unweighted arithmetic average of the interest rate levels in Bulgaria, Slovenia and Spain plus 2 percentage points. The reference value is 4.0%.

Chart 5.5.6 Long-term interest rate and HICP inflation differentials vis-à-vis the euro area

(monthly averages in percentage points)



Sources: European System of Central Banks, ECB calculations and European Commission (Eurostat).

Table 5.5.4 Long-term interest rates and indicators of financial development and integration

(as a percentage of GDP, unless otherwise indicated)

	2006-2015 1)	2006-2010 1)	2011-2015 1)	2012	2013	2014	2015	May 2015 to Apr. 2016	Memo item: euro area 2015
Long-term interest rates									
Poland 2)	5.0	5.7	4.2	5.0	4.0	3.5	2.7	2.9	-
Euro area 2), 3)	3.4	4.0	2.9	3.9	3.0	2.0	1.2	1.2	-
Euro area AAA par curve, ten-year residual maturity 2), 3)	2.8	3.8	1.8	2.1	1.9	1.4	0.6	0.6	-
Indicators of financial development and integration									
Debt securities issued by financial corporations 4)	6.8	4.5	9.1	9.6	10.6	8.5	7.7	-	73.6
Debt securities issued by non-financial corporations 5)	3.5	2.6	4.5	4.2	4.3	4.9	5.0	-	10.8
Stock market capitalisation 6)	32.7	33.9	31.4	31.9	34.8	33.6	28.5	-	60.4
MFI credit to non-government residents 7)	49.2	44.1	54.2	52.1	53.5	55.4	57.2	-	114.7
Claims of euro area MFIs on resident MFIs 8)	9.0	9.9	8.0	8.9	8.1	5.8	5.4	-	27.4

Sources: European System of Central Banks and ECB calculations.
1) Multi-annual averages calculated using the arithmetic average.
2) Average interest rate.
3) Included for information only.
4) Outstanding amount of debt securities issued by resident MFIs and other financial corporations.
5) Outstanding amount of debt securities issued by resident non-financial corporations.
6) Outstanding amount of listed shares issued by residents at the end of the period at market values.
7) MFI (excluding NCB) credit to domestic non-MFI residents other than general government. Credit includes outstanding amounts of loans and debt securities.
8) Outstanding amount of deposits and debt securities issued by domestic MFIs (excluding the NCB) held by euro area MFIs as a percentage of total liabilities of domestic MFIs (excluding the NCB). Total liabilities exclude capital and reserves and remaining liabilities.

5.6 Romania

5.6.1 Price developments

In April 2016 the 12-month average rate of HICP inflation in Romania was -1.3%, i.e. well below the reference value of 0.7% (see Chart 5.6.1). This rate is expected to increase over the coming months.

Over the past ten years the 12-month average rate of HICP inflation has fluctuated within a relatively wide range, from -1.3% to 8.5%, and the average for that period was elevated, standing at 4.5%. In the years leading up to the global financial crisis in 2008, inflation stood at elevated levels amid signs of overheating in the Romanian economy. At the same time, unemployment declined and wage growth significantly outpaced productivity growth, which, in turn, drove up unit labour cost growth to double-digit levels. Following sharp increases in energy and food prices, as well as the depreciation of the leu, the average annual rate of HICP inflation peaked at 7.9% in 2008. Thereafter, it decelerated alongside the sharp contraction in economic activity in 2009 and 2010, which was followed by a rather moderate recovery (see Table 5.6.1). Following three years of wage cuts, mainly in the public sector, from 2009 to 2011, including a 25% cut in public sector wages in 2010, compensation per employee rose again as of 2012, albeit at a somewhat lower rate than before. In 2014 and, in particular, in 2015 inflation declined to historically low levels, closely reflecting developments in energy and food prices, which together represent around 50% of Romania's HICP basket of goods and services. The fall in HICP inflation was also driven by successive cuts in indirect taxes. In particular, on the back of a reduction in the value added tax (VAT) rate on food items, non-alcoholic beverages and food services from 24% to 9% in June 2015, HICP inflation declined sharply and entered into negative territory. Given the latest developments in inflation and the inflation outlook in particular, the key policy interest rate has been kept unchanged since May 2015 at the historically low level of 1.75%.

For the first four months of 2016, the average annual rate of HICP inflation stood at -2.2%. To a large extent, the negative rate of inflation reflects exceptional country-specific factors, in particular the broadening of the scope of the reduced VAT rate (9%) to all food items, non-alcoholic beverages and food services in June 2015 and the reduction in the standard VAT rate from 24% to 20% in January 2016. The significant impact of these tax cuts is evidenced by the gap between headline inflation and the annual rate of growth in the HICP at constant tax rates. The steep fall in HICP inflation has occurred in an environment of very low levels of inflation across the globe, robust growth in real GDP and a closing output gap.

Policy choices have played an important role in shaping inflation dynamics in Romania over the past decade, most notably the orientation of monetary policy towards price stability. In 2005 Banca Naţională a României shifted to an inflation-targeting framework combined with a managed floating exchange rate regime. The annual CPI inflation target was initially set at 7.5% and was reduced gradually to stand at 2.5% from 2013, with a 1 percentage point variation band around the central target.

Inflation is expected to increase in the coming years; over the longer term there are concerns regarding the sustainability of inflation convergence in Romania. According to the European Commission’s Spring 2016 Economic Forecast, average annual HICP inflation will remain in negative territory, at -0.6%, in 2016 on account of substantial VAT cuts and generally low oil and commodity prices. Thereafter, inflation is projected to move into the inflation targeting band, reaching 2.5% in 2017. The balance of risks surrounding the forecast is on the upside. Upside risks are associated with increasing wage pressure on the back of wage hikes in the public sector and a series of minimum wage increases, as well as the faster than expected closing of the output gap. Moreover, there are risks stemming from the persistent uncertainty regarding the progress on structural reforms and from potential fiscal slippages in the context of an unstable political environment, which could, in turn, lead to depreciation pressure on the leu. Downside risks to the inflation outlook are related to the heightened uncertainty regarding developments in the global economy, which could reduce external price pressures. 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 significantly lower in Romania 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 Romania requires stability-oriented economic policies and wide-ranging structural reforms. More specifically, the government should continue with product market reforms to boost private investment and competition. The deregulation of gas prices should be completed and reforms aimed at enhancing the corporate governance of state-owned enterprises need to be stepped up. Improving Romania’s very weak absorption of EU funds warrants attention, in particular with a view to improving the quality of the infrastructure in the energy and transport sector. In order to enhance growth prospects and competitiveness, it is essential to advance structural reforms (including the fight against corruption), as well as the quality and efficiency of public institutions. In terms of the labour market, measures aimed at reducing youth and long-term unemployment should be implemented more broadly and participation in lifelong learning should be promoted. With regard to macroeconomic imbalances, the European Commission selected Romania for an in-depth review in its Alert Mechanism Report 2016 and concluded that Romania is not experiencing macroeconomic imbalances.

Financial sector policies should be geared to continuing to safeguard financial stability and ensuring that the financial sector makes a sound contribution to economic growth. In order to safeguard financial sector stability in the future, it is of utmost importance to continue the clean-up of bank balance sheets and to support a sustainable recovery in lending, in particular to non-financial corporations. The impact on the banking sector of recent legal initiatives warrants special attention, particularly with regard to the potential negative spillover effects on the economy as a whole.

5.6.2 Fiscal developments

Romania's government deficit and debt complied with the Maastricht criteria in 2015. In the reference year 2015 the general government budget balance recorded a deficit of 0.7% of GDP, well below the 3% reference value. The general government gross debt-to-GDP ratio was 38.4%, well below the 60% reference value (see Table 5.6.2). Compared with the previous year, the deficit and debt ratios decreased by 0.1 and 1.4 percentage points of GDP respectively. The European Commission's Spring 2016 Economic Forecast expects the deficit to deteriorate markedly to 2.8% of GDP in 2016 as a result of cuts in VAT and personal income taxation, as well as sharp increases in public wages. On a no-policy-change basis, the Commission expects the deficit to worsen further to 3.4% of GDP in 2017. Government debt is projected to increase to 40.1% of GDP in 2017. With regard to other fiscal factors, the deficit ratio did not exceed the ratio of public investment to GDP in 2015, nor is it expected to do so in 2016.

Romania has been subject to the preventive arm of the Stability and Growth Pact since 2013. Against the background of the rise in the budget deficit above the reference value in 2008, the ECOFIN Council decided on 7 July 2009 that an excessive deficit situation existed in Romania and set 2011 as the deadline for correcting it. Its recommendation of 12 February 2010 extended this deadline to 2012. The ECOFIN Council abrogated the excessive deficit procedure on 21 June 2013. Romania achieved its medium-term objective of a structural deficit of 1% of GDP over the period 2013-15.

Sizeable consolidation efforts contributed to the deficit reduction between 2009 and 2015. The deficit ratio peaked in 2009 at 9.1% of GDP and declined steadily afterwards, reaching 0.7% of GDP in 2015. European Commission estimates (presented in Table 5.6.2) indicate that cyclical factors contributed only marginally to the changes in the budget balance in the period 2010-15, whereas the structural balance improved by 8.7 percentage points over the same period, reflecting the significant consolidation measures adopted by the government in the period 2010-12. Fiscal consolidation packages were agreed under the EU/IMF financial assistance programme and mainly included an increase in indirect taxes, wage cuts in the public sector and other spending cuts to contain public expenditure in general. Consolidation continued at a slower pace in 2013-14, while the fiscal stance turned slightly expansionary in 2015.

The debt-to-GDP ratio more than tripled during the crisis, reaching 39.9% of GDP in 2014, but remained well below the 60% reference value. The debt-to-GDP ratio increased rapidly from 13.2% of GDP in 2008 to 37.4% of GDP in 2012, driven by high primary deficits and the impact of the recession (see Chart 5.6.2). After 2012 the increase in the debt ratio slowed on the back of a gradually improving primary balance and a recovery in real GDP growth. Debt increased in 2012 and

2014, mainly on account of the build-up of a foreign currency-denominated cash buffer. In 2015 debt decreased for the first time since the crisis. European Commission estimates point to a risk of adverse debt dynamics in the years to come (see Table 5.6.2).The Romanian government has not incurred contingent liabilities resulting from government interventions to support financial institutions and financial markets during the crisis.

The level and structure of government debt indicate that Romania's fiscal balances are protected from sudden changes in interest rates; however, the balances are sensitive to exchange rate fluctuations. The share of government debt with a short-term maturity is low (6.7% of overall debt in 2014 – see Table 5.6.2). Taking into account the share of 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 (57.0% in 2014). Taking the size of the debt as a share of GDP into consideration, it can therefore be concluded that the fiscal balances are sensitive to exchange rate movements, mainly the EUR/RON exchange rate, as a large part of the debt is denominated in euro (81% of foreign denominated debt in 2014). Despite some fluctuations, the share of debt denominated in euro and other foreign currency has remained relatively stable since 2009. After decreasing during the financial crisis, the share of debt with a long-term maturity reached a peak of 93.8% in 2013.

There are risks of a significant deviation from the SGP preventive arm requirements in 2016 and, under unchanged policies, also in 2017. According to the European Commission’s Spring 2016 Economic Forecast, the structural deficit is projected to increase to 2.8% of GDP in 2016 and 3.4% in 2017 on account of expansionary fiscal measures, such as further indirect tax cuts and higher spending on public wages. Net expenditure growth is projected to be well above the benchmark rate, pointing to a significant deviation from the SGP's provisions. This procyclical fiscal stance is expected to push the deficit above the 3% of GDP reference rate in 2017 and put the debt-to-GDP ratio on an upward path. Romania’s medium-term fiscal policy strategy, as presented in the April 2016 Convergence Programme update, also projects a significant deterioration of both the headline and structural deficits in 2016 that brings the headline deficit just below the 3% threshold in 2016 and 2017. Despite a smaller projected deterioration in the structural deficit in 2017 compared with the European Commission’s latest forecast, the structural deficit is projected to deviate significantly from the medium-term objective in both 2016 and 2017. Therefore, further consolidation measures are needed in 2016 and 2017 in order to ensure compliance with the Stability and Growth Pact’s provisions.

Romania has strengthened its national fiscal governance framework significantly in recent years, but it has not always been applied effectively. Romania's fiscal governance framework has been strengthened following the adoption of the Fiscal Compact (through the implementation of a structural budget balance rule, debt rule and a correction mechanism), the creation of an independent fiscal council in 2010 and reform of the tax collection agency (ANAF). Romanian authorities should fully support the fiscal council by means of a more timely submission of the budget and by increasing the transparency of macroeconomic and fiscal forecasts and the budget documentation. The government should also increase efforts to improve its public finance management, to reform the public administration, to make the tax policy and administration more efficient, to improve tax collection and to combat tax evasion. Privatisations and governance reforms of state-owned enterprises should continue.

The Commission's analysis points to high sustainability risks in the medium term and the need to address the projected increase in healthcare and long-term care spending. Its 2015 Fiscal Sustainability Report points to there being no risks over the short term, but high and medium risks over the medium and long term respectively. This assessment is primarily underpinned by the unfavourable initial budgetary position and is compounded by the projected impact of age-related public spending. In respect of the latter, Romania has taken steps to tackle the costs of ageing. Notably, the authorities (i) implemented the comprehensive pension reform that was passed in 2010 and (ii) introduced a basic package of health policies in 2014 to improve the efficiency of health care. Nevertheless, according to the 2015 projections by the European Commission and the EU's Economic Policy Committee[120], Romania is likely to experience a notable increase in strictly age-related public expenditure from a level of 15.3% of GDP in 2013 to 17.4% of GDP by the year 2060 in the AWG reference scenario. In the risk scenario, the increase in the cost of ageing amounts to 5.2 percentage points of GDP, significantly above the average for the 28 EU Member States. All these developments suggest that further reforms are needed to enhance the long-term sustainability of public finances, in particular to improve the effectiveness and efficiency of the healthcare system. The Romanian government's decision to partially re-establish the special pensions abolished in 2010 goes in the opposite direction and further hampers the sustainability of the pension system.

Further reforms and a sound fiscal position in line with the provisions of the SGP are warranted in order to safeguard the sustainability of public finances over the medium term. Romania needs to ensure compliance with the SGP requirements in 2016 and beyond. The authorities should avoid the significant deviation from the medium-term objective that is planned. Additional government investment should be financed by better absorption of EU funds, with a view to improving the quality of public infrastructure. The Romanian government should make further efforts to improve the tax collection system, to fight tax evasion, to advance structural fiscal reforms (including the corporate governance of state-owned enterprises) and to tackle the projected increase in healthcare and long-term care spending.

5.6.3 Exchange rate developments

Over the reference period from 19 May 2014 to 18 May 2016, the Romanian leu did not participate in ERM II, but traded under a flexible exchange rate regime

[120] Published in "The 2015 Ageing Report: Economic and budgetary projections for the EU-28 Member States (2013-2060)", prepared by the AWG.

involving a managed floating of the currency's exchange rate. In the two-year reference period the Romanian leu traded close to its May 2014 average exchange rate against the euro of 4.4237 lei per euro, which is used as a benchmark for illustrative purposes in the absence of an ERM II central rate (see Chart 5.6.3). On 18 May 2016 the exchange rate stood at 4.4990 lei per euro, i.e. 1.7% weaker than its average level in May 2014. Over the reference period the maximum upward deviation from this benchmark was 0.9%, while the maximum downward deviation amounted to 2.6%. Looking back over a longer period the exchange rate of the Romanian leu against the euro has depreciated by 28.3% over the past ten years.

The exchange rate of the Romanian leu against the euro exhibited, on average, a relatively high degree of volatility over the reference period. Between November 2014 and January 2015 the Romanian leu depreciated against the euro amid a deteriorating economic outlook in the country's key trading partners and elevated geopolitical risks. Thereafter, in the period up to mid-April 2015, the Romanian leu appreciated, recovering its previous losses, which coincided with the monetary policy decisions in the country's key trading partners and their subsequent impact on financial markets. However, it then came under renewed pressure during a period of increased international financial market volatility in mid-2015. After a period of relative exchange rate stability up to late November 2015, the Romanian leu depreciated until the end of 2015 on the back of global financial market developments associated with the monetary policy decisions adopted by major central banks. Thereafter, the leu strengthened against the euro until the end of the reference period, reflecting the relatively strong macroeconomic performance of the Romanian economy. Over the reference period short-term interest rate differentials against the three-month EURIBOR remained at somewhat wide but, on average, decreasing levels on account of higher monetary policy rates in Romania than in the euro area. The spreads decreased from 2.2 percentage points in the three-month period ending in June 2014 to 0.8 percentage point in the three-month period ending in March 2016 amid seven interest rate cuts by Banca Naţională a României.

In 2009 an international financial assistance package led by the EU and the IMF was agreed for Romania. This was followed by two precautionary financial assistance programmes, totalling €4 billion each, which ran from 2011 to 2013 and from 2013 to 2015 respectively. The latest programme expired in September 2015. Romania did not draw on the resources of the precautionary arrangements. As these three consecutive agreements helped to reduce financial vulnerabilities, they might also have contributed to reducing exchange rate pressures over the reference period.

The real effective exchange rate of the Romanian leu has depreciated overall over the past ten years (see Chart 5.6.4). However, this indicator should be interpreted with caution, as during this period Romania was subject to a process of economic convergence, which complicates any historical assessment of real exchange rate developments.

Romania's current and capital account has improved substantially over the past decade, while the country's net foreign liabilities, although declining gradually, remain high (see Table 5.6.3). After reaching double-digit levels from

2006 to 2008, the combined current and capital account deficit declined to 3.4% of GDP in 2012 and turned into a surplus of 1.0% of GDP in 2013, 2.2% and 1.3% in 2014 and 2015 respectively. The improvement in the current and capital account balance primarily reflected the sharp decline in the goods deficit, which was driven mainly by a strong export performance and moderate domestic demand. The external deficit has been financed mainly by net inflows in direct and portfolio investment since 2012 and by official borrowing in the period 2009-11. Against this background, gross external debt increased substantially to 75.5% of GDP in 2012 and decreased thereafter to 56.2% in 2015. At the same time the country's net international investment position deteriorated up to 2012, but improved thereafter, to -50.2% of GDP in 2015. However, the country's net foreign liabilities are still high. Fiscal and structural policies therefore continue to be important for supporting external sustainability and the competitiveness of the economy.

The Romanian economy is well integrated with the euro area through trade and investment linkages. In 2015 exports of goods and services to the euro area constituted 54.9% of total exports, while the corresponding figure for imports amounted to 54.3%. The share of the euro area in Romania's stock of inward direct investment stood at 83.8% and its share in the country's stock of portfolio investment liabilities was 49.1% in 2015. The share of Romania's stock of foreign assets invested in the euro area amounted to 81.9% in the case of direct investment and 63.1% in the case of portfolio investment in 2015.

5.6.4 Long-term interest rate developments

Over the reference period from May 2015 to April 2016, long-term interest rates in Romania were 3.6% on average and thus below the 4.0% reference value for the interest rate convergence criterion (see Chart 5.6.5).

Long-term interest rates in Romania have declined steadily since early 2012, with 12-month moving average rates approximately halving from over 7% to a near-historical low of 3.6% at the end of the reference period. Volatility around this trend has been very low, especially if compared with developments in 2008 and 2009 when a combination of global financial tensions, a deteriorating domestic outlook and liquidity strains raised Romanian long-term rates to almost 12% (see Chart 5.6.5). Recently, the only substantial increase in Romania's long-term interest rates was in the first half of 2015, but this was in line with the increases observed in the euro area.

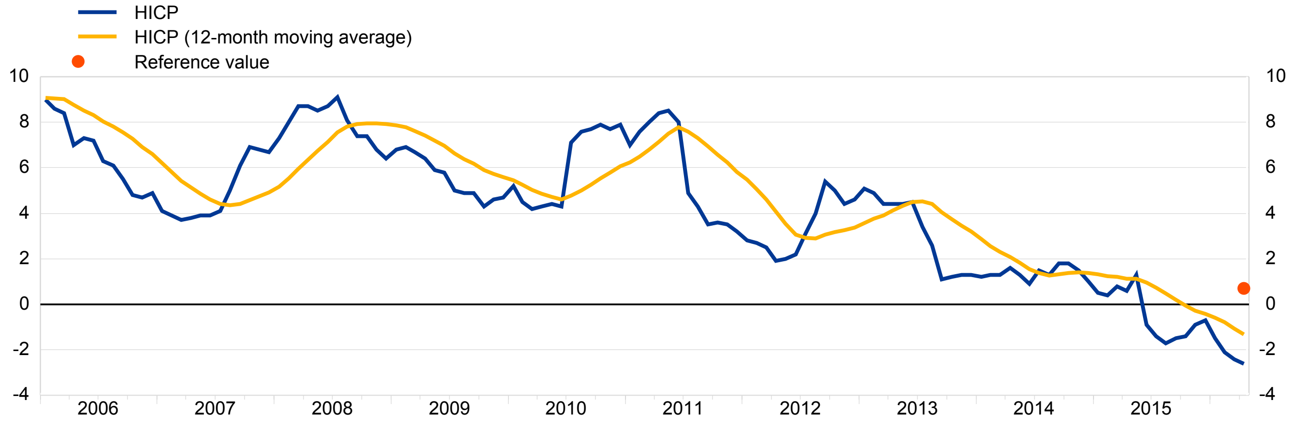
Romania's long-term interest rate differential vis-à-vis the euro area has recently been both stable and low relative to the past decade. More precisely, long-term interest rates in Romania have stayed within 3 percentage points of those in the euro area since 2013, and the differential hit a low of 1.8 percentage points in early 2015, before reaching 2.6 percentage points at the end of the reference period (see Chart 5.6.6). The differential vis-à-vis the euro area AAA yield was slightly higher, at 3.3 percentage points. However, this compares favourably with the peak reached in mid-2009. Moreover, the volatility of the differential has been more muted in recent years than was the case from 2006 to 2008 and from 2010 to 2012, periods in which the differential fluctuated in a corridor of around 2 to 4 percentage points.

At the end of 2015 Romania's capital market was much smaller than the euro area average and still underdeveloped. This was particularly true for the corporate debt segment, as both financial and non-financial corporations were issuing securities amounting to less than 1% of GDP (see Table 5.6.4). Romania's equity market was also less developed but, at 9.5% of GDP, the difference with the euro area (60.4% of GDP) was lower than in the case of corporate debt markets. Integration of the Romanian financial sector with the euro area, as measured by the claims of euro area banks on Romanian banks, has reached a considerable level. Claims of euro area MFIs accounted for 13.1% of Romanian banks' liabilities at the end of 2015 (see Table 5.6.4). Moreover, the Romanian banking system is highly integrated into the EU financial system, as institutions controlled by euro area banks account for a substantial amount of credit to the private sector. However, overall Romania's banking sector is relatively small, with private sector credit, for example, standing at only 30.4% of GDP in 2015 (the corresponding euro area figure being 114.7% of GDP).

Romania - Price developments

Chart 5.6.1 HICP inflation and reference value [1)]

(annual percentage changes)



Sources: European Commission (Eurostat) and ECB calculations.

1) The basis of the calculation of the reference value for the period from May 2015 to April 2016 is the unweighted arithmetic average of the annual percentage changes in the HICP for Bulgaria, Slovenia and Spain plus 1.5 percentage points. The reference value is 0.7%.

Table 5.6.1 Measures of inflation and related indicators

(annual percentage changes, unless otherwise indicated)

	2006-2015 [1)]	2006-2010 [1)]	2011-2015 [1)]	2011	2012	2013	2014	2015	2016 [2)]	2017 [2)]
Measures of inflation										
HICP	4.4	6.2	2.7	5.8	3.4	3.2	1.4	-0.4	-0.6	2.5
HICP excluding unprocessed food and energy	4.5	6.4	2.6	5.0	3.3	2.3	1.7	0.7	0.3	2.7
HICP at constant tax rates [3)]	3.5	4.5	2.5	3.8	3.2	3.0	1.1	1.2	-	-
CPI	4.4	6.2	2.7	5.8	3.3	4.0	1.1	-0.6	-0.6	2.5
Private consumption deflator	4.4	6.1	2.7	4.2	4.5	2.6	1.2	1.2	0.2	1.8
GDP deflator	6.6	9.7	3.5	4.7	4.7	3.4	1.7	2.9	2.0	2.4
Producer prices [4)]	4.5	6.4	2.7	6.6	4.8	3.7	0.2	-1.8	-	-
Related indicators										
Real GDP growth	2.6	2.9	2.4	1.1	0.6	3.5	3.0	3.8	4.2	3.7
GDP per capita in PPS [5)] (euro area = 100)	45.4	41.8	49.9	47.1	50.2	50.5	51.7	.	-	-
Comparative price levels (euro area = 100)	55.7	58.3	52.3	53.6	50.9	52.5	52.4	.	-	-
Output gap [6)]	-0.2	2.6	-3.0	-3.8	-4.9	-3.1	-2.1	-1.1	0.0	0.3
Unemployment rate (%) [7)]	6.7	6.5	6.9	7.2	6.8	7.1	6.8	6.8	6.8	6.7
Unit labour costs, whole economy	3.8	8.0	-0.3	-5.8	3.4	-0.6	3.1	-1.3	2.5	2.3
Compensation per employee, whole economy	7.4	11.4	3.4	-4.1	9.4	3.8	5.3	3.2	6.9	6.2
Labour productivity, whole economy	3.5	3.2	3.8	1.9	5.7	4.5	2.1	4.7	4.2	3.8
Imports of goods and services deflator	1.9	3.1	0.6	6.0	7.3	-6.0	-1.5	-2.0	-2.9	1.2
Nominal effective exchange rate [8)]	-1.9	-2.7	-1.1	0.1	-6.4	2.7	0.9	-2.4	-	-
Money supply (M3) [9)]	9.4	11.9	6.9	6.1	3.8	8.7	7.8	8.4	-	-
Lending from banks [10)]	13.1	26.4	1.2	7.6	-0.7	-3.5	-1.3	4.5	-	-
Stock prices (BET) [11)]	6.3	-20.0	32.9	-17.7	18.7	26.1	9.1	-1.1	-	-
Residential property prices [12)]	-4.7	-7.8	-4.1	-14.2	-6.5	-0.2	-2.3	3.7	-	-

Sources: European Commission (Eurostat, DG ECFIN), national data for CPI, money supply, lending from banks and residential property prices, and ECB calculations based on Thomson Reuters data for stock prices.

1) Multi-annual averages calculated using the geometric mean, except for GDP per capita in PPS, comparative price levels, output gap and unemployment rate, for which the arithmetic mean is used.

2) Data from the European Commission's Spring 2016 Economic Forecast.

3) The difference between the HICP and the HICP at constant tax rates shows the theoretical impact of changes in indirect taxes (e.g. VAT and excise duties) on the overall rate of inflation. This impact assumes a full and instantaneous pass-through of tax rate changes to the price paid by the consumer.

4) Domestic sales, total industry excluding construction.

5) PPS stands for purchasing power standards.

6) Percentage difference of potential GDP: a positive (negative) sign indicates that actual GDP is above (below) potential GDP.

7) Definition conforms to International Labour Organization guidelines.

8) EER-38 group of trading partners. A positive (negative) sign indicates an appreciation (depreciation).

9) The series includes repurchase agreements with central counterparties.

10) Not adjusted for the derecognition of loans from the MFI statistical balance sheet due to their sale or securitisation.

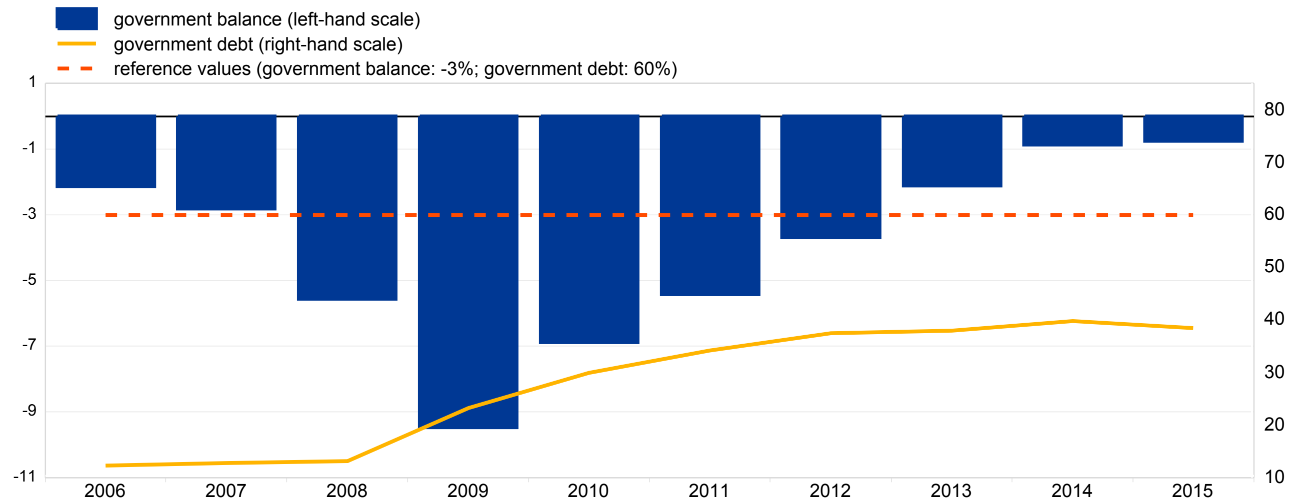
11) Multi-annual and annual figures represent the percentage change between the end of the given period and the end of the previous period.

12) Data available since 2009.

Romania - Fiscal developments

Chart 5.6.2 General government balance and debt

(as a percentage of GDP)



Sources: European System of Central Banks and European Commission (Eurostat).

Table 5.6.2 Government budgetary developments and projections

(as a percentage of GDP, unless otherwise indicated)

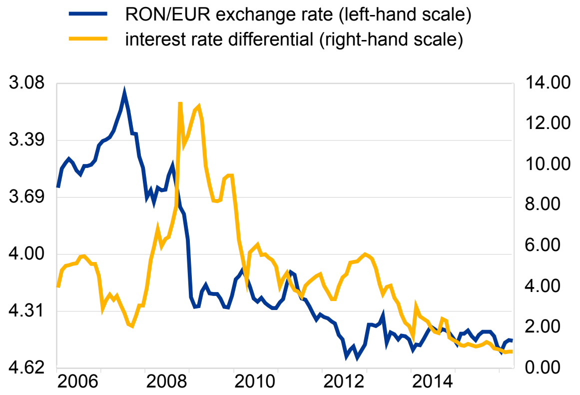
	2006-2015 1)	2006-2010 1)	2011-2015 1)	2011	2012	2013	2014	2015	2016 2)	2017 2)	2018	2019
Government balance	**-4.0**	**-5.4**	**-2.6**	**-5.4**	**-3.7**	**-2.1**	**-0.9**	**-0.7**	**-2.8**	**-3.4**	.	.
Total revenue	33.4	33.2	33.7	33.7	33.4	33.1	33.5	34.8	31.8	31.5	.	.
Current revenue	32.3	32.5	32.0	33.0	32.0	31.6	31.4	32.2	30.5	29.7	.	.
Direct taxes	6.2	6.2	6.2	6.0	5.9	6.0	6.3	6.7	6.4	6.5	.	.
Indirect taxes	12.4	11.8	13.0	13.0	13.2	12.8	12.8	13.2	11.9	11.2	.	.
Net social contributions	9.3	10.0	8.6	9.0	8.8	8.7	8.6	8.1	8.2	8.1	.	.
Other current revenue 3)	4.4	4.5	4.2	5.0	4.1	4.2	3.8	4.1	3.9	3.9	.	.
Capital revenue	1.2	0.6	1.7	0.7	1.5	1.5	2.1	2.6	1.4	1.8	.	.
Total expenditure	37.4	38.5	36.3	39.1	37.1	35.2	34.3	35.5	34.6	34.9	.	.
Current expenditure	30.8	31.5	30.1	31.3	30.8	29.7	29.3	29.3	29.7	29.7	.	.
Compensation of employees	8.8	9.9	7.8	7.8	7.8	8.1	7.7	7.6	8.3	8.4	.	.
Social benefits	11.7	11.5	12.0	13.1	12.1	11.7	11.5	11.5	11.4	11.2	.	.
Interest payable	1.4	1.0	1.7	1.6	1.8	1.7	1.7	1.6	1.7	1.7	.	.
Other current expenditure 4)	8.8	9.1	8.6	8.7	9.2	8.1	8.4	8.5	8.3	8.3	.	.
Capital expenditure	6.6	7.0	6.2	7.9	6.3	5.6	5.0	6.2	4.9	5.2	.	.
of which: Investment	5.4	6.0	4.8	5.4	4.8	4.5	4.3	5.1	3.8	4.1	.	.
Cyclically adjusted balance	-3.9	-6.2	-1.6	-4.1	-2.0	-1.1	-0.2	-0.4	-2.8	-3.4	.	.
One-off and temporary measures	.	.	-0.1	-1.1	0.5	0.0	0.0	0.3	0.1	0.0	.	.
Structural balance 5)	.	.	-1.5	-3.0	-2.6	-1.1	-0.2	-0.6	-2.8	-3.4	.	.
Government debt	**27.9**	**18.3**	**37.6**	**34.2**	**37.4**	**38.0**	**39.8**	**38.4**	**38.7**	**40.1**	.	.
Average residual maturity (in years)	5.3	5.8	4.8	5.0	4.1	4.4	5.3	5.4	.	.	.	.
In foreign currencies (% of total)	60.4	64.0	56.8	57.7	58.8	56.5	57.0	53.8	.	.	.	.
of which: Euro	46.6	46.9	46.2	47.6	47.4	46.7	46.3	43.1	.	.	.	.
Domestic ownership (% of total)	44.3	39.8	48.8	50.8	49.1	45.5	48.0	50.3	.	.	.	.
Medium and long-term maturity (% of total) 6)	85.4	82.3	88.5	77.1	84.8	93.8	93.3	93.5	.	.	.	.
of which: Variable interest rate (% of total)	22.7	31.1	14.3	20.0	16.5	12.7	11.2	11.3	.	.	.	.
Deficit-debt adjustment	**0.1**	**-0.9**	**1.2**	**0.5**	**1.3**	**0.9**	**2.6**	**0.4**	.	.	.	.
Net acquisitions of main financial assets	0.3	-0.2	0.9	1.2	1.5	0.6	1.6	-0.6	.	.	.	.
Currency and deposits	0.6	0.3	1.0	1.0	1.8	0.9	1.7	-0.5	.	.	.	.
Debt securities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	.	.	.	.
Loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	.	.	.	.
Equity and investment fund shares or units	-0.3	-0.6	-0.1	0.1	-0.3	-0.3	0.0	0.0	.	.	.	.
Revaluation effects on debt	0.0	0.1	0.0	0.2	0.4	-0.2	-0.3	-0.2	.	.	.	.
of which: Foreign exchange holding gains/losses	0.2	0.1	0.2	0.1	0.6	0.3	0.0	0.2	.	.	.	.
Other 7)	-0.3	-0.8	0.3	-0.8	-0.6	0.5	1.4	1.1	.	.	.	.
Convergence programme: government balance	-	-	-	-	-	-	-	-	-2.9	-2.9	-2.3	-1.6
Convergence programme: structural balance	-	-	-	-	-	-	-	-	-2.7	-2.9	-2.4	-1.9
Convergence programme: government debt	-	-	-	-	-	-	-	-	39.1	39.8	39.9	39.3

Sources: European System of Central Banks and European Commission (Eurostat, DG ECFIN).
1) Multi-annual averages.
2) Data from the European Commission's Spring 2016 Economic Forecast, except for convergence programme data.
3) Sales and other current revenue.
4) Intermediate consumption, subsidies payable and other current expenditure.
5) Cyclically-adjusted balance excluding one-off and other temporary measures.
6) Original maturity of more than one year.
7) Time of recording differences and other discrepancies (sector reclassifications and statistical discrepancies).

Romania - Exchange rate and external developments

Chart 5.6.3 Bilateral exchange rate and short-term interest rate differential

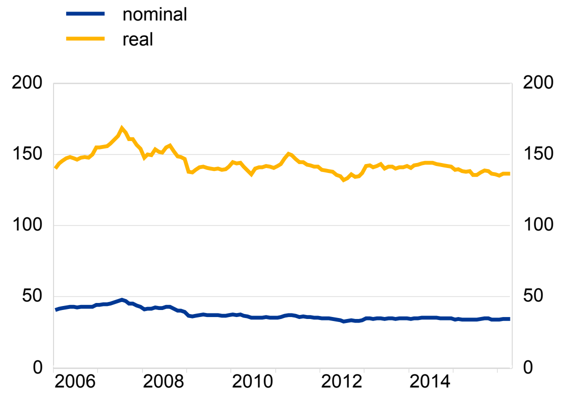
(RON/EUR exchange rate: monthly averages;
difference between three-month interbank interest rates
and three-month EURIBOR: basis points, monthly values)



Sources: National data and ECB calculations.

Chart 5.6.4 Effective exchange rates [1)]

(EER-38 group of trading partners; monthly averages; base index: Q1 1999 = 100)



Source: ECB.
1) The real EER-38 is CPI deflated. An increase (decrease) in the EER indicates an appreciation (depreciation).

Table 5.6.3 External developments

(as a percentage of GDP, unless otherwise indicated)

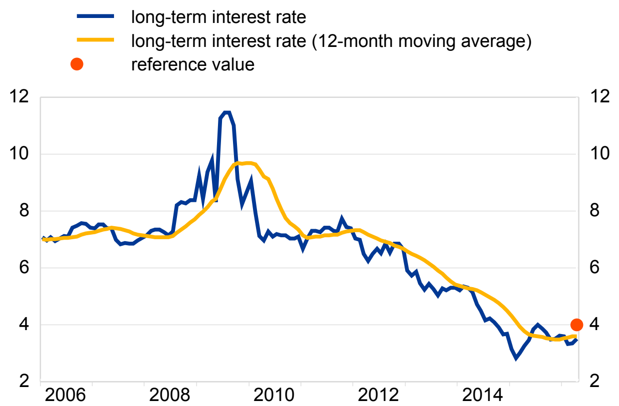
	2008-2015 1)	2008-2010 1)	2011-2015 1)	2011	2012	2013	2014	2015	2016 2)	2017 2)
Balance of payments										
Current account and capital account balance 3)	-3.0	-6.9	-0.7	-4.4	-3.4	1.0	2.2	1.3	0.1	-0.7
Current account balance	-4.3	-7.3	-2.5	-5.0	-4.8	-1.1	-0.5	-1.1	-2.1	-2.8
Goods	-7.2	-10.2	-5.4	-7.0	-7.0	-4.0	-4.2	-4.8	.	.
Services	2.3	1.3	2.9	1.2	1.9	3.3	3.9	4.3	.	.
Primary income	-1.7	-1.6	-1.8	-1.3	-1.7	-2.2	-1.3	-2.4	.	.
Secondary income	2.3	3.2	1.8	2.1	2.0	1.9	1.1	1.8	.	.
Capital account balance	1.3	0.3	1.8	0.5	1.4	2.1	2.6	2.4	.	.
Combined direct and portfolio investment balance 3)	-3.7	-3.9	-3.6	-2.5	-4.6	-5.8	-3.7	-1.2	.	.
Direct investment	-2.5	-3.7	-1.7	-1.3	-1.9	-2.0	-1.8	-1.7	.	.
Portfolio investment	-1.2	-0.2	-1.8	-1.3	-2.6	-3.8	-1.9	0.5	.	.
Other investment balance	0.3	-4.8	3.3	-1.8	3.0	5.5	6.6	3.4	.	.
Reserve assets	-	-	-	-	-	1.4	-0.9	-0.4	.	.
Exports of goods and services	35.2	28.7	39.2	36.7	37.3	39.8	41.2	41.1	.	.
Imports of goods and services	40.1	37.5	41.7	42.4	42.4	40.5	41.5	41.6	.	.
Net international investment position 4)	-59.2	-57.6	-60.2	-64.2	-67.8	-61.9	-56.8	-50.2	.	.
Gross external debt 4)	66.4	64.4	67.6	75.0	75.5	68.3	63.0	56.2	.	.
Internal trade with the euro area 5)										
Exports of goods and services	.	.	.	.	.	52.2	53.1	54.9	.	.
Imports of goods and services	.	.	.	.	.	53.6	52.9	54.3	.	.
Investment position with the euro area 5)										
Direct investment assets 4)	.	.	.	.	.	56.6	81.7	81.9	.	.
Direct investment liabilities 4)	.	.	.	.	.	83.1	82.9	83.8	.	.
Portfolio investment assets 4)	.	.	.	.	.	57.3	53.7	63.1	.	.
Portfolio investment liabilities 4)	61.6	75.3	53.3	68.5	49.8	48.9	50.2	49.1	.	.

Sources: European System of Central Banks and European Commission (Eurostat, DG ECFIN).
Note: Backdata are available from 2008.
1) Multi-annual averages.
2) Data from the European Commission's Spring 2016 Economic Forecast.
3) Differences between totals and sum of their components are due to rounding.
4) End-of-period outstanding amounts.
5) As a percentage of the total.

Romania - Long-term interest rate developments

Chart 5.6.5 Long-term interest rate 1)

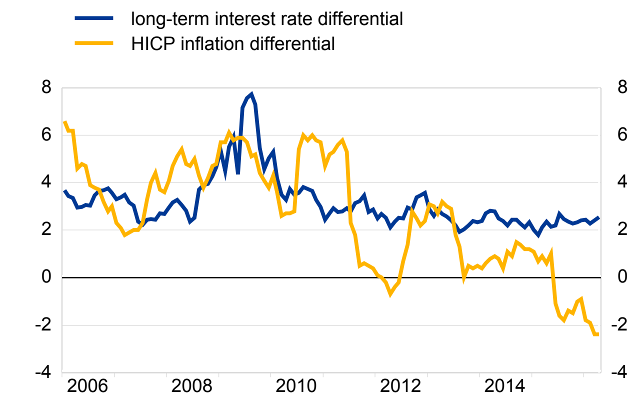
(monthly averages in percentages)



Sources: European System of Central Banks and ECB calculations.
1) The basis of the calculation of the reference value for the period from May 2015 to April 2016 is the unweighted arithmetic average of the interest rate levels in Bulgaria, Slovenia and Spain plus 2 percentage points. The reference value is 4.0%.

Chart 5.6.6 Long-term interest rate and HICP inflation differentials vis-à-vis the euro area

(monthly averages in percentage points)



Sources: European System of Central Banks, ECB calculations and European Commission (Eurostat).

Table 5.6.4 Long-term interest rates and indicators of financial development and integration

(as a percentage of GDP, unless otherwise indicated)

	2006-2015 1)	2006-2010 1)	2011-2015 1)	2012	2013	2014	2015	May 2015 to Apr. 2016	Memo item: euro area 2015
Long-term interest rates									
Romania 2)	6.6	7.8	5.5	6.7	5.4	4.5	3.5	3.6	-
Euro area 2), 3)	3.4	4.0	2.9	3.9	3.0	2.0	1.2	1.2	-
Euro area AAA par curve, ten-year residual maturity 2), 3)	2.8	3.8	1.8	2.1	1.9	1.4	0.6	0.6	-
Indicators of financial development and integration									
Debt securities issued by financial corporations 4)	0.4	0.5	0.3	0.2	0.3	0.3	0.3	-	73.6
Debt securities issued by non-financial corporations 5)	0.0	0.0	0.0	0.0	0.0	0.1	0.1	-	10.8
Stock market capitalisation 6)	11.5	13.0	10.0	8.8	11.4	11.3	9.5	-	60.4
MFI credit to non-government residents 7)	35.2	35.7	34.8	37.9	34.3	31.6	30.4	-	114.7
Claims of euro area MFIs on resident MFIs 8)	24.0	29.0	20.1	23.5	20.1	16.6	13.1	-	27.4

Sources: European System of Central Banks and ECB calculations.
1) Multi-annual averages calculated using the arithmetic average.
2) Average interest rate.
3) Included for information only.
4) Outstanding amount of debt securities issued by resident MFIs and other financial corporations.
5) Outstanding amount of debt securities issued by resident non-financial corporations.
6) Outstanding amount of listed shares issued by residents at the end of the period at market values.
7) MFI (excluding NCB) credit to domestic non-MFI residents other than general government. Credit includes outstanding amounts of loans and debt securities.
8) Outstanding amount of deposits and debt securities issued by domestic MFIs (excluding the NCB) held by euro area MFIs as a percentage of total liabilities of domestic MFIs (excluding the NCB). Total liabilities exclude capital and reserves and remaining liabilities. Data available since 2007.

5.7 Sweden

5.7.1 Price developments

In April 2016 the 12-month average rate of HICP inflation in Sweden was 0.9%, i.e. above the reference value of 0.7% for the criterion on price stability (see Chart 5.7.1). This rate is expected to increase over the coming months.

Over the past ten years the 12-month average rate of HICP inflation has fluctuated within a range from 0.2% to 3.4%, and the average for that period was subdued, standing at 1.4%. In 2008 inflation picked up from moderate levels, driven largely by the spike in global commodity prices and the sharp depreciation of the krona. In the wake of the global financial crisis, inflation declined substantially amid plummeting commodity prices and ample spare capacity in the Swedish economy. The unemployment rate increased and the growth in unit labour costs declined. Despite the subsequent recovery in economic activity, spare capacity persisted for some time. In that environment, companies found it difficult to pass on cost pressures to consumer prices. The steady appreciation of the krona in nominal effective terms from 2009 to 2013, along with low external price pressures, also kept a lid on consumer price inflation over that period. In 2015 inflation picked up from very low levels, supported by the lagged effects of the krona's depreciation in 2014 and strong economic growth (see Table 5.7.1). The upward trend in inflation was underpinned by an accommodative monetary policy stance. In particular, Sveriges Riksbank reduced its main policy rate into negative territory and launched a programme of government bond purchases. Amid historically low interest rates and supply-side frictions in the housing market, house prices have increased substantially over recent years, together with household indebtedness.

In the first four months of 2016 consumer price developments in Sweden were rather subdued, albeit slightly more dynamic than in the majority of EU Member States. The average annual rate of HICP inflation during that period was 1.1%. The strong underlying growth momentum and the past weakening of the krona continued to exert upward pressure on prices, underpinned by an accommodative monetary policy stance. Tax increases in the form of lower tax deductions for certain construction-related services also had a positive, albeit temporary, effect on inflation. At the same time, the decline in global commodity prices over the past year, lower electricity prices and subdued external price pressures weighed on headline inflation.

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% in the CPI. In June 2010 the tolerance margin of ±1 percentage point was removed from the policy objective. Sweden's institutional framework, which fosters prudent fiscal policy and wage formation, has generally lent support to the achievement of price stability. In recent years Sweden has consistently been among the top-performing EU Member States in terms of the international rankings of institutional environments.

Inflation in Sweden is expected to increase in the coming years, albeit remaining below 2%. According to the European Commission's Spring 2016 Economic Forecast, average annual HICP inflation is set to increase in 2016 and reach 1.2% in 2017. The outlook is based on expectations of relatively strong economic growth, which will drive up underlying cost pressures and facilitate their pass-through to consumer prices. However, low external price pressures are likely to weigh on inflation and the positive effects of the past depreciation of the krona will gradually wane. The risks to the inflation outlook are broadly balanced. A key upside risk relates to the build-up of stronger than expected domestic price pressures amid very robust economic growth. Downside risks relate to the heightened uncertainty regarding developments in the global economy, which could reduce external price pressures. Exchange rate developments are an additional source of uncertainty surrounding the inflation outlook. Looking further ahead, monetary policy and the stability-oriented institutional framework should continue to support the achievement of price stability in Sweden. Furthermore, price level convergence would require lower inflation rates than in the euro area over the medium term, since the price level in Sweden is comparatively high.

Maintaining an environment that is conducive to sustainable convergence in Sweden requires the continuation of stability-oriented economic policies and targeted structural reforms. In particular, decisive efforts are needed to address the risks to macroeconomic stability arising from the ongoing housing boom and the elevated level of private debt. A disorderly correction of house prices in Sweden could dampen consumption and, in turn, trigger an economic downturn. Therefore, it is essential that structural reforms alleviate supply-side bottlenecks and other inefficiencies in the housing market, such as planning and zoning restrictions, as well as rigid rental regulations. Against this backdrop, the European Commission selected Sweden for an in-depth review in its Alert Mechanism Report 2016 and concluded that Sweden is experiencing macroeconomic imbalances.

Financial sector policies should be geared to continuing to safeguard financial stability and ensuring that the financial sector makes a sound contribution to economic growth. Given the credit-financed housing boom, financial sector policies should first and foremost aim to prepare the ground for a "soft landing" in Sweden. This requires measures to curb mortgage demand, such as a gradual reduction in mortgage interest rate deductibility from the income tax or increases in recurrent property taxes. In order to further improve the resilience of the large banking sector, the Swedish authorities could consider additional measures, such as a minimum leverage ratio requirement.

5.7.2 Fiscal developments

The deficit and debt complied with the Maastricht criteria in 2015. In 2015 the general government recorded a balanced budget, thus standing well below the 3% reference value. The general government gross debt-to-GDP ratio was 43.4%, i.e. below the 60% reference value (see Table 5.7.2). Compared with the previous year, the deficit and debt ratios decreased by 1.6 and 1.3 percentage points of GDP respectively. According to the European Commission’s Spring 2016 Economic Forecast, the deficit ratio is projected to increase to 0.4% in 2016, whereas the government debt ratio is projected to decrease to 41.3%. With regard to other fiscal factors, the deficit ratio did not exceed the ratio of public investment to GDP in 2015, nor is it expected to do so in 2016.

Sweden is currently subject to the preventive arm of the Stability and Growth Pact. Sweden has never been subject to a European Council decision on the existence of an excessive deficit. According to the information provided in the 2016 Convergence Programme on 28 April 2016, Sweden is expected to comply with its medium-term objective (a structural deficit of 1% of GDP at most) over the programme horizon. The European Commission’s Spring 2016 Economic Forecast projects the structural deficit to remain below the medium-term objective from 2015 to 2017. It therefore assesses the country to be compliant with the preventive arm requirements throughout the reference period.

The deficit-to-GDP ratio stayed at levels well below the 3% reference value during the crisis. The deficit ratio reached its trough in 2015 at 0.0% of GDP, after improving by 0.7 percentage points since 2009. The European Commission's estimates (presented in Table 5.7.2) indicate that cyclical factors improved the budget balance by 2.9 percentage points of GDP between 2009 and 2015, following their large deficit-increasing impact in 2008 and 2009 (5.3 percentage points) as the Swedish government let automatic stabilisers operate freely. The structural balance deteriorated by 2.2 percentage points between 2009 and 2015, while no substantial temporary or one-off measures occurred in the same period.

The debt-to-GDP ratio increased progressively after the crisis, while staying at levels well below the 60% reference value. The debt ratio increased steadily from its post-crisis trough of 36.9% of GDP in 2011 to its peak of 44.8% of GDP in 2014, mainly driven by large deficit-debt adjustments (see Table 5.7.2). The latter increased the debt ratio by 7.0 percentage points over 2013 and 2014, mainly reflecting loans to strengthen the currency reserves of Sveriges Riksbank and a redefinition of statistics. Primary deficits more than offset a debt-reducing growth-interest rate differential in the same period. Contingent liability risks remain low, as the banking sector is fully capitalised and public provisions related to the support given to financial institutions are negligible.

Sweden’s government debt structure shows that fiscal balances are relatively sensitive to interest rate and exchange rate fluctuations. The share of government debt with a short-term maturity is relatively high (27.2% in 2015 – see Table 5.7.2). Taking into account the level of the debt ratio, fiscal balances are relatively sensitive to changes in interest rates. At the same time, the proportion of government debt denominated in foreign currency is relatively high (25.8% in 2015). Taking the size of the debt as a share of GDP into consideration, this leaves fiscal balances relatively sensitive to the exchange rate movements of foreign currencies. Moreover, potential short-term risks in terms of maturity structure emerge as a result of a significant increase (5.5 percentage points) in the share of short-term debt between 2013 and 2015.

The European Commission's Spring 2016 Economic Forecast points to compliance under the preventive arm of the Stability and Growth Pact. According to the Commission's latest forecast, a structural surplus of 0.3% of GDP in 2015 is projected to turn into a structural deficit of 0.5% and 0.9% of GDP in 2016 and, under unchanged policies, in 2017 respectively. It therefore sees no risk of deviation from the medium-term objective (i.e. a structural deficit of 1% of GDP at most).

Sweden has further strengthened its already strong national fiscal governance framework over recent years. Sweden has a strong rule-based fiscal framework consisting of three key components: (i) a general government surplus target of 1% of GDP over the business cycle, (ii) a three-year rolling nominal expenditure ceiling for central government and the pension system, and (iii) a balanced budget requirement for local governments. Over recent years, the Swedish government has introduced a number of changes aimed at increasing the scope of budget bills under the new European Semester, including regular evaluations to improve the accuracy of forecasts and provisions to enhance the control of revenue. A parliamentary committee is investigating whether to change the level of the surplus target. Any change in the national target should ensure the medium-term sustainability of public finances under the requirements of the Stability and Growth Pact.

Sweden faces low risks to the long-term sustainability of public finances, but expenditure on long-term care raises some concerns. The detailed examination performed for the European Commission's 2015 Fiscal Sustainability Report points to there being no risks over the short term, low risks over the medium term and medium risks in the long term. The long-term risks stem from both the relatively unfavourable initial budgetary position and the projected impact of age-related public spending. In respect of the latter, according to the estimates by the European Commission and the Economic Policy Committee reported in the 2015 Ageing Report,[121] an ageing population poses some challenges to Swedish public finances, especially in the area of long-term care. According to the AWG reference scenario, strictly age-related expenditure is projected to rise by 0.7 percentage points of GDP by the year 2060 from a level of 25.1% of GDP in 2013, mainly driven by long-term care costs. In the AWG risk scenario, the increase in the cost of ageing amounts to 3.8 percentage points of GDP, a figure that was partly determined by long-term care costs. Reforms aimed at increasing the availability of substitutes for publicly financed formal care are needed, thus enhancing the long-term sustainability of public finances.

Sweden should build on its strong track record so as to ensure the continued compliance of its public finances with the requirements under the preventive arm of the Stability and Growth Pact. Sweden should continue to anchor sound public finances in its rule-based fiscal framework, thus ensuring compliance with its medium-term objective in the years to come. In the short-to-medium term, risks are low and mainly relate to the composition of government debt as a result of its

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[121] "The 2015 Ageing Report: Economic and budgetary projections for the EU-28 Member States (2013-2060)", prepared by the AWG.

sensitivity to interest rate and exchange rate movements. However, Sweden should focus on minimising debt-financed expenditure linked to the recent influx of asylum seekers, which is expected to continue over the coming years. In the long term, fiscal risks arise from age-related expenditure, particularly in the area of long-term care. Therefore, the Swedish government should adhere to its commitment to diversify its liability structure towards safer components, such as long-term and krona-denominated debt. Most importantly, the government should contain the growth in age-related expenditure in order to stave off long-term risks to the sustainability of public finances.

5.7.3 Exchange rate developments

In the two-year reference period from 19 May 2014 to 18 May 2016, the Swedish krona did not participate in ERM II, but traded under a flexible exchange rate regime. Over the reference period the Swedish currency often traded substantially below its May 2014 average exchange rate against the euro of 9.0298 kronor per euro, which is used as a benchmark for illustrative purposes in the absence of an ERM II central rate (see Chart 5.7.3). On 18 May 2016 the exchange rate stood at 9.3525 kronor per euro, i.e. 3.6% weaker than its average level in May 2014. Over the reference period the maximum upward deviation from this benchmark was 0.4%, while the maximum downward deviation amounted to 6.9%. Looking back over a longer period the exchange rate of the Swedish krona against the euro has depreciated by 0.2% over the past ten years. On 4 January 2016 Sveriges Riksbank announced its intention to intervene on the foreign exchange market if necessary to ensure that developments in the krona exchange rate do not comprise a serious risk to the upturn in inflation. Furthermore, Sveriges Riksbank maintained a swap agreement with the ECB for borrowing up to €10 billion in exchange for Swedish kronor, which had been in place since 20 December 2007 with the aim of facilitating the functioning of financial markets and providing euro liquidity to the latter if needed. As this agreement has helped to reduce financial vulnerabilities, it might also have had an impact on the exchange rate of the Swedish krona against the euro.

The exchange rate of the Swedish krona against the euro exhibited, on average, a relatively high degree of volatility over the two-year reference period. The currency depreciated by around 5% against the euro between May 2014 and August 2015, while the interest rate differential vis-à-vis euro area assets turned negative. Thereafter, the krona strengthened by around 3% against the euro up to the end of 2015 on account of a narrowing interest rate differential and the strong performance of the Swedish economy. In the first two months of 2016, following the above-mentioned announcement by Sveriges Riksbank regarding possible exchange rate interventions, the Swedish currency depreciated again vis-à-vis the euro. More recently, the krona appreciated somewhat. Over the reference period short-term interest rate differentials against the three-month EURIBOR were overall very small and stood at -0.2 percentage point in the three-month period ending in March 2016.

The real effective exchange rate of the Swedish krona has depreciated overall over the past ten years (see Chart 5.7.4).

Over the past ten years Sweden has recorded large current account surpluses, usually coupled with a relatively small negative net international investment position (see Table 5.7.3). In 2015 the surplus in the combined current and capital account of the balance of payments stood at 5.7% of GDP, reflecting surpluses in the goods, services and primary income balances. The corresponding net capital outflows in the financial account were mainly in direct investment and other investment. Gross external debt, which is concentrated in monetary financial institutions, stood at 181.4% of GDP in 2015. Over the past ten years Sweden has usually recorded a relatively small negative net international investment position, which stood at -1.6% in 2015.

The Swedish economy is well integrated with the euro area through trade and investment linkages. In 2015 exports of goods and services to the euro area constituted 39.3% of total exports, while the corresponding figure for imports was higher, at 47.9%. The share of the euro area in Sweden's stock of inward direct investment stood at 57.2% in 2015, and its share in the country's stock of portfolio investment liabilities was 31.9%. The share of Sweden's stock of foreign assets invested in the euro area amounted to 47.7% in the case of direct investment and 37.1% in the case of portfolio investment in 2015.

5.7.4 Long-term interest rate developments

Over the reference period from May 2015 to April 2016, long-term interest rates in Sweden were 0.8% on average and thus well below the 4.0% reference value for the interest rate convergence criterion (see Chart 5.7.5).

Long-term interest rates in Sweden have been on a declining trend since 2008, with some volatility, as 12-month moving averages fell from over 4% to only 0.8% at the end of the reference period. Substantial decreases in Swedish long-term interest rates were recorded between 2011 and 2012, and then from late 2013 until early 2015 (see Chart 5.7.5). In the first episode, the decline partly reflected safe-haven flows into Swedish sovereign debt. At the time, Swedish sovereign debt continued to hold the highest possible credit rating from the major credit rating agencies while several euro area sovereigns were coming under stress. After safe-haven flows had lessened as tensions in euro area financial markets eased, long-term interest rates in Sweden increased. However, from late 2013 onwards long-term interest rates in Sweden began to experience a protracted decline, partly on the back of the government bond purchase programme launched by Sveriges Riksbank.

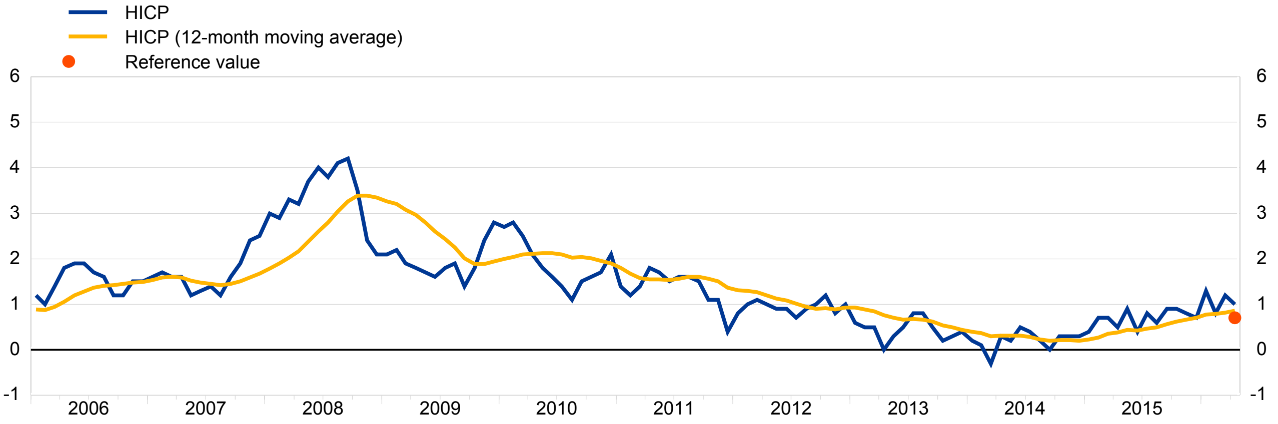
Sweden's long-term interest rate differential vis-à-vis the euro area had almost disappeared at the end of the reference period, following sizeable moves over the past ten years. These moves reflect to a large extent the build-up and subsequent reversal of safe-haven flows to Sweden, as the differential dropped rapidly to its low point of -3 percentage points in late 2011. The differential dropped amid sovereign tensions in the euro area, before starting to converge back towards zero in mid-2012 as those tensions abated (see Chart 5.7.6). Ever since 2013, Swedish long-term rates have traded below, but within 1 percentage point of, their euro area average equivalents, as rates in both jurisdictions declined in comparable fashion. At the end of the reference period, the differential reached -0.1 percentage points (0.6 percentage points as compared with the AAA euro area yield).

At the end of 2015 the Swedish capital market was highly developed, with corporate bond issuance and equity market capitalisation accounting for a higher share of GDP than in the euro area (see Table 5.7.4). In particular, relative to economic activity, non-financial corporations in Sweden finance themselves about one and a half times as intensively through bonds as their euro area counterparts, while the relative size of the stock market is approximately twice the size of that of the euro area. Integration of the Swedish financial sector with the euro area, as measured by the claims of euro area banks on Swedish banks, is moderate. Claims of euro area MFIs accounted for 8.3% of Swedish banks' liabilities in 2015 (see Table 5.7.4). Sweden's financial sector is highly developed. This is evident, among other indicators, in the provision of bank loans to the private sector. At the end of 2015, these stood at a level of 130.5% of GDP and, thus, somewhat higher than the corresponding figure in the euro area of 114.7%. Even though foreign-owned banks in general do not play a particularly prominent role in Sweden, the Swedish banking sector is well integrated into the EU financial system. Unlike in many peer countries, integration exists in the form of ownership by Swedish banks of euro area MFIs, rather than vice versa. Moreover, Swedish banks are particularly active in the Nordic-Baltic euro area countries.

Sweden - Price developments

Chart 5.7.1 HICP inflation and reference value [1)]

(annual percentage changes)



Sources: European Commission (Eurostat) and ECB calculations.

1) The basis of the calculation of the reference value for the period from May 2015 to April 2016 is the unweighted arithmetic average of the annual percentage changes in the HICP for Bulgaria, Slovenia and Spain plus 1.5 percentage points. The reference value is 0.7%.

Table 5.7.1 Measures of inflation and related indicators

(annual percentage changes, unless otherwise indicated)

	2006-2015 [1)]	2006-2010 [1)]	2011-2015 [1)]	2011	2012	2013	2014	2015	2016 [2)]	2017 [2)]
Measures of inflation										
HICP	1.4	2.1	0.7	1.4	0.9	0.4	0.2	0.7	0.9	1.2
HICP excluding unprocessed food and energy	1.3	1.7	0.9	1.1	1.0	0.5	0.5	1.1	1.2	1.3
HICP at constant tax rates [3)]	1.3	1.8	0.7	1.4	1.3	0.4	0.2	0.5	-	-
CPI	1.1	1.5	0.7	3.0	0.9	0.0	-0.2	0.0	-	-
Private consumption deflator	1.4	1.9	0.9	1.7	0.5	0.7	0.7	1.0	1.1	1.3
GDP deflator	1.8	2.3	1.4	1.2	1.1	1.1	1.6	1.9	2.7	1.8
Producer prices [4)]	1.7	3.7	-0.2	0.9	-0.3	-0.7	0.1	-1.1	-	-
Related indicators										
Real GDP growth	1.8	1.6	2.0	2.7	-0.3	1.2	2.3	4.1	3.4	2.9
GDP per capita in PPS [5)] (euro area = 100)	116.0	115.6	116.5	116.8	117.9	116.3	115.1	.	-	-
Comparative price levels (euro area = 100)	117.7	111.9	124.9	122.2	124.3	129.3	123.9	.	-	-
Output gap [6)]	-0.7	0.0	-1.4	-0.2	-1.9	-2.4	-2.1	-0.5	0.2	0.4
Unemployment rate (%) [7)]	7.5	7.2	7.8	7.8	8.0	8.0	7.9	7.4	6.8	6.3
Unit labour costs, whole economy	2.3	2.5	2.1	2.6	4.1	1.7	1.3	1.0	1.3	1.8
Compensation per employee, whole economy	3.1	3.4	2.8	3.2	3.1	2.0	2.2	3.6	3.1	3.2
Labour productivity, whole economy	0.8	0.9	0.6	0.5	-1.0	0.3	0.9	2.6	1.8	1.4
Imports of goods and services deflator	0.7	1.7	-0.3	-0.2	-1.1	-2.8	1.7	0.9	-2.4	1.2
Nominal effective exchange rate [8)]	-0.2	-0.4	0.0	6.1	1.0	3.2	-3.5	-6.1	-	-
Money supply (M3) [9)]	6.6	8.6	4.7	6.5	3.8	3.1	4.2	6.1	-	-
Lending from banks [10)]	6.5	8.7	4.3	5.5	3.6	3.0	5.1	4.4	-	-
Stock prices (OMXS30) [11)]	50.7	20.4	25.2	-14.5	11.8	20.7	9.9	-1.2	-	-
Residential property prices	6.8	7.3	6.2	2.5	1.2	5.5	9.4	13.1	-	-

Sources: European Commission (Eurostat, DG ECFIN), national data for CPI, money supply, lending from banks and residential property prices, and ECB calculations based on Thomson Reuters data for stock prices.

1) Multi-annual averages calculated using the geometric mean, except for GDP per capita in PPS, comparative price levels, output gap and unemployment rate, for which the arithmetic mean is used.

2) Data from the European Commission's Spring 2016 Economic Forecast.

3) The difference between the HICP and the HICP at constant tax rates shows the theoretical impact of changes in indirect taxes (e.g. VAT and excise duties) on the overall rate of inflation. This impact assumes a full and instantaneous pass-through of tax rate changes to the price paid by the consumer.

4) Domestic sales, total industry excluding construction.

5) PPS stands for purchasing power standards.

6) Percentage difference of potential GDP: a positive (negative) sign indicates that actual GDP is above (below) potential GDP.

7) Definition conforms to International Labour Organization guidelines.

8) EER-38 group of trading partners. A positive (negative) sign indicates an appreciation (depreciation).

9) The series includes repurchase agreements with central counterparties.

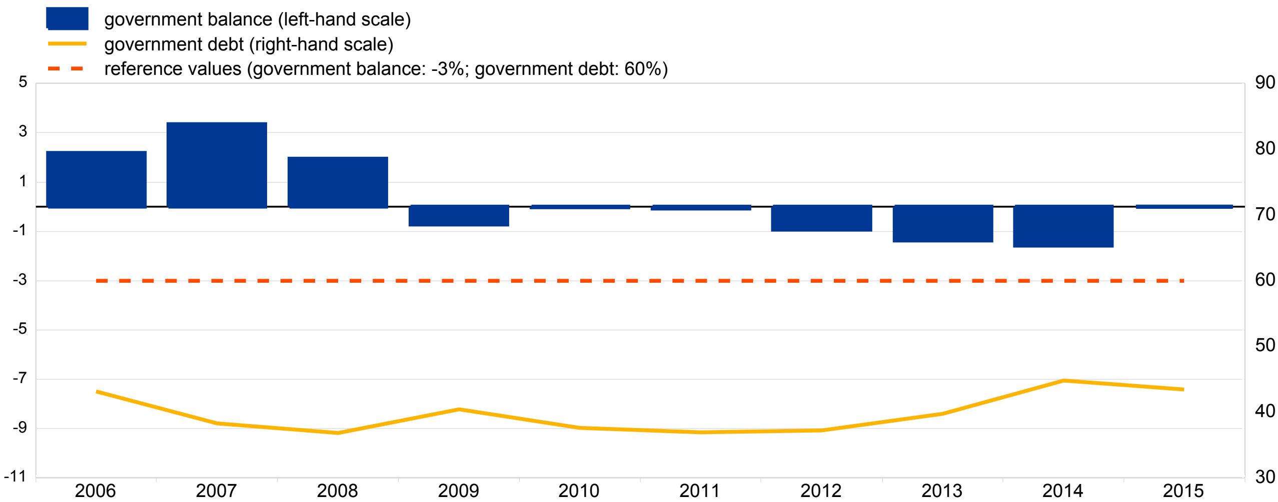
10) Not adjusted for the derecognition of loans from the MFI statistical balance sheet due to their sale or securitisation.

11) Multi-annual and annual figures represent the percentage change between the end of the given period and the end of the previous period.

Sweden - Fiscal developments

Chart 5.7.2 General government balance and debt

(as a percentage of GDP)



Sources: European System of Central Banks and European Commission (Eurostat).

Table 5.7.2 Government budgetary developments and projections

(as a percentage of GDP, unless otherwise indicated)

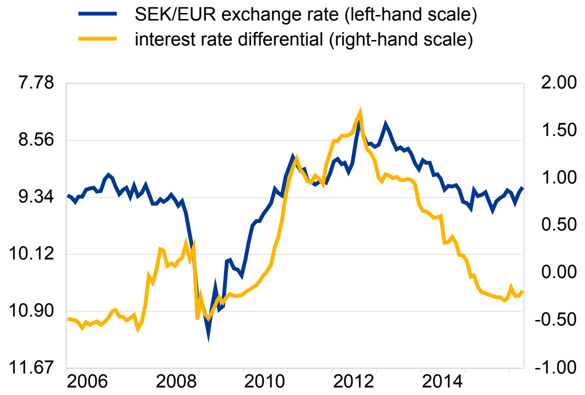
	2006-2015 [1]	2006-2010 [1]	2011-2015 [1]	2011	2012	2013	2014	2015	2016 [2]	2017 [2]	2018	2019
Government balance	**0.3**	**1.3**	**-0.8**	**-0.1**	**-0.9**	**-1.4**	**-1.6**	**0.0**	**-0.4**	**-0.7**	.	.
Total revenue	51.5	52.5	50.6	50.5	50.7	51.0	50.2	50.4	49.8	49.7	.	.
Current revenue	51.4	52.4	50.3	50.4	50.4	50.6	50.1	50.3	49.6	49.6	.	.
Direct taxes	18.6	19.3	17.8	17.6	17.4	17.8	17.9	18.3	18.1	18.2	.	.
Indirect taxes	22.1	22.2	22.0	21.9	22.2	22.2	21.9	22.0	22.0	22.1	.	.
Net social contributions	3.7	3.6	3.7	3.7	3.8	3.8	3.7	3.7	3.6	3.6	.	.
Other current revenue [3]	7.0	7.2	6.7	7.1	7.0	6.9	6.4	6.2	5.9	5.7	.	.
Capital revenue	0.2	0.1	0.2	0.1	0.4	0.3	0.1	0.2	0.1	0.1	.	.
Total expenditure	51.2	51.1	51.4	50.5	51.7	52.4	51.7	50.4	50.1	50.4	.	.
Current expenditure	46.7	46.8	46.7	45.9	46.9	47.7	47.1	45.9	45.6	45.8	.	.
Compensation of employees	12.4	12.4	12.5	12.1	12.5	12.6	12.6	12.4	12.3	12.3	.	.
Social benefits	18.3	18.2	18.3	17.8	18.4	18.9	18.6	18.1	16.9	16.9	.	.
Interest payable	1.1	1.4	0.8	1.1	0.9	0.8	0.7	0.5	0.5	0.5	.	.
Other current expenditure [4]	14.9	14.7	15.1	14.9	15.1	15.4	15.2	15.0	16.0	16.0	.	.
Capital expenditure	4.5	4.4	4.6	4.6	4.8	4.7	4.6	4.5	4.5	4.6	.	.
of which: Investment	4.4	4.3	4.4	4.4	4.6	4.5	4.5	4.3	4.4	4.4	.	.
Cyclically adjusted balance	0.7	1.4	0.0	0.1	0.2	0.0	-0.3	0.3	-0.5	-0.9	.	.
One-off and temporary measures	.	.	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	.	.
Structural balance [5]	.	.	0.0	0.1	0.2	0.0	-0.3	0.3	-0.5	-0.9	.	.
Government debt	**39.8**	**39.3**	**40.4**	**36.9**	**37.2**	**39.8**	**44.8**	**43.4**	**41.3**	**40.1**	.	.
Average residual maturity (in years)	-	-	-	-	-	-	-	-	.	.	.	.
In foreign currencies (% of total)	22.7	21.7	23.8	20.1	18.6	28.2	26.2	25.8	.	.	.	.
of which: Euro	8.8	8.5	9.1	9.1	8.0	10.7	9.1	8.7	.	.	.	.
Domestic ownership (% of total)	67.6	73.0	62.2	68.2	64.7	60.8	56.1	61.2	.	.	.	.
Medium and long-term maturity (% of total) [6]	73.4	73.2	73.5	74.3	71.8	78.3	70.6	72.8	.	.	.	.
of which: Variable interest rate (% of total)	-	-	-	-	-	-	-	-	.	.	.	.
Deficit-debt adjustment	**1.3**	**0.9**	**1.7**	**0.6**	**-0.4**	**2.1**	**4.9**	**1.2**	.	.	.	.
Net acquisitions of main financial assets	1.4	1.2	1.6	1.4	0.9	2.6	3.8	-0.8	.	.	.	.
Currency and deposits	0.3	0.1	0.5	0.9	-0.2	-0.2	2.0	-0.3	.	.	.	.
Debt securities	0.3	0.4	0.3	-0.2	-0.1	0.0	1.5	0.2	.	.	.	.
Loans	1.1	1.0	1.2	0.8	0.5	3.4	0.8	0.7	.	.	.	.
Equity and investment fund shares or units	-0.3	-0.3	-0.4	-0.1	0.6	-0.6	-0.5	-1.4	.	.	.	.
Revaluation effects on debt	0.2	-0.2	0.5	0.4	-0.1	0.5	1.2	0.5	.	.	.	.
of which: Foreign exchange holding gains/losses	-	-	0.3	-0.1	-0.4	0.1	1.4	0.6	.	.	.	.
Other [7]	-0.3	-0.2	-0.4	-1.1	-1.2	-1.0	0.0	1.5	.	.	.	.
Convergence programme: government balance	-	-	-	-	-	-	-	-	-0.4	-0.7	-0.4	0.1
Convergence programme: structural balance	-	-	-	-	-	-	-	-	-0.2	-0.7	-0.5	0.0
Convergence programme: government debt	-	-	-	-	-	-	-	-	42.5	41.1	40.3	39.1

Sources: European System of Central Banks and European Commission (Eurostat, DG ECFIN).
1) Multi-annual averages.
2) Data from the European Commission's Spring 2016 Economic Forecast, except for convergence programme data.
3) Sales and other current revenue.
4) Intermediate consumption, subsidies payable and other current expenditure.
5) Cyclically-adjusted balance excluding one-off and other temporary measures.
6) Original maturity of more than one year.
7) Time of recording differences and other discrepancies (sector reclassifications and statistical discrepancies).

Sweden - Exchange rate and external developments

Chart 5.7.3 Bilateral exchange rate and short-term interest rate differential

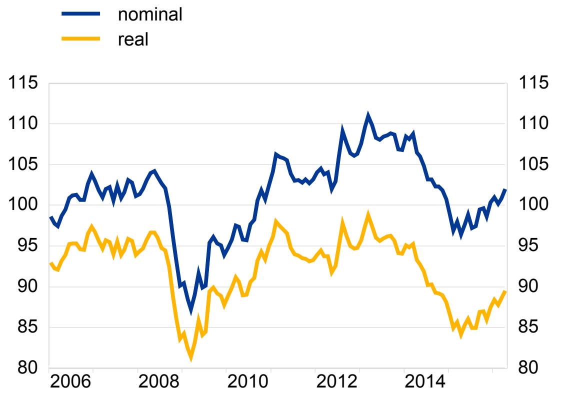
(SEK/EUR exchange rate: monthly averages; difference between three-month interbank interest rates and three-month EURIBOR: basis points, monthly values)



Sources: National data and ECB calculations.

Chart 5.7.4 Effective exchange rates [1]

(EER-38 group of trading partners; monthly averages; base index: Q1 1999 = 100)



Source: ECB.
1) The real EER-38 is CPI deflated. An increase (decrease) in the EER indicates an appreciation (depreciation).

Table 5.7.3 External developments

(as a percentage of GDP, unless otherwise indicated)

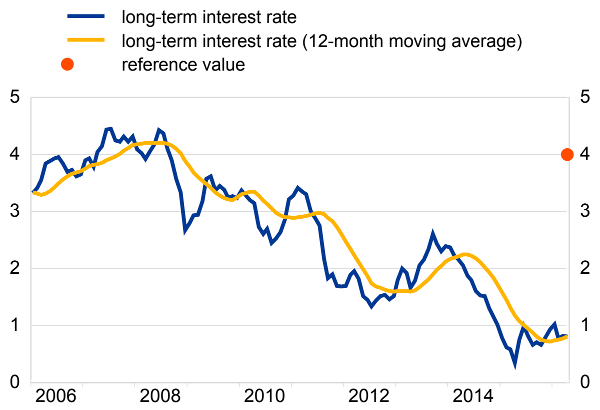
	2008-2015 [1]	2008-2010 [1]	2011-2015 [1]	2011	2012	2013	2014	2015	2016 [2]	2017 [2]
Balance of payments										
Current account and capital account balance [3]	6.0	6.7	5.7	5.9	5.7	5.8	5.2	5.7	5.6	5.5
Current account balance	6.2	6.8	5.9	6.1	5.9	6.0	5.4	5.9	5.8	5.7
Goods	3.8	4.5	3.4	3.6	3.7	3.6	3.3	2.9	.	.
Services	1.8	1.3	2.0	1.8	1.8	2.1	1.8	2.6	.	.
Primary income	2.2	2.4	2.0	2.0	2.2	1.9	1.9	2.1	.	.
Secondary income	-1.5	-1.3	-1.6	-1.3	-1.8	-1.7	-1.7	-1.6	.	.
Capital account balance	-0.2	-0.1	-0.2	-0.2	-0.2	-0.2	-0.1	-0.2	.	.
Combined direct and portfolio investment balance [3]	-1.0	-2.1	-0.3	-2.0	-0.8	-4.0	5.0	0.1	.	.
Direct investment	2.4	2.1	2.6	3.0	2.3	4.4	0.9	2.3	.	.
Portfolio investment	-3.4	-4.3	-2.9	-5.1	-3.1	-8.4	4.2	-2.1	.	.
Other investment balance	3.8	3.3	4.1	9.4	3.2	6.4	-1.3	2.9	.	.
Reserve assets	-	-	0.6	0.1	0.1	2.6	0.0	0.3	.	.
Exports of goods and services	45.6	46.2	45.3	46.6	45.9	43.9	44.8	45.3	.	.
Imports of goods and services	40.0	40.4	39.8	41.2	40.3	38.1	39.6	39.8	.	.
Net international investment position [4]	-5.4	0.8	-9.1	-10.4	-16.9	-14.3	-2.5	-1.6	.	.
Gross external debt [4]	189.0	191.9	187.3	192.9	187.0	184.6	190.6	181.4	.	.
Internal trade with the euro area [5]										
Exports of goods and services	.	.	39.3	38.8	38.5	39.9	40.1	39.3	.	.
Imports of goods and services	.	.	48.7	49.3	48.2	49.8	48.3	47.9	.	.
Investment position with the euro area [5]										
Direct investment assets [4]	.	.	48.8	49.6	48.5	49.4	48.8	47.7	.	.
Direct investment liabilities [4]	.	.	58.3	60.9	59.2	57.4	56.8	57.2	.	.
Portfolio investment assets [4]	.	.	38.6	40.1	40.2	39.5	36.0	37.1	.	.
Portfolio investment liabilities [4]	34.1	36.7	32.5	33.4	34.3	31.6	31.1	31.9	.	.

Sources: European System of Central Banks and European Commission (Eurostat, DG ECFIN).
Note: Backdata are available from 2008.
1) Multi-annual averages.
2) Data from the European Commission's Spring 2016 Economic Forecast.
3) Differences between totals and sum of their components are due to rounding.
4) End-of-period outstanding amounts.
5) As a percentage of the total.

Sweden - Long-term interest rate developments

Chart 5.7.5 Long-term interest rate 1)

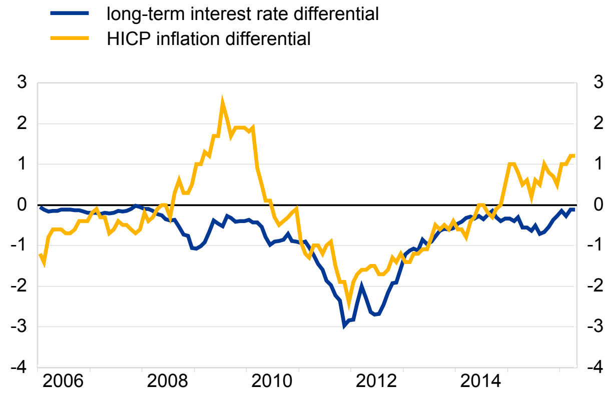
(monthly averages in percentages)



Sources: European System of Central Banks and ECB calculations.
1) The basis of the calculation of the reference value for the period from May 2015 to April 2016 is the unweighted arithmetic average of the interest rate levels in Bulgaria, Slovenia and Spain plus 2 percentage points. The reference value is 4.0%.

Chart 5.7.6 Long-term interest rate and HICP inflation differentials vis-à-vis the euro area

(monthly averages in percentage points)



Sources: European System of Central Banks, ECB calculations and European Commission (Eurostat).

Table 5.7.4 Long-term interest rates and indicators of financial development and integration

(as a percentage of GDP, unless otherwise indicated)

	2006-2015 1)	2006-2010 1)	2011-2015 1)	2012	2013	2014	2015	May 2015 to Apr. 2016	Memo item: euro area 2015
Long-term interest rates									
Sweden 2)	2.7	3.6	1.8	1.6	2.1	1.7	0.7	0.8	-
Euro area 2), 3)	3.4	4.0	2.9	3.9	3.0	2.0	1.2	1.2	-
Euro area AAA par curve, ten-year residual maturity 2), 3)	2.8	3.8	1.8	2.1	1.9	1.4	0.6	0.6	-
Indicators of financial development and integration									
Debt securities issued by financial corporations 4)	101.4	92.1	110.7	106.9	111.8	115.6	112.0	-	73.6
Debt securities issued by non-financial corporations 5)	17.2	15.0	19.4	17.7	21.2	21.0	20.9	-	10.8
Stock market capitalisation 6)	110.1	105.2	115.0	102.4	120.3	128.0	132.9	-	60.4
MFI credit to non-government residents 7)	124.2	117.8	130.5	130.3	131.3	132.9	130.5	-	114.7
Claims of euro area MFIs on resident MFIs 8)	9.3	9.9	8.6	8.0	8.4	9.0	8.3	-	27.4

Sources: European System of Central Banks and ECB calculations.
1) Multi-annual averages calculated using the arithmetic average.
2) Average interest rate.
3) Included for information only.
4) Outstanding amount of debt securities issued by resident MFIs and other financial corporations.
5) Outstanding amount of debt securities issued by resident non-financial corporations.
6) Outstanding amount of listed shares issued by residents at the end of the period at market values.
7) MFI (excluding NCB) credit to domestic non-MFI residents other than general government. Credit includes outstanding amounts of loans and debt securities.
8) Outstanding amount of deposits and debt securities issued by domestic MFIs (excluding the NCB) held by euro area MFIs as a percentage of total liabilities of domestic MFIs (excluding the NCB). Total liabilities exclude capital and reserves and remaining liabilities.

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 political considerations. 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 certain 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, Regulation (EC) No 223/2009 as amended by Regulation (EU) 2015/759 (Regulation on European statistics)[122] and the European Statistics Code of Practice endorsed by the Commission in 2005 and revised in September 2011 (the Code of Practice).[123] 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 further elaborated on in the 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 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 679/2010[124] granted Eurostat new competences for regularly monitoring and verifying public finance data,

[122] Regulation (EC) No 223/2009 of the European Parliament and of the Council of 11 March 2009 on European statistics (OJ L 87, 31.03.2009, p. 164) as amended by Regulation (EU) 2015/759 of the European Parliament and of the Council of 29 April 2015 (OJ L 123, 19.5.2015, p. 90).

[123] European Statistics Code of Practice endorsed by the 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).

[124] 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, 30.07.2010, p. 1).

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 to strengthen the economic governance structure of the euro area and the EU as a whole relies on high-quality statistical information, which needs to be produced under robust quality management.[125] In this context, the 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.

The Regulation on European statistics has been recently 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.

Bulgaria, Poland and Romania are urged to reconsider the division of responsibilities in the field of general government statistics to ensure that the compilation of EDP and GFS statistics is impartial and is not subject to political considerations. The institutional responsibilities for the compilation of EDP data and GFS in the countries are shown in Table 6.1. In Poland and Romania the Ministry of Finance compiles EDP debt data. In Bulgaria, the Ministry of Finance compiles quarterly government debt data, while the NSI compiles annual government debt. Consistency of the annual and quarterly debt data is one of the criteria used to evaluate the quality of the data. Such consistency can only be achieved effectively if the data are compiled by the same independent institution.

[125] On 13 December 2011, the reinforced Stability and Growth Pact 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 by all EU Member States and the European Parliament in October 2011.

Table 6.1

Quality and integrity of convergence statistics

	Bulgaria	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	According to the Law on Statistics, statistics are based on the principles of professional independence, impartiality, objectivity, reliability, statistical confidentiality and cost effectiveness. According to 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).	According to Article 5 of the State Statistical Service Act, statistics are based on objectivity, impartiality and independence. According to Article 3, the Head of the NSI is appointed by the President of the Republic.
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.	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 Law on Statistics determines the main principles of data collection.	The State Statistical Service Act determines the main principles of data collection.
Legal provisions regarding statistical confidentiality	According to Articles 25 to 27a of the Law on Statistics, the confidentiality of the statistical data is secured.	According to Articles 16, 17 and 18 of the State Statistical Service Act, the confidentiality of the statistical data is secured.
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. There were no apparent instances of non-compliance with the HICP methodology.	Eurostat made a compliance monitoring visit in 2008 and published a report in 2009 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.
Other issues	Eurostat considered the representativity of the HICP to be generally appropriate.	Eurostat considered the representativity 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 2006-15.	Revenue, expenditure, deficit and debt data are provided for the period 2004-15.
Outstanding statistical issues	No major outstanding statistical issues identified.	No major outstanding statistical issues identified.
Institution responsible for the compilation of statistics	The NSI compiles the non-financial and financial accounts of government, as well as annual government debt. The Ministry of Finance compiles quarterly government debt.	The NSI compiles the non-financial and financial accounts of government, as well as government debt.

1) The full reports on the findings and recommendations of the HICP compliance monitoring visits for each country are available at http://ec.europa.eu/eurostat/web/hicp/methodology/compliance-monitoring

Table 6.1

Quality and integrity of convergence statistics (cont'd)

	Croatia	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	According to Article 5 of the Official Statistics Act, statistics are based on the principles of relevance, impartiality, reliability, transparency, timeliness, professional independence, cost effectiveness, consistency, publicity, statistical confidentiality, the use of individual data for exclusively statistical purposes, and public accountability. The Head of the NSI is appointed by the Government and is accountable to the Government.	According to Article 1 and 3/A of Act XLVI on Statistics, statistics are based on 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 state administration organisation which autonomously performs its tasks in conformity with the law. It has budget autonomy on the basis of an annual amount assigned from the state budget.	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	The Official Statistics Act determines the main principles of data collection.	Act XLVI on Statistics determines the main principles of data collection.
Legal provisions regarding statistical confidentiality	According to Article 59 of the Official Statistics Act, the confidentiality of the statistical data is secured.	According to Article 17 of Act XLVI on Statistics, the confidentiality of the statistical data is secured.
HICP inflation[1]		
Compliance with legal minimum standards	Eurostat made a compliance monitoring visit in 2015 and published a report in that year 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 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.	Eurostat made a compliance monitoring visit in 2008 and published a report in 2009 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 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 that comparability to the HICP of other countries can be regarded as assured.	Eurostat considered the representativity 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 2006-15.	Revenue, expenditure and deficit data are provided for the period 2006-15.
Outstanding statistical issues	No major outstanding statistical issues identified.	In April 2016 Eurostat expressed a reservation on the quality of the data reported by Hungary in relation to the sector classification of Eximbank.
Institution responsible for the compilation of statistics	The NSI compiles the non-financial accounts; the NCB compiles the debt and financial accounts.	The NSI compiles the non-financial accounts; the NCB compiles the debt and financial accounts.

Table 6.1

Quality and integrity of convergence statistics (cont'd)

	Poland	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	According to Article 1 of the Law on Official 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).	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	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.	According to 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	The Law on Official Statistics determines the main principles of data collection.	According to the Statistical Law, "the official statistics in Romania are implemented and coordinated by the NSI".
Legal provisions regarding statistical confidentiality	According to Articles 10, 11, 12, 38, 39 and 54 of the Law on Official Statistics, the confidentiality of the statistical data is secured.	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 2015. The report from this visit is not yet finalised. In its 2008 report, Eurostat confirmed that in general the methods used for producing the HICP are satisfactory. Some instances of non-compliance with the HICP methodology were found, but 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.	Eurostat made a compliance monitoring visit in 2007 and published a report in that year 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.
Other issues	Eurostat considered the representativity of the HICP in terms of accuracy and reliability to be generally adequate.	Eurostat considered the representativity 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 2006-15.	Revenue, expenditure, deficit and debt data are provided for the period 2006-15.
Outstanding statistical issues	No major outstanding statistical issues identified.	There is a unit currently classified as being in the financial sector which may be subject to a reclassification.
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.	The NSI compiles the non-financial accounts of government. The Ministry of Finance compiles government debt. The NCB compiles the financial accounts of government.

Table 6.1

Quality and integrity of convergence statistics (cont'd)

	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	According to 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 (for a maximum of three years).
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 by 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	According to Sections 5 and 6 of the Official Statistics Act, the confidentiality of the statistical data is secured.
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 found, but 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 representativity 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 2006-15.
Outstanding statistical issues	No major outstanding statistical issues identified.
Institution responsible for the compilation of statistics	The NSI compiles the non-financial and financial accounts of government, as well as government debt.

6.2 HICP inflation

This section considers the methodology and quality of the statistics underlying the measurement of price developments, specifically the 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.[126] The HICP covering the euro area as a whole has been the main measure of price developments for the single 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. Council Regulation (EC) No 2494/95 concerning harmonized indices of consumer

126 For details on the HICP legislative framework, recommendations and information notes in force, see the *Compendium of HICP reference documents*, Publications Office of the European Union, Luxembourg, 2013.

prices was adopted in October 1995.[127] The HICPs have also been further harmonised on the basis of several EU Council and European Commission 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 costs. 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. Estimates of the development of administered prices in the HICP refer to prices which are directly set or significantly influenced by the government, including national regulators. They are based on a common definition and compilation and are 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.

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 2010[128] and Commission Regulation (EU) No 220/2014 of 7 March 2014 amending Council Regulation (EU) No 479/2009.[129] 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.

[127] OJ L 257, 27.10.1995, p. 1.

[128] 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 174/1, 26.06.2013).

[129] 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 69/101, 08.03.2014).

The methodological changes related to the changeover from the ESA 95 to the ESA 2010 in October 2014 had a varied impact on the GFS, with very limited impact on the government deficit/surplus and a more pronounced impact on government debt. The levels of government debt increased mainly because more entities were included in the general government sector owing to changes in the criteria applied for classification. The increase in the number of entities classified in the general government sector also had a small impact on the government balance (deficit/surplus). Moreover, GDP increased for most countries with the change to the ESA 2010, resulting in lower debt-to-GDP and deficit-to-GDP ratios. In general, the changeover to the ESA 2010 in October 2014 did not impact the availability of the GFS data adversely.

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 swaps[130], as well as trade credits[131] 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.

The measure of GDP used for compiling government deficit and debt ratios is the ESA 2010 GDP at current market prices.

6.3.1 Data source

The NCBs provide the ECB with detailed GFS data under the ECB's GFS Guideline.[132] 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 figures on

[130] 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.

[131] 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.

[132] Guideline ECB/2014/21 of 3 June 2014 amending Guideline ECB/2013/23 on government finance statistics (OJ L 267, 6.9.2014, p. 9).

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

6.3.2 Methodological issues

The 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 statistical compilers and may lead to further reclassifications and changes in the EDP and GFS data.

In the Czech Republic two MFIs and an insurance company are reclassified inside the general government sector for EDP purposes. These entities are classified as part of the financial sector in other statistical data compiled by the NCB (e.g. monetary and financial statistics, and balance of payments statistics). The resultant discrepancy in sector classification between those statistics and GFS is well documented and has been made known to users.

In April 2016 Eurostat expressed a reservation on the quality of the data reported by Hungary in relation to the sector classification of Eximbank (Hungarian Export-Import Bank Plc, which is included in the ECB's list of MFIs). According to Eurostat, Eximbank should be reclassified inside the general government sector, which would result in an increase in government debt. Eximbank is currently classified in the financial sector uniformly in all statistics, including monetary and financial statistics, as well as balance of payments statistics. The Hungarian statistical authorities consider the bank to be a financial intermediary and would like to ensure the consistency of financial statistics.

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 ERM 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 published on the ECB's website.[133] 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 38 trading partners. Both nominal and real EER statistics are calculated by the ECB.

[133] From 1 July 2016 the ECB's euro foreign exchange reference rates will be published at around 16:00 CET (see press release: http://www.ecb.europa.eu/press/pr/date/2015/html/pr151207.en.html).

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 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 liaison 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".

As regards 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;[134] and ii) statistics on financial and non-financial integration with the euro area.[135]

The data covering the structure of the financial system are provided by the NCBs. The data underlying the indicators concerning the debt securities issued by resident financial corporations (MFIs and non-monetary financial corporations) and non-financial corporations are reported by the respective NCBs in accordance with the methodology set out in Guideline ECB/2014/43 of 6 November 2014 amending Guideline ECB/2014/15 on monetary and financial statistics.[136] 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 is obtained from the countries under review and, for the latter indicator, also from the euro area countries covered by Regulation ECB/2013/33 of 24 September 2013 concerning the balance sheet of the monetary financial institutions sector (recast).[137] Historical data are compiled by the relevant NCBs, where appropriate. For the indicators mentioned, 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)[138] and with compilation guidance provided by the ECB and 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 Forecast.[139]

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

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

[135] External trade and investment position with the euro area.

[136] OJ L 93, 9.4.2015, p. 82.

[137] OJ L 297, 7.11.2013, p. 1

[138] For more details, see *European Union balance of payments and international investment position statistical methods (“B.o.p. and i.i.p. book”)*, ECB, Frankfurt am Main, 2014.

[139] The economic forecasts made by the Directorate-General for Economic and Financial Affairs (DG ECFIN) on behalf of the European Commission: http://ec.europa.eu/economy_finance/eu/forecasts/index_en.htm

a harmonised basis under the EU regulation concerning short-term statistics.[140] 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. Statistics on the harmonised unemployment rate (calculated as the number of unemployed over the labour force) take into account persons between the ages of 15 and 74.

[140] Council Regulation (EC) No 1165/98 of 19 May 1998 concerning short-term statistics (OJ L 162, 5.6.1998, p. 1).

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 problematic from the perspective of their compatibility with provisions on the independence of NCBs 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. They also 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).[141]

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,[142]
- the Law on Българска народна банка (Bulgarian National Bank) (hereinafter the “Law on BNB”).[143]

The Law on the prevention and ascertainment of conflicts of interest (hereinafter the “Law on the prevention of conflicts of interest”)[144] applies to public office holders.

In addition, the Law on credit institutions has become relevant since it has been recently amended[145] to confer new tasks on Българска народна банка (Bulgarian National Bank) in relation to the establishment of a bank account register.

There have been no major changes in relation to the points identified in the ECB’s Convergence Report of June 2014, and those comments are therefore repeated in this year’s assessment. Article 14(2) of the Law on BNB has been repealed[146]; therefore the comment regarding its compliance with Article 14.2 of the Statute has been removed.

[141] According to Section 2.2.2.1 of this Convergence Report.

[142] Constitution of the Republic of Bulgaria, Darjaven vestnik issue 56, 13.7.1991.

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

[144] Darjaven vestnik issue 94, 31.10.2008.

[145] Darjaven vestnik issue 94, 4.12.2015.

[146] Darjaven vestnik issue 48, 27.6.2015.

7.1.2 Independence of the NCB

With regard to the independence of Българска народна банка (Bulgarian National Bank), the Law on BNB and the Law on the prevention of conflicts of interests need to be adapted as set out below.

7.1.2.1 Institutional independence

Article 44 of the Law on BNB prohibits the Council of Ministers and other bodies and institutions from giving instructions to Българска народна банка (Bulgarian National Bank), the Governor or the members of the Governing Council. It further prohibits Българска народна банка (Bulgarian National Bank), its Governor and the members of its Governing Council from seeking or taking instructions from the Council of Ministers or from any other body or institution. The ECB understands that the provision encompasses both national and foreign institutions in line with Article 130 of the Treaty and Article 7 of the Statute. For legal certainty reasons, at the first opportunity, this provision should be brought fully into line with Article 130 of the Treaty and Article 7 of the Statute.

7.1.2.2 Personal independence

Article 14(1) of the Law on BNB lists the grounds for dismissal of the members of the Governing Council, according to which the National Assembly or Bulgaria's President may relieve a member of the Governing Council from office, including the Governor, if they: (i) no longer fulfil the conditions required for the performance of their duties under Article 11(4);[147] (ii) are in practice unable to perform their duties for more than six months; or (iii) have been guilty of serious professional misconduct.

The first sub-paragraph of Article 14(1) of the Law on BNB cross-refers to the conditions of appointment and election in Article 11(4). To avoid any circumvention of the conditions for dismissal of Governors as established by Article 14.2 of the Statute, the first sub-paragraph of Article 14(1) of the Law on BNB should only foresee conditions that are objective, clearly defined and linked to the performance of duties of the members of the Governing Council. Therefore, this provision needs to be revised so that it mirrors the wording of Article 14.2 of the Statute.

The second sub-paragraph of Article 14(1) of the Law on BNB is in addition to the two grounds for dismissal provided for in Article 14.2 of the Statute. The third sub-

[147] Under Article 11(4) of the Law on BNB, a member of the Governing Council, including the Governor, may not: (i) be sentenced to imprisonment for a premeditated crime; (ii) declared bankrupt in their capacity as sole proprietor or general partner in a commercial company; (iii) have been a member of a managing or supervisory body of a company or cooperative in the two years prior to the said company or cooperative being declared insolvent; (iv) be sole proprietor, unlimited liability partner in a trading company, manager, trade proxy, trade representative, procurator, trade agent, liquidator or receiver, member of a management or controlling body of a trade company or a cooperative, with the exception of companies where Българска народна банка (Bulgarian National Bank) participates; (v) be a spouse of, live with, be a relative in direct or lateral line up to and including the fourth degree, or be connected by marriage up to and including the second degree to a member of the Governing Council.

paragraph narrows the concept of “serious misconduct” in Article 14.2 of the Statute to “serious professional misconduct”. Article 14(1) of the Law on BNB needs to be adapted further in these respects to fully comply with Article 14.2 of the Statute.

The Law on the prevention of conflicts of interests provides that breach of its provisions and the existence of a conflict of interests are grounds for dismissal of the Governor, Deputy Governors and the other members of the Governing Council of Българска народна банка (Bulgarian National Bank). Thus, the Law on the prevention of conflicts of interests specifies grounds for dismissal that are in addition to the two grounds contained in Article 14.2 of the Statute. Therefore, the Law on the prevention of conflicts of interests is incompatible with the Treaty and the Statute and needs to be brought into line with them.[148]

The Law on BNB is silent on the right of national courts to review a decision to dismiss any member, other than the Governor, of Българска народна банка (Bulgarian National Bank) decision-making bodies, 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 could increase legal certainty.

Article 12(1) and (2) of the Law on BNB provide for the National Assembly’s powers to elect the Governor and the Deputy Governors of Българска народна банка (Bulgarian National Bank). In a 2009 case, the National Assembly claimed and acted upon the claim that it has the power to annul or amend its previous decisions, including decisions concerning the election of the Governor and Deputy Governors of Българска народна банка (Bulgarian National Bank) taken under Article 12(1) and (2) of the Law on BNB. In practice, any proper election or appointment of members of an NCB’s decision-making body should 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 dismissed under conditions other than those mentioned in Article 14.2 of the Statute, even if they have not yet taken up their duties. Therefore, taking the above-mentioned case into account, the ECB reiterates that the Law on BNB should be revised to mirror the wording of Article 14.2 of the Statute and to provide specifically for a right of review of decisions removing members of Българска народна банка (Bulgarian National Bank) decision-making bodies from office.

7.1.3 Confidentiality

Article 4(2) of the Law on BNB provides that Българска народна банка (Bulgarian National Bank) may not disclose or pass to third parties any information obtained which is of a confidential banking or commercial nature for banks and the other participants in the money turnover and credit relations, except in the cases provided for by the Law on the protection of classified information. Under Article 23(2) of the

[148] See also Opinion CON/2009/13.

Law on BNB, the employees of Българска народна банка (Bulgarian National Bank) may not disclose any information concerning negotiations, contracts entered into, the level of assets on customers' deposits and their operations, information received by Българска народна банка (Bulgarian National Bank), as well as any circumstances concerning the activities of Българска народна банка (Bulgarian National Bank) or its customers which constitute official, banking, commercial or other secrecy protected by law, even after the termination of their contracts of employment. Under Article 37 of the Statute, professional secrecy is an ESCB-wide matter. Therefore, the ECB assumes that Articles 4(2) and 23(2) of the Law on BNB are without prejudice to the confidentiality obligations towards the ECB and the ESCB.

7.1.4 Monetary financing and privileged access

Article 45(1) of the Law on BNB provides that Българска народна банка (Bulgarian National Bank) may not grant credits or guarantees in any form whatsoever, including through the purchase of debt instruments, to the Council of Ministers, municipalities, or to other government or municipal institutions, organisations and undertakings. Pursuant to Article 45(2) of the Law on BNB, this does not apply to the extension of credits to state-owned and municipal banks in emergency cases of liquidity risk that may affect the stability of the banking system. Article 45(1) and (2) of the Law on BNB need to be adjusted to be fully consistent with the Treaty. In particular, the range of public sector entities referred to in Article 45(1) of the Law on BNB needs to be extended to include central governments, regional, local or other public authorities, public undertakings and bodies governed by public law of other Member States and EU institutions and bodies to fully mirror the wording of Article 123 of the Treaty. Moreover, Article 45(1) of the Law on BNB needs to be slightly redrafted to ensure that it accurately reflects the prohibition of monetary financing to cover both (a) lending 'to' the range of public sector entities; and (b) purchases of debt instruments 'from' the range of public sector entities.

The prohibition of monetary financing prohibits the direct purchase of public sector debt, but such purchases in the secondary market are allowed, in principle, as long as such secondary market purchases are not used to circumvent the objective of Article 123 of the Treaty. For this reason the word 'direct' should be inserted in Article 45(1) of the Law on BNB.

Furthermore, while acknowledging the particularities arising out of the currency-board regime, i.e. prohibition on Българска народна банка (Bulgarian National Bank) extending credit to credit institutions other than in the context of emergency liquidity operations, it is recommended that the scope of the exemption addressed to publicly-owned credit institutions is brought into line with the scope of the exemption under the Treaty.

Pursuant to Article 56a(7) of the Law on credit institutions, several national law enforcement authorities and other public authorities, as well as the persons who represent them, which will have access to the bank account register operated by

Българска народна банка (Bulgarian National Bank), must pay a system access fee as determined by Българска народна банка (Bulgarian National Bank) based on expenditure incurred. Article 56a(7) of the Law on credit institutions needs to be adapted to provide sufficient safeguards to ensure that Българска народна банка (Bulgarian National Bank) is adequately remunerated for all the costs incurred in connection with both setting up and operating the bank account register.[149] The reimbursement of these costs should be made 'at arm's length,' i.e. on equal commercial terms, either in advance or on a regular and prompt basis as the costs arise.[150] In addition, in order to further ensure compatibility with the monetary financing prohibition, the Law on credit institutions would benefit from a limitation of Българска народна банка (Bulgarian National Bank)'s liability in relation to the operation of the bank account register.

7.1.5 Legal integration of the NCB into the Eurosystem

With regard to the legal integration of Българска народна банка (Bulgarian National Bank) into the Eurosystem, the Law on BNB needs to be adapted in the respects set out below.

7.1.5.1 Tasks

Monetary policy

Article 2(1) and Article 3, Article 16, items 4 and 5 and Articles 28, 30, 31, 32, 35, 38, 41 and 61 of the Law on BNB, which provide for the powers of Българска народна банка (Bulgarian National Bank) in the field of monetary policy and instruments for the implementation thereof, do not recognise the ECB’s powers in this field.

Article 33 of the Law of BNB, which empowers Българска народна банка (Bulgarian National Bank) to enter into certain financial transactions, also fails to recognise the ECB’s powers in this field.

Collection of statistics

Article 4(1) and Article 42 of the Law on BNB, which provide for the powers of Българска народна банка (Bulgarian National Bank) relating to the collection of statistics, do not recognise the ECB’s powers in this field.

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149 In order to ensure compliance with the monetary financing prohibition, Българска народна банка (Bulgarian National Bank) needs to be adequately remunerated: (a) where a new task entrusted to Българска народна банка (Bulgarian National Bank) is either not a central bank task or does not facilitate the performance of such a task; and (b) where a new task is both linked to a government task and performed in the interest of the government.

150 See paragraph 3.1.6 of Opinion CON/2015/46.

Official foreign reserve management

Article 20(1) and Articles 28, 31 and 32 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, do not recognise the ECB's powers in this field.

Payment systems

Articles 2(4) and 40(1) of the Law on BNB, which provide for the powers of Българска народна банка (Bulgarian National Bank) 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 2(5), Article 16, item 9, and Articles 24 to 27 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, do not recognise the Council's and the ECB's powers in this field.

7.1.5.2 Financial provisions

Appointment of independent auditors

Article 49(4) of the Law on BNB, which provides that the external auditor is appointed by the Governing Council for a term of three years on the basis of a procedure complying with the Law on public procurement, does not recognise the Council's and the ECB's powers under Article 27.1 of the Statute.

Financial reporting

Article 16, item 11 and Articles 46 and 49 of the Law on BNB do not reflect the obligation to comply with the Eurosystem's regime for financial reporting of NCB operations, pursuant to Article 26 of the Statute.

7.1.5.3 Exchange rate policy

Articles 28, 31, 32 of the Law on BNB, which provide for the powers of Българска народна банка (Bulgarian National Bank) with regard to the exchange rate policy, do not recognise the Council's and the ECB's powers in this field.

7.1.5.4 International cooperation

Article 5, Article 16, item 12 and Article 37(4) of the Law on BNB, which provide for the powers of Българска народна банка (Bulgarian National Bank) with regard to international cooperation, do not recognise the ECB's powers in this field.

7.1.5.5 Miscellaneous

Articles 61 and 62 of the Law on BNB do not recognise the ECB's powers to impose sanctions.

7.1.6 Conclusions

The Law on BNB, the Law on the prevention of conflicts of interest and the Law on credit institutions do not comply with all the requirements for central bank independence, the monetary financing prohibition, and legal integration into the Eurosystem. Bulgaria is a Member State with a derogation and must therefore comply with all adaptation requirements under Article 131 of the Treaty.

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,[151]
- the Law on Česká národní banka (hereinafter the "Law on CNB").[152]

This year's assessment takes into account the relevant amendments made to the Law on CNB by Law No 135/2014 Coll., Laws No 204/2015 Coll. and 375/2015 Coll. and Law No 377/2015 Coll. amending Law No 6/1993 Coll. on Česká národní banka and other related laws.[153] It also takes into account Law No 78/2015 Coll., which has amended, inter alia, Article 23 of Law No 166/1993 Coll. on the Supreme Audit Office (hereinafter the "Law on NKU"). The comment regarding compliance of the Law on NKU with Article 37 of the Statute has been removed. Article 23 of the Law on NKU now provides that the duty of confidentiality of Česká národní banka laid down in Article 37 of the Statute remains unaffected by the first sentence of Article 23, which provides for exemptions from the duty of confidentiality.

[151] Constitutional law No 1/1993 Coll.

[152] Law No 6/1993 Coll.

[153] In respect of Laws No. 135/2014 and 375/2015, see Opinion CON/2015/22.

In relation to the points identified in the ECB's Convergence Report of June 2014 which were not addressed by the above amendments, the comments made in that report are largely repeated, with the exception set out below.

7.2.2 Independence of the NCB

The comment regarding compliance with the principle of financial independence has been removed. Česká národní banka was faced with accumulated losses that were higher than its capital and reserve levels, which have been carried over for several years. A negative capital situation may adversely affect an NCB's ability to perform its ESCB-related tasks as well as its national tasks. At the end of 2015, Česká národní banka had positive net equity.

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

7.2.2.1 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.

7.2.2.2 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.

Pursuant to the Law on NKU, as amended, 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.

7.2.2.3 Personal independence

The Law on CNB, in particular Article 6, no longer refers to the Governor's right in case of dismissal to seek a remedy before the Court of Justice of the European Union in accordance with Article 14.2 of the Statute. The ECB understands that although the Law on CNB is now silent on the jurisdiction of the Court of Justice of the European Union to hear cases with regard to decisions to dismiss the Governor, Article 14.2 of the Statute applies.

The Law on CNB is also silent on the right of national courts to review a decision to dismiss any member, other than the Governor, of 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 could 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 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, where the FMGS does not have sufficient funds to perform its tasks and this situation might jeopardise the stability of the financial market. Article 33a of the Law on CNB has no provision requiring Česká národní banka to provide temporary loans or other types of repayable financial assistance in order to address an urgent situation. Even if such funding is discretionary, temporary and in the interests of financial stability, it should be expressly stipulated that the funding may be granted only in demonstrably urgent cases in order to be compatible with the monetary financing prohibition. Further, when exercising its discretion to grant a loan, Česká národní banka must ensure that it is not in effect taking over a government task. In particular, central bank support for deposit guarantee schemes should not amount to a systematic 'pre-funding' operation. For the reasons laid down in this paragraph, Article 33a of the Law on CNB should be amended to include more express safeguards in relation to the conditions under which Česká národní banka may finance the FMGS, in order to avoid incompatibility with the monetary financing prohibition under Article 123 of the Treaty.[154]

Article 34a of the Law on CNB aims at addressing defects highlighted in the ECB's Convergence Report in relation to the prohibition on monetary financing, but fails to provide for an exception to the monetary financing prohibition in favour of publicly owned credit institutions in the context of the supply of reserves. Article 34a(2) of the Law on CNB provides instead for an exception with reference to "publicly owned banks, foreign banks and credit unions". Article 34a(2) of the Law on CNB should be amended to reflect the text of Article 123(2) of the Treaty accordingly.

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.

7.2.4.1 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 6.2.2.1 but also to the secondary objective of the ESCB.

[154] See paragraphs 3.1.2 and 3.1.3 of CON/2015/22.

7.2.4.2 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.

7.2.4.3 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.

7.2.4.4 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.

7.2.4.5 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 and international financial institutions, does not recognise the ECB's powers in this field.

7.2.4.6 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 43e of the Law on CNB requires Česká národní banka to "ensure on-going protection of confidential statistical information obtained on the basis of this Law […] so that such information is used for statistical purposes only". While Article 43f(1)(a) of the Law on CNB expressly allows Česká národní banka to provide confidential statistical information to another member of the ESCB to the extent and at the level of detail necessary to perform ESCB tasks, in compliance with Article 8(4)(a) of

Council Regulation (EC) No 2533/98,[155] Article 43e of the Law on CNB should be redrafted so as not to contradict Article 43f(1)a of that Law.

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 Croatia

7.3.1 Compatibility of national legislation

The following legislation forms the legal basis for Hrvatska narodna banka and its operations:

- the Croatian Constitution,[156]
- the Law on Hrvatska narodna banka (hereinafter the "Law on HNB").[157]
- There have been no changes in relation to the points identified in the ECB's Convergence Report of June 2014, and those comments are therefore repeated in this year's assessment.

7.3.2 Independence of the NCB

With regard to Hrvatska narodna banka's institutional independence, the Law on HNB needs to be adapted as set out below.

155 Council Regulation (EC) No 2533/98 of 23 November 1998 concerning the collection of statistical information by the European Central Bank (OJ L 318, 27.11.1998, p. 8).

156 Constitution of the Republic of Croatia, OG 5/2014. - Decision of the Constitutional Court No SuP-O-2014 of 14 January 2014.

157 Law on Hrvatska narodna banka OG 75/2008 of 01 July 2008. Amendments to the Law on Hrvatska narodna banka OG 54/2013 of 7 May 2013.

7.3.2.1 Institutional and personal independence

Article 71 of the Law on HNB partially mirrors Article 130 of the Treaty and Article 7 of the Statute. In particular Article 71(2) of the Law on HNB does not expressly prohibit the Croatian Government from seeking to influence the members of Hrvatska narodna banka's decision-making bodies in the performance of their tasks. In this respect the Law on HNB needs to be adapted to be fully consistent with Article 130 of the Treaty and Article 7 of the Statute.

7.3.3 Legal integration of the NCB into the Eurosystem

With regard to the legal integration of Hrvatska narodna banka into the Eurosystem, the Law on HNB needs to be adapted in the respects set out below.

7.3.3.1 International cooperation

Pursuant to Article 104(11) of the Law on HNB, the Hrvatska narodna banka's Council decides on Hrvatska narodna banka's membership of international institutions and organisations. The ECB understands that this power of the Hrvatska narodna banka's Council is without prejudice to the ECB's powers under Article 6(1) of the Statute.

7.3.4 Conclusions

The Law on HNB does not comply with all the requirements for central bank independence. Croatia is a Member State with a derogation and must therefore comply with all adaptation requirements under Article 131 of the Treaty.

7.4 Hungary

7.4.1 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,[158]
- Law CXXXIX of 2013 on the Magyar Nemzeti Bank (hereinafter the "Law on the MNB").[159]

[158] Magyarország Alaptörvénye, Magyar Közlöny 2013/163. (X.3.).

There have been no major changes in relation to the points identified in the ECB's Convergence Report of June 2014, and those comments are therefore repeated in this year's assessment. In relation to the Law on the MNB, and the number and combined effects of amendments to the Law on the MNB, which has been amended more than ten times since the ECB's Convergence Report of June 2014, there are additional points made in this year's assessment.

7.4.2 Independence of the NCB

With regard to the Magyar Nemzeti Bank’s independence, the Law on the MNB and Law XXVII of 2008[160] need to be adapted as set out below.

7.4.2.1 Institutional independence

The legislation and institutional framework regarding the Magyar Nemzeti Bank have been changed many times over the course of the past years.[161] The latest recast of the Law on the MNB, which entered into force on 1 October 2013, resulted in 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.[162] Further recent amendments concerned the allocation of new tasks to the Magyar Nemzeti Bank, such as: resolution tasks[163]; supervisory tasks involving the verification of compliance with the new legal measures applicable to consumer loan contracts[164]; mediation of complaints and the initiation of legal proceedings in the public interest.[165] 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 for the need to amend the Magyar Nemzeti Bank’s institutional framework, adversely affect the organisational and governance stability of the Magyar Nemzeti Bank and impact its institutional independence. The principle of central bank independence requires that a central bank has a stable legal framework to enable it to function.

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159 2013. évi CXXXIX. törvény a Magyar Nemzeti Bankról, 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.

160 Law XXVII of 2008 on the oath of certain public officials.

161 There have been several changes in the institutional framework for the Magyar Nemzeti Bank as identified in the ECB’s Convergence Report of June 2014, Chapter 6.5, p. 245, footnote 44. In addition to the changes referred to in the Convergence Report of June 2014, there have been further changes in the institutional framework for the Magyar Nemzeti Bank as follows. In 2014 Law XVI of 2014 made further amendments to the Law on the Magyar Nemzeti Bank. Further legislative amendments to the Law on the MNB were introduced by Law XVI of 2014, Law XXV of 2014, Law XXXVII of 2014, Law CI of 2014, Law CIV of 2014, Law XXXIX of 2015, Law LXXXV of 2015, Law CI of 2015, Law CLXII of 2015, Law CCXIV of 2015 and Law CCXV of 2015.

162 See Articles 176 to 183 of the Law on the MNB as well as ECB Opinions CON/2013/56 and CON/2013/71.

163 Law XXXVII of 2014.

164 Law XL of 2014.

165 Law XL of 2014 and Law LXXXV of 2015.

7.4.2.2 Personal independence

The ECB's Convergence Reports of 2010, 2012 and 2014 noted that Law XXVII of 2008 specifies the wording of the oath that the members of the Monetary Council – including the Governor – are required to take. Pursuant to Article 9(7), in conjunction with Articles 10(3) and 11(2) of the Law on the MNB which entered into force on 1 October 2013, 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.[166] Therefore, it is not clear whether the Governor and Deputy Governors take the same oath as the other members of the Monetary Council.

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.[167]

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 entities[168] 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[169]; (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

[166] Law XXVII of 2008 on the oath of certain public officials. 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!"

[167] Law XXVII of 2008 was amended by Law XIV of 2014, but these changes do not affect the assessment of the Hungarian law laid down in this section.

[168] These entities are voluntary mutual insurance funds, private pension funds, cooperative credit institutions and insurance associations.

[169] 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.

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 owned by the Magyar Nemzeti Bank. Furthermore, pursuant to Article 153(6) of the Law on the MNB[170], 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 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 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.[171] 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.

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[170] As introduced by Law LXXXV of 2015 on amendments to specific acts in order to enhance the development of the system of financial intermediation, 2015. évi LXXXV.

[171] Introduced to Article 156(7) of the Law CXXXIX of 2013 by Article 174 of Law LXXXV of 2015.

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(2) of the Law on the MNB, in the case 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 adapted so that 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.[172]

7.4.2.3 Financial independence

Article 183 read in conjunction with Article 176 of the Law on the MNB provides that on 1 October 2013 all employees of the HFSA are to be employees of the Magyar Nemzeti Bank and that the Magyar Nemzeti Bank is to bear the financial obligations arising from any employment relations which HSFA 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 impedes the Magyar Nemzeti Bank’s ability to decide on employing and retaining necessary and qualified staff for the Magyar Nemzeti Bank. See, also, the following Section regarding compatibility with the prohibition on monetary financing.

As noted in the section on institutional independence, recently the Magyar Nemzeti Bank has been entrusted with several new tasks. The legal provisions entrusting the Magyar Nemzeti Bank with several new tasks that require additional human and financial resources within a relatively short period of time may be seen as an instrument to influence the Magyar Nemzeti Bank's ability to fulfil its mandate, both operationally and financially. Therefore, this raises concerns as regards the provisions' compliance with the principle of financial independence. Any allocation of new tasks should be supplemented by provisions regarding the necessary resources to carry them out.[173]

[172] See paragraphs 2.3 to 2.5 of the Opinion CON/2014/8.

[173] See paragraph 2.2 of Opinion CON/2014/62 and paragraph 3.4 of Opinion CON/2014/72.

7.4.3 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 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,[174] 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)[175]. 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 will have 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 which 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 are not

[174] See, for example, paragraph 9.3 of Opinion CON/2011/104.

[175] See also footnote 42.

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 current provisions of the Law on the MNB involve 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. 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 member and the HFSA, in light of the mass redundancy scheme provided for under Article 183(10) of the Law on the MNB.

In addition, the ECB in the 2015 Annual Report[176] addresses some other monetary financing concerns in relation to the activities and operations of the Magyar Nemzeti Bank.

7.4.4 Single spelling of the euro

In several Hungarian legal acts[177] 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.[178]

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.

7.4.5 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.

176 Published on the ECB's website.

177 For example, the Laws on the 2015 general budget in Hungary.

178 Opinion CON/2006/55.

7.4.5.1 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. 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.

7.4.5.2 Tasks

Monetary policy

Article 41 of the Fundamental Law of Hungary and Articles 1(2), 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(7) 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, Article 1(2), as well as Articles 30 and 171(1) 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 27 and 28, and Article 171(2) and (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, 23 to 26 and Article 171(1) of the Law 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.

7.4.5.3 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 his or her 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) of the Law on the MNB and Law C of 2000,[179] in conjunction with Government Decree 221/2000 (XII.19),[180] 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.

7.4.5.4 Exchange rate policy

Article 1(2), 4(4) and (12), Articles 9, 22 and 147 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.

7.4.5.5 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

[179] A számvitelről szóló törvény, Magyar Közlöny 2000/95. (IX. 21.).

[180] A Magyar Nemzeti Bank éves beszámoló készítési és könyvvezetési kötelezettségének sajátosságairól szóló kormányrendelet, Magyar Közlöny 2000/125. (XII.19.).

recognise the ECB's powers as far as issues under Article 6 of the Statute are concerned.

7.4.5.6 Miscellaneous

Articles 75 and 76 of the Law on the MNB do not recognise the ECB's powers to impose sanctions.

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 6.5.2.2, 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.[181]

7.4.6 Conclusions

The Fundamental Law of Hungary, the Law on the MNB and Law XXVII of 2008 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.

7.5 Poland

7.5.1 Compatibility of national legislation

The following legislation forms the legal basis for Narodowy Bank Polski and its operations:

- the Polish Constitution,[182]
- the Law on Narodowy Bank Polski (hereinafter the "Law on NBP"),[183]
- the Law on the Bank Guarantee Fund,[184]

[181] See paragraph 3.7 of Opinion CON/2008/83.

[182] Konstytucja Rzeczypospolitej Polskiej of 2 April 1997, Dziennik Ustaw of 1997, No 78, item 483.

[183] Ustawa o Narodowym Banku Polskim of 29 August 1997. Consolidated version published in Dziennik Ustaw of 2013, item 908, with further amendments.

- the Law on banking (hereinafter the “Law on banking”),[185]
- the Law on settlement finality in the payment and settlement systems and on the supervision of such systems. [186]

No major new legislation has been enacted in relation to the points identified in the ECB’s Convergence Report of June 2014, and those comments are therefore largely repeated in this year’s assessment.

7.5.2 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 Tribunal[187] need to be adapted in the respects set out below.

7.5.2.1 Institutional independence

The Law on NBP does not prohibit Narodowy Bank Polski and members of its decision-making bodies from seeking or taking outside instructions; it also does not expressly prohibit the Government from seeking to influence members of Narodowy Bank Polski’s decision-making bodies in situations where this may have an impact on Narodowy Bank Polski’s fulfilment of its ESCB-related tasks. In this respect, the Law on NBP needs to be adapted to comply with Article 130 of the Treaty and Article 7 of the Statute. Furthermore, the Polish Constitutional Court has confirmed[188] that, while the Polish Constitution does not expressly lay down the principle of Narodowy Bank Polski's central bank independence, such principle can be implicitly derived from the Constitution's provisions relating to Narodowy Bank Polski. Making explicit provision for this principle in the Polish Constitution on the occasion of a future amendment could increase legal certainty.

Article 11(3) of the Law on NBP, which provides that Narodowy Bank Polski’s President 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.

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184 Ustawa o Bankowym Funduszu Gwarancyjnym of 14 December 1994. Consolidated version published in Dziennik Ustaw of 2014, item 1866, with further amendments.

185 Ustawa Prawo bankowe of 29 August 1997. Consolidated version published in Dziennik Ustaw of 2015, item 128, with further amendments.

186 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 2013, item 246, with further amendments.

187 Ustawa o Trybunale Stanu of 26 March 1982; consolidated version published in Dziennik Ustaw of 2002, No 101, item 925, with further amendments.

188 Judgment of 16 July 2009 of the Polish Constitutional Court. Kp 4/08.

Article 23(1)(2) of the Law on NBP, which obliges Narodowy Bank Polski's President 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 all public 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,[189] 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 "efficacy criterion" does not extend to an evaluation of Narodowy Bank Polski's activities related to its primary objective of price stability.[190] Article 203(1) of the Constitution needs to be adapted to comply with Article 130 of the Treaty and Article 7 of the Statute.

7.5.2.2 Personal independence

Article 9(5) of the Law on NBP regulates the dismissal of Narodowy Bank Polski's President by the Sejm (lower house of Parliament), 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,[191]
- been prohibited by the State Tribunal from occupying executive positions or holding posts of particular responsibility in state bodies.[192]

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 President may also be removed from office if he or she violates the Constitution or a law.[193]

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[189] For the activities of the NCB's independent external auditors see, as an example, Article 27.1 of the Statute.

[190] See paragraph 3.6 of Opinion CON/2011/9.

[191] 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 2007, No 63, item 425).

[192] The resolution of the Sejm producing an indictment of the President of Narodowy Bank Polski before the State Tribunal results, by operation of law, in suspension of the President from office (Article 11(1), second sentence in connection with Article 1(1)(3) of the Law on the State Tribunal).

[193] The indictment by the Sejm of the President of Narodowy Bank Polski before the State Tribunal results, by operation of law, in suspension of the President from office, see previous footnote.

The grounds listed above are in addition to the two grounds for dismissal provided for in Article 14.2 of the Statute. Therefore, Article 9(5) of the Law on NBP and the relevant provisions of the Law on the State Tribunal need to be adapted to comply 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 President, 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 disclosure declaration as confirmed by a final court judgment,[194]
- non-suspension of membership of a political party or trade union.

The grounds listed above are in addition to the two grounds for dismissal provided for in Article 14.2 of the Statute. Article 13(5) of the Law on NBP therefore needs to be adapted to comply with Article 14.2 of the Statute. Article 14(3) of the Law on NBP, which reaffirms the possibility of dismissal of a member of the Monetary Council of Narodowy Bank Polski for a conviction for a criminal offence, needs also to be adapted to comply with Article 14.2 of the Statute.

The President 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 President, needs to be adapted to reflect the status and the obligations and duties of the President 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, other than the President, 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, providing specifically for such a right of review could increase legal certainty.

[194] 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 2007, No 63, item 425).

7.5.3 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”.[195] 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.[196]

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 Chapter 7.5.2.1, 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 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.

7.5.4 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.[197] In addition, Article 42(3) of the Law on NBP allows Narodowy Bank Polski to grant refinancing credit for the purpose of implementing bank rehabilitation proceedings, which are initiated in the event of a bank suffering a net loss, being threatened with such a loss or insolvency.[198] 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.[199] 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

[195] Article 23(7)(3) of the Law on NBP.

[196] See Opinion CON/2008/53.

[197] 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).

[198] Article 142(1) of the Law on banking.

[199] Article 42(7) of the Law on NBP.

undergoing rehabilitation proceedings which then becomes insolvent.[200] 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.[201] 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 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 Regulation (EC) No 3603/93, is directly applicable, so in general, it is unnecessary to transpose it into national legislation.

7.5.5 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.

7.5.5.1 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 secondary objective of supporting the general economic policies of the Union.

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200 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).

201 See Opinion CON/2013/5.

7.5.5.2 Tasks

Monetary policy

Article 227(1) and (5) 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.

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.

7.5.5.3 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.

7.5.5.4 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.

7.5.5.5 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.

7.5.5.6 Miscellaneous

Article 9(3) of the Law on NBP, which specifies the wording of the oath sworn by Narodowy Bank Polski's President, 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.

7.5.6 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.[202]

[202] For a detailed review of necessary adaptations of the Constitution, the Law on NBP and other laws, see Opinion CON/2011/9.

7.6 Romania

7.6.1 Compatibility of national legislation

The following legislation forms the legal basis for Banca Naţională a României and its operations:

- Law No 312 on the Statute of Banca Naţională a României (hereinafter the "Law on BNR").[203]

There have been no changes in relation to the points identified in the ECB's Convergence Report of June 2014 concerning the Law on BNR, and therefore those comments are repeated in this year's assessment.

7.6.2 Independence of the NCB

With regard to Banca Naţională a României's independence, the Law on BNR and other legislation needs to be adapted in the respects set out below.

7.6.2.1 Institutional independence

Article 3(1) of the Law on BNR provides that, when carrying out their tasks, Banca Naţională a României and the members of its decision-making bodies may not seek or take instructions from public authorities or from any other institution or authority. The ECB understands that the provision encompasses both national and foreign institutions in line with Article 130 of the Treaty and Article 7 of the Statute. For legal certainty reasons, the next amendment to the Law on BNR should bring this provision fully in line with Article 130 of the Treaty and Article 7 of the Statute.

Further, Article 3 of the Law on BNR does not expressly prohibit the Government from seeking to influence the members of Banca Naţională a României's decision-making bodies in situations where this may have an impact on Banca Naţională 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.

7.6.2.2 Personal independence

Article 33(9) of the Law on BNR provides that an appeal may be brought to the High Court of Cassation and Justice against a decision to recall from office a member of the Board of Banca Naţională a României within 15 days of its publication in Monitorul Oficial al României. The Law on BNR is silent on the jurisdiction of the

[203] Monitorul Oficial al României, Part One, No 582, 30.6.2004.

Court of Justice of the European Union to hear cases with regard to the dismissal of the Governor. The ECB understands that in spite of this silence, Article 14.2 of the Statute applies.

Article 33(7) of the Law on BNR provides that no member of the Board of Banca Naţională 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,[204] and Law 176/2010 on the integrity in the exercise of public functions and dignities,[205] define the conflicts of interest and incompatibilities applicable to the Governor and the other members of the Board of Banca Naţională 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 incompatibility[206] do not constitute new grounds for dismissal of the Governor or other members of the Board of Banca Naţională a României in addition to those contained in Article 33 of the Law on BNR. For legal certainty reasons and in line with Article 33 of the Law on BNR, a clarification to this end in the above-mentioned Laws would be welcome.

7.6.2.3 Financial independence

Article 43 of the Law on BNR provides that each month, Banca Naţională 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. As noted in Chapter 7.6.4, this arrangement may in certain circumstances amount to an intra-year credit, which in turn may undermine the financial independence of Banca Naţională a României.

A Member State may not put its NCB in a position where it has insufficient financial resources to carry out its ESCB or Eurosystem-related tasks, and also its own national tasks, such as financing its administration and own operations.

Article 43(3) of the Law on BNR also provides that Banca Naţională 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.

204 Published in Monitorul Oficial al României, Part One, No 279, 21.4.2003.

205 Published in Monitorul Oficial al României, Part One, No 621, 2.9.2010.

206 According to the relevant provisions of Article 99 of Law 161/2003, if a member of the Board of Banca Naţională a României or an employee occupying a leading position with Banca Naţională 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.

Article 43 of the Law on BNR should therefore be adapted, in addition to taking into account the issues highlighted in Chapter 7.6.4, to ensure that such arrangement does not undermine the ability of Banca Naţională a României to carry out its 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,[207] the Court of Auditors is empowered to control the establishment, management and use of the public sector's financial resources, including Banca Naţională a României's financial resources, and to audit management of the funds of Banca Naţională 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 Naţională 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 Naţională 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 Naţională a României.[208]

7.6.3 Confidentiality

Pursuant to Article 52(2) of the Law on BNR, the Governor may release confidential information on the four grounds listed under Article 52(2) of that Law. 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.

7.6.4 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 Naţională 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 Naţională a României is prohibited from granting overdraft facilities or any other type of credit facility to the State, central and local public 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

[207] Published in Monitorul Oficial al României, Part One, No 238, 3.4.2014.

[208] For the activities of the NCB's independent external auditors see, as an example, Article 27.1 of the Statute.

needs to be extended to be consistent with and fully mirror Article 123 of the Treaty and aligned with the definitions contained in Regulation (EC) No 3603/93.

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 Naţională a României in the same way as any other credit institution eligible under Banca Naţională a României's regulations. The wording of Article 7(3) of the Law on BNR should be aligned 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".

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 Naţională 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 Naţională 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 Naţională 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 loss 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 Naţională 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 Naţională 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.

7.6.5 Legal integration of the NCB into the Eurosystem

With regard to Banca Naţională a României's legal integration into the Eurosystem, the Law on BNR needs to be adapted in the respects set out below.

7.6.5.1 Economic policy objectives

Article 2(3) of the Law on BNR provides that, without prejudice to the primary objective of price stability, Banca Naţională 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 secondary objective of supporting the general economic policies of the Union.

7.6.5.2 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 Naţională 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 Naţională 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 Naţională 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 Naţională 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 Naţională a României's role in issuing banknotes and coins, do not recognise the Council's and the ECB's powers in this field.

7.6.5.3 Financial provisions

Appointment of independent auditors

Article 36(1) of the Law on BNR, which provides that the annual financial statements of Banca Naţională 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 Naţională 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 Naţională 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 Naţională 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 Naţională 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 Naţională a României's obligation to comply with the Eurosystem's regime for financial reporting of NCB operations, pursuant to Article 26 of the Statute.

7.6.5.4 Exchange rate policy

Article 2(2)(a) and (d), Article 9 and Article 33(1)(a) of the Law on BNR, which empower Banca Naţională 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 Naţională 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.

7.6.6 Miscellaneous

With regard to Article 3(2) of the Law on BNR, which entitles Banca Naţională a României to be consulted on draft national legislation, consulting Banca Naţională 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 Naţională 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.

7.6.7 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.

7.7 Sweden

7.7.1 Compatibility of national legislation

The following legislation forms the legal basis for Sveriges Riksbank and its operations:

- the Instrument of Government,[209] which forms part of the Swedish Constitution,
- the Law on Sveriges Riksbank,[210]
- the Law on exchange rate policy.[211]

There have been no major changes to the Law on Sveriges Riksbank in relation to the points identified in the ECB's Convergence Report of May 2014, and those comments are therefore largely repeated in this year's assessment.

7.7.2 Independence of the NCB

With regard to Sveriges Riksbank's independence, the Law on Sveriges Riksbank needs to be adapted in the respects set out below.

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[209] SFS 1974:152.

[210] SFS 1988:1385.

[211] SFS 1998:1404.

7.7.2.1 Institutional independence

Article 13 of Chapter 9 of the Instrument of Government states that Sveriges Riksbank is an authority under the Riksdag. Article 2 of Chapter 3 of the Law on Sveriges Riksbank, which prohibits the members of the Executive Board from seeking or taking of instructions, and Article 13 of Chapter 9 of the Instrument of Government, which prohibits any authority from giving instructions to Sveriges Riksbank, do not cover all ESCB-related tasks, as required by Article 130 of the Treaty and Article 7 of the Statute.

Although the explanatory memorandum to the Law on Sveriges Riksbank extends the coverage to all ESCB-related tasks, it would be beneficial if this issue and the relation with Article 13 of Chapter 9 of the Instrument of Government were addressed in the next amendments to the relevant provisions of Swedish legislation.

In addition, pursuant to Article 13(1) of Chapter 8 of the Instrument of Government, the Parliament may direct Sveriges Riksbank in an act of law within its sphere of responsibility under Chapter 9 (Financial power) to adopt provisions concerning its duty to promote secure and efficient payment systems. The ECB understands that this provision only enables the Parliament to assign the adoption of regulations to Sveriges Riksbank within the Sveriges Riksbank's areas of responsibility for promoting secure and efficient payment systems.

Article 3 of Chapter 6 of the Law on Sveriges Riksbank, which establishes the right of the minister appointed by the Swedish Government to be informed prior to Sveriges Riksbank making a monetary policy decision of major importance, could potentially breach the prohibition on giving instructions to the NCBs pursuant to Article 130 of the Treaty and Article 7 of the Statute. Article 3 of Chapter 6 of the Law on Sveriges Riksbank is therefore incompatible with central bank independence and should be adapted accordingly.

7.7.2.2 Financial independence

In accordance with Article 3 of Chapter 10 of the Law on Sveriges Riksbank, the General Council of Sveriges Riksbank submits proposals to the Swedish Parliament and the Swedish National Audit Office on the allocation of Sveriges Riksbank's profit. Pursuant to Article 4 of Chapter 10 of the Law on Sveriges Riksbank, the Swedish Parliament then determines the allocation of Sveriges Riksbank's profit. These provisions are supplemented by non-statutory guidelines on profit distribution, which state that Sveriges Riksbank should pay 80% of its profit to the Swedish State, after adjustment for exchange rate and gold valuation effects and based on a five-year average, with the remaining 20% used to increase its own capital. However, these guidelines are not legally binding and there is no statutory provision limiting the amount of profit that may be paid out.

The present arrangements on profit distribution are under review.[212] However, as they currently stand, they are incompatible with the requirement of central bank independence in Article 130 of the Treaty and Article 7 of the Statute. To safeguard Sveriges Riksbank's financial independence, statutory provisions should be adopted containing clear provisions concerning the limitations applicable to the Swedish Parliament's decisions on Sveriges Riksbank's profit allocation.

7.7.3 Monetary financing prohibition

Article 1(3) of Chapter 8 of the Law on Sveriges Riksbank provides that Sveriges Riksbank may not extend credit or purchase debt instruments directly from the State, another public body or a Union institution. Although the explanatory memorandum to the Law on Sveriges Riksbank, which according to Swedish legal tradition will be closely followed by Swedish courts when interpreting national legislation, states that the coverage is extended to Union bodies and the public sector including public undertakings of other Member States, it would be beneficial if this issue could be addressed when the Law on Sveriges Riksbank is next amended, to bring it fully in line with Article 123 of the Treaty.

In addition, Article 1(4) of Chapter 8 of the Law on Sveriges Riksbank provides that "subject to other provisions in this Law, the Riksbank may also grant credit to and purchase debt instruments from financial institutions owned by the State or another public body". The wording of Article 1(4) of Chapter 8 of the Law on Sveriges Riksbank should be aligned with the wording of Article 123(2) of the Treaty, which only exempts publicly owned credit institutions from the prohibition on monetary financing in respect of the supply of reserves by central banks; the central bank may not supply reserves to other public financial institutions. In the same vein, the range of public sector entities would need to be made consistent with Article 123(2) of the Treaty, and the ECB suggests, for reasons of legal certainty, inserting a reference to Article 123 of the Treaty in Article 1 of Chapter 8 of the Law on Sveriges Riksbank.

As noted above, the provisions of the Law on the allocation of Sveriges Riksbank's profit are supplemented by non-statutory guidelines on profit distribution, that are not legally binding, and state that Sveriges Riksbank should pay 80% of its profit to the Swedish State, after adjustment for exchange rate and gold valuation effects and based on a five-year average, with the remaining 20% used to increase its own capital. It is essential for the five-year average rule to be applied in a way which remains consistent with the prohibition on monetary financing under Article 123 of the Treaty, i.e. only as a calculation method and a cap for the NCB's profit distribution to the State budget. Statutory provisions providing for necessary limitations and ensuring that a breach of the monetary financing prohibition may not occur in this respect should also be adopted. To comply with the monetary financing prohibition, the amount distributed to the State budget pursuant to the applicable

[212] See Opinion CON/2013/53.

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.

7.7.4 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.

7.7.4.1 Economic policy objectives

Article 2 of Chapter 1 of the Law on Sveriges Riksbank provides that Sveriges Riksbank's objective is to maintain price stability. It also provides that Sveriges Riksbank promotes a safe and efficient payments system. The ECB notes that insofar as this is a task and not an objective of the Sveriges Riksbank, there is no need to subordinate it to the ESCB's primary and secondary objectives. In any case, Article 2 should reflect the ESCB's secondary objective of supporting the general economic policies of the Union in line with Article 127(1) of the Treaty and Article 2 of the Statute.

7.7.4.2 Tasks

Article 1 of Chapter 1 of the Law on Sveriges Riksbank, which provides that Sveriges Riksbank may only conduct, or participate in, such activities for which it has been authorised by Swedish law, is incompatible with the provisions of the Treaty and the Statute as it does not provide for Sveriges Riksbank's legal integration into the Eurosystem.

Monetary policy

Article 13 of Chapter 9 of the Instrument of Government and Article 2 of Chapter 1 of the Law on Sveriges Riksbank, which establish Sveriges Riksbank's powers in the field of monetary policy, do not recognise the ECB's powers in this field.

Articles 2, 5 and 6 of Chapter 6 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 6 of Chapter 6 and Articles 1 and 2a of Chapter 11 of the Law on Sveriges Riksbank, concerning the imposition of minimum reserves on financial institutions and the payment of a special fee to the Swedish State in the event of a breach of this requirement, do not recognise the ECB's powers in this field.

Collection of statistics

Article 4(2) and Articles 9, 10 and 11[213] of Chapter 6 of the Law on Sveriges Riksbank, which establish Sveriges Riksbank's powers relating to the collection of statistics, do not recognise the ECB's powers in this field.

Official foreign reserve management

Chapter 7 of the Law on Sveriges Riksbank, and Article 12 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 14(2) of Chapter 9 of the Instrument of Government and Article 2 of Chapter 1 and Article 7 of Chapter 6 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 5 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.

7.7.4.3 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.

7.7.4.4 Exchange rate policy

Article 12 of Chapter 9 of the Instrument of Government and Chapter 7 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

[213] These articles have been introduced in Chapter 6 of the Law on Sveriges Riksbank by amendments which entered into force in June 2014 (SFS 2014:485).

rate policy. These provisions do not recognise the Council's and the ECB's powers in this field.

7.7.4.5 International cooperation

Pursuant to Article 6 of Chapter 7 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.

7.7.4.6 Miscellaneous

With regard to Article 4 of Chapter 2 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 Act [214] 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.

7.7.5 Conclusions

The Law on Sveriges Riksbank, the Constitution 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 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. Over the years no legislative action has been taken by the Swedish authorities to remedy the incompatibilities described in this and previous reports.

[214] SFS 2009:400.

Glossary

Acquis communautaire: the body of EU legislation, including its interpretation by the Court of Justice of the European Union, by which all EU Member States are bound.

Alert Mechanism Report: the first step of the EU's new surveillance procedure for preventing and correcting macroeconomic imbalances. In the report, the European Commission identifies EU Member States that will be subject to further in-depth analysis under the **macroeconomic imbalance procedure**.

Banking union: one of the building blocks for completing Economic and Monetary Union, which consists of an integrated financial framework with a single rulebook, a **Single Supervisory Mechanism**, common deposit protection and a single bank resolution mechanism.

Central government: the government as defined in the **European System of Accounts 2010**, but excluding regional and local governments (see also **general government**). The term includes all administrative departments of the (central) state and other central agencies whose competence extends over the entire economic territory, except for the administration of social security funds.

Central rate: the exchange rate of each **ERM II** member's currency vis-à-vis the euro, around which the ERM II fluctuation margins are defined.

Combined direct and portfolio investment balance: the sum of the direct investment balance and the portfolio investment balance in the financial account of the balance of payments. Direct investment is cross-border investment for the purpose of acquiring a lasting interest in an enterprise resident in another economy (assumed, in practice, for ownership of at least 10% of ordinary shares or voting power). This includes equity capital, reinvested earnings and "other capital" associated with inter-company operations. Portfolio investment includes equity securities (when not a direct investment) and debt securities (bonds and notes, and money market instruments).

Contingent liabilities: government obligations that arise only upon the realisation of particular events (e.g. state guarantees).

Convergence criteria: the criteria set out in Article 140(1) of the **Treaty** (and developed further in Protocol (No 13) on the convergence criteria) that must be fulfilled by each EU Member State before it can adopt the euro. They relate to performance in respect of price stability, government financial positions, exchange rates and long-term interest rates. The reports produced under Article 140(1) by the European Commission and the European Central Bank examine whether a high degree of sustainable convergence has been achieved by each EU Member State on the basis of its fulfilment of these criteria, in addition to examining the compatibility of their national legislation, including the statute of their respective **national central bank**, with the **Treaties**.

Convergence programme: a programme outlining the path towards the achievement of **reference values** indicated in the **Treaty**, containing medium-term government plans and assumptions regarding the development of key economic variables. Measures to consolidate fiscal balances are also highlighted, together with underlying economic scenarios. Convergence programmes normally cover the following three to four years and are updated annually. They are examined by the European Commission and the Economic and Financial Committee, whose reports serve as the basis for an assessment by the ECOFIN Council. Following the start of Stage Three of **Economic and Monetary Union**, EU Member States with a derogation continue to submit convergence programmes, whereas countries which are members of the euro area present annual stability programmes, in accordance with the **Stability and Growth Pact**.

Current transfers: transfers of the **general government** (e.g. relating to international cooperation), payments of current taxes on income and wealth, and other transfers, such as workers' remittances, which are not related to capital expenditure; they also include production and import subsidies, social benefits and transfers to EU institutions.

Cyclical component of the budget balance: the effect on the budget balance of the output gap, as estimated by the European Commission.

Debt ratio (general government): general government debt is defined as total gross debt at nominal value outstanding at the end of the year and consolidated between and within the sectors of general government. The government debt-to-GDP ratio is defined as the ratio of general government debt to GDP at current market prices. It is the subject of one of the fiscal criteria used to define the existence of an excessive deficit, as laid down in Article 126(2) of the **Treaty**.

Deficit-debt adjustment: the difference between the **general government** budget balance (government deficit or surplus) and the change in general government debt. Such adjustments may stem from, among other things, changes in the amount of financial assets held by the government, revaluations or statistical adjustments.

Deficit ratio (general government): the **general government** deficit is defined as net borrowing and corresponds to the difference between general government revenue and general government expenditure. The deficit ratio is defined as the ratio of the general government deficit to GDP at current market prices. It is the subject of one of the fiscal criteria used to define the existence of an excessive deficit, as laid down in Article 126(2) of the **Treaty**.

Economic and Monetary Union (EMU): the outcome of the process for the harmonisation of the economic policies of the EU Member States that led to the single currency, the euro, and the single monetary policy of the euro area. The process for achieving EMU, as laid down in the Treaty on European Union, involved three stages. Stage Three, the final stage, began on 1 January 1999 with the irrevocable fixing of exchange rates, the transfer of monetary competence to the European Central Bank and the introduction of the euro. The cash changeover on 1 January 2002 completed the process of setting up EMU.

Effective exchange rate (EER) (nominal/real): a weighted average of the bilateral exchange rates of a country's currency against the currencies of major trading partners. The weights used reflect the share of each partner country in the trade of the country under consideration and account for competition in third markets. The real EER is the nominal EER deflated by a weighted average of foreign prices relative to domestic prices.

Elderly dependency ratio: the proportion of the population of a country aged 65 and over in relation to the population aged 15 to 64.

ERM II (exchange rate mechanism II): the exchange rate mechanism which provides the framework for exchange rate policy cooperation between the **euro area** countries and the non-euro area EU Member States. ERM II is a multilateral arrangement with fixed, but adjustable, central rates and a standard fluctuation band of ±15% within which currencies are allowed to fluctuate. Decisions concerning central rates and, possibly, narrower fluctuation bands are taken by mutual agreement between the EU Member State concerned, the euro area countries, the European Central Bank (ECB) and the other EU Member States participating in the mechanism. All participants in ERM II, including the ECB, have the right to initiate a confidential procedure aimed at a realignment of the central rates.

ERM II fluctuation margins: the mutually agreed floor and ceiling within which **ERM II** member currencies are allowed to fluctuate against the euro.

Euro area: the area formed by the EU Member States whose currency is the euro and in which a single monetary policy is conducted under the responsibility of the **Governing Council of the European Central Bank**. The euro area currently comprises Belgium, Germany, Estonia, Ireland, Greece, Spain, France, Italy, Cyprus, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Austria, Portugal, Slovenia, Slovakia and Finland.

European System of Accounts 2010 (ESA 2010): a comprehensive and integrated system of macroeconomic accounts based on a set of internationally agreed statistical concepts, definitions, classifications and accounting rules aimed at achieving a harmonised quantitative description of the economies of the EU Member States. The ESA 2010 is the EU's version of the world System of National Accounts 2008 (2008 SNA).

European System of Central Banks (ESCB): composed of the European Central Bank (ECB) and the **national central banks (NCBs)** of all 28 EU Member States, i.e. it includes, in addition to the members of the **Eurosystem**, the NCBs of those EU Member States whose currency is not the euro. The ESCB is governed by the **Governing Council of the ECB** and the **Executive Board of the ECB**, and, as a third decision-making body of the ECB, by the **General Council of the ECB**.

European Systemic Risk Board (ESRB): an independent EU body responsible for the macroprudential oversight of the financial system within the EU. It contributes to the prevention or mitigation of systemic risks to financial stability that arise from developments within the financial system, taking into account macroeconomic developments, so as to avoid periods of widespread financial distress.

Eurostat: the Statistical Office of the EU. It is part of the European Commission and responsible for the production of EU statistics.

Eurosystem: the central banking system of the euro area. It comprises the European Central Bank and the **national central banks** of the EU Member States whose currency is the euro.

Excessive deficit procedure: the provisions set out in Article 126 of the **Treaty**, and specified in Protocol (No 12) on the excessive deficit procedure, require EU Member States to maintain budgetary discipline, define the criteria for a budgetary position to be considered an excessive deficit, and regulate steps to be taken following the observation that the requirements for the budgetary balance or government debt have not been fulfilled. Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure is also an element of the **Stability and Growth Pact**.

Excessive imbalance procedure: refers to the corrective arm of the **macroeconomic imbalance procedure**, which is initiated when excessive macroeconomic imbalances are identified in an EU Member State, including imbalances that jeopardise the proper functioning of **Economic and Monetary Union**. The procedure includes issuing policy recommendations, the preparation of a corrective action plan by the Member State concerned, enhanced surveillance and monitoring requirements and, in respect of EU Member States whose currency is the euro, the possibility of financial sanctions in the event of a failure to take corrective action.

Exchange rate volatility: a measure of the variability of exchange rates, usually calculated on the basis of the annualised standard deviation of daily percentage changes.

Executive Board of the ECB: one of the decision-making bodies of the European Central Bank (ECB). It comprises the President and the Vice-President of the ECB and four other members appointed by the European Council, acting by a qualified majority among the Heads of State or Government of the euro area member countries, on a recommendation from the Council of the European Union, after it has consulted the European Parliament and the ECB.

Fiscal compact: a part (Title III) of the **Treaty on Stability, Coordination and Governance in the Economic and Monetary Union** stipulates that the budgetary position of the **general government** of signatory Member States must be balanced or in surplus.

Funded and unfunded pension schemes: funded pension schemes are schemes that finance pension payments by drawing down on segregated and earmarked assets. These schemes can be exactly funded, under-funded or over-funded, depending on the size of the accumulated assets in relation to the pension entitlements. Unfunded pension schemes are schemes that finance current pension payments with the ongoing contributions paid by future pensioners and/or other ongoing revenue, such as taxes or transfers; unfunded schemes may hold sizeable assets (e.g. for liquidity reasons or as buffer funds).

General Council of the ECB: one of the decision-making bodies of the European Central Bank (ECB). It comprises the President and the Vice-President of the ECB and the governors of all the **national central banks** of the **European System of Central Banks**.

General government: a sector defined in the **European System of Accounts 2010** as comprising resident entities that are engaged primarily in the production of non-market goods and services intended for individual and collective consumption and/or in the redistribution of national income and wealth. Included are central, regional and local government authorities, as well as social security funds. Excluded are government-owned entities that conduct commercial operations, such as public enterprises.

Governing Council of the ECB: the supreme decision-making body of the European Central Bank (ECB). It comprises all the members of the **Executive Board of the ECB** and the governors of the **national central banks** of the EU Member States whose currency is the euro.

Gross external debt: the outstanding amount of an economy's financial liabilities that require payments of principal and/or interest at some point in the future to the rest of the world.

Harmonised Index of Consumer Prices (HICP): a measure of the development of consumer prices that is compiled by **Eurostat** and harmonised for all EU Member States.

Harmonised long-term interest rates: Article 4 of Protocol (No 13) on the convergence criteria requires interest rate convergence to be measured by means of interest rates on long-term government bonds or comparable securities, taking into account differences in national definitions. In order to fulfil the Treaty requirement, the European Central Bank has carried out conceptual work on the harmonisation of long-term interest rate statistics and regularly collects data from the **national central banks**, in cooperation with and on behalf of **Eurostat**. Harmonised data are used for the convergence examination in this report.

Interest-growth differential: the difference between the annual change in nominal GDP and the nominal average interest rate paid on outstanding government debt (the "effective" interest rate). The interest-growth differential is one of the determinants of changes in the government **debt ratio**.

International investment position (i.i.p.): the value and composition of an economy's outstanding financial claims on and financial liabilities to the rest of the world. The net i.i.p. is also referred to as the net external or foreign asset position.

Intervention at the limits: compulsory intervention by central banks if their currencies reach the floor or the ceiling of their **ERM II fluctuation margins**.

Intra-marginal intervention: intervention by a central bank to influence the exchange rate of its currency within its **ERM II fluctuation margins**.

Investment: gross fixed capital formation as defined in the **European System of Accounts 2010**.

Legal convergence: the process of adaptation by EU Member States of their legislation, in order to make it compatible with the **Treaties** and the **Statute** for the purposes of: (i) integrating their **national central banks (NCBs)** into the **European System of Central Banks**; and (ii) adopting the euro and making their NCBs an integral part of the **Eurosystem**.

Macroeconomic imbalance procedure (MIP): a procedure aimed at broadening the surveillance of economic policies of the EU Member States to include a detailed and formal framework to prevent and correct excessive imbalances and to help the EU Member States affected to establish corrective action plans before divergences become entrenched. The MIP is based on Article 121(6) of the **Treaty**. The first step of this surveillance procedure of the EU is the **Alert Mechanism Report**. The MIP has a preventive and a corrective arm. The latter is made operational by the **excessive imbalance procedure**.

Measures with a temporary effect: all non-cyclical effects on fiscal variables which (i) reduce (or increase) the **general government** deficit or gross debt (see also **debt ratio** and **deficit ratio**) in a specified period only (“one-off” effects), or (ii) improve (or worsen) the budgetary situation in a specified period at the expense (or to the benefit) of future budgetary situations (“self-reversing” effects).

National central bank (NCB): a central bank of an EU Member State.

Net capital expenditure: comprises a government’s final capital expenditure (i.e. gross fixed capital formation, plus net purchases of land and intangible assets, plus changes in stocks) and net capital transfers paid (i.e. investment grants, plus unrequited transfers paid by the **general government** sector to finance specific items of gross fixed capital formation by other sectors, minus capital taxes and other capital transfers received by the general government sector).

Non-cyclical factors: influences on a government budget balance that are not due to cyclical fluctuations (see the **cyclical component of the budget balance**). They can therefore result from either structural, i.e. permanent, changes in budgetary policies or from **measures with a temporary effect**.

Output gap: the difference between the actual and potential levels of output of an economy as a percentage of potential output. Potential output is calculated on the basis of the trend rate of growth of the economy. A positive output gap means that actual output is above the trend or potential level of output and suggests the possible emergence of inflationary pressures. A negative output gap signifies that actual output is below the trend or potential level of output and indicates the possible absence of inflationary pressures.

Primary balance: the **general government** sector’s net borrowing or net lending excluding interest payments on consolidated government liabilities.

Private sector credit flow: annual transactions on debt securities issued and loans taken out by non-financial corporations and households (including non-profit institutions serving households). The private sector credit flow-to-GDP ratio is defined as the ratio of private sector credit flow to GDP at current market prices.

Private sector debt: outstanding amounts at the end of the year of securities issued and loans taken out by non-financial corporations and households (including non-profit institutions serving households). The private sector debt-to-GDP ratio is defined as the ratio of private sector debt to GDP at current market prices.

Realignment: a change in the **central rate** of a currency participating in **ERM II**.

Reference period: the time interval specified in Article 140 of the **Treaty** and in Protocol (No 13) on the convergence criteria for examining progress towards convergence.

Reference value: Protocol (No 12) on the excessive deficit procedure sets explicit reference values for the **deficit ratio** (3% of GDP) and the debt ratio (60% of GDP), while Protocol (No 13) on the convergence criteria specifies the methodology for calculating the reference values for the examination of price and long-term interest rate convergence.

Single Supervisory Mechanism (SSM): a mechanism composed of the European Central Bank (ECB) and national competent authorities of participating EU Member States for the exercise of the prudential supervisory tasks conferred upon the ECB (in line with Article 127(6) of the **Treaty**) by the SSM Regulation (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 institution), which entered into force on 3 November 2013. The main aims of the SSM are to ensure the safety and soundness of credit institutions and the stability of the financial system within the EU and within each Member State. The ECB is responsible for the effective and consistent functioning of the SSM, which forms part of the **banking union**, and assumed its full supervisory tasks on 4 November 2014, i.e. 12 months after the Regulation entered into force. All euro area countries participate automatically in the SSM, and other EU Member States may participate by entering into close cooperation under the SSM Regulation.

Six pack: five regulations and one directive that entered into force on 13 December 2011 to strengthen the **Stability and Growth Pact**. The four fiscally-related legislative acts are aimed at strengthening budgetary surveillance and coordination of economic policies, speeding up and clarifying the implementation of the excessive deficit procedure, and ensuring the effective enforcement of budgetary surveillance in the euro area and the requirements for the fiscal frameworks of the Member States. The two macroeconomic-related legislative acts are aimed at preventing and correcting macroeconomic imbalances and at allowing enforcement action to correct excessive macroeconomic imbalances in the euro area.

Stability and Growth Pact: intended to serve as a means of safeguarding sound government finances in the EU Member States in order to strengthen the conditions for price stability and for strong, sustainable growth that is conducive to employment creation. The Stability and Growth Pact has two arms – a preventive arm and a corrective arm. The preventive arm prescribes that Member States specify medium-term budgetary objectives, while the corrective arm contains concrete specifications on the **excessive deficit procedure**.

Statute: refers to Protocol (No 4) on the Statute of the **European System of Central Banks** and of the European Central Bank, annexed to the **Treaties**.

Treaties: 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.

Treaty: 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.

Treaty of Lisbon (Lisbon Treaty): amended the EU's two core treaties, the Treaty on European Union and the Treaty establishing the European Community, and renamed the latter as Treaty on the Functioning of the European Union. The Treaty of Lisbon was signed in Lisbon on 13 December 2007 and entered into force on 1 December 2009.

Treaty on Stability, Coordination and Governance in the Economic and Monetary Union: an intergovernmental treaty, which was signed in Brussels on 2 March 2012 and entered into force on 1 January 2013. It contains a "fiscal compact", which complements and, in some areas, enhances key provisions of the **Stability and Growth Pact**. Among other things, the Treaty requires the Member States that have ratified it to enshrine a balanced budget in national law and increases the role of independent fiscal monitoring bodies.

Two-pack: two regulations on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area (Regulation (EU) No 473/2013), and on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability (Regulation (EU) 472/2013).

Abbreviations

Countries

BE	Belgium	**HR**	Croatia	**PL**	Poland
BG	Bulgaria	**IT**	Italy	**PT**	Portugal
CZ	Czech Republic	**CY**	Cyprus	**RO**	Romania
DK	Denmark	**LV**	Latvia	**SI**	Slovenia
DE	Germany	**LT**	Lithuania	**SK**	Slovakia
EE	Estonia	**LU**	Luxembourg	**FI**	Finland
IE	Ireland	**HU**	Hungary	**SE**	Sweden
GR	Greece	**MT**	Malta	**UK**	United Kingdom
ES	Spain	**NL**	Netherlands	**US**	United States
FR	France	**AT**	Austria		

In accordance with EU practice, the EU Member States are listed in this report using the alphabetical order of the country names in the national languages.

Others

AWG	Economic Policy Committee's Working Group on Ageing Populations and Sustainability
BIS	Bank for International Settlements
CPI	consumer price index
DG ECFIN	Directorate General for Economic and Financial Affairs, European Commission
ECB	European Central Bank
EDP	excessive deficit procedure
EER	effective exchange rate
EMI	European Monetary Institute
EMU	Economic and Monetary Union
ERM	exchange rate mechanism
ESA 2010	European System of Accounts 2010
ESCB	European System of Central Banks
ESRB	European Systemic Risk Board
EU	European Union
EUR	euro
GDP	gross domestic product
HICP	Harmonised Index of Consumer Prices
ILO	International Labour Organization
IMF	International Monetary Fund
MFI	monetary financial institution
MIP	macroeconomic imbalance procedure
MTO	medium-term budgetary objective
NCB	national central bank
OECD	Organisation for Economic Cooperation and Development
SGP	Stability and Growth Pact
SSM	Single Supervisory Mechanism
TSCG	Treaty on Stability, Coordination and Governance in the Economic and Monetary Union

Conventions used in the tables

- data do not exist/data are not applicable
. data are not yet available

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