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EUROSYSTEM

Euro Introduction in Croatia and Macroeconomic Developments in the Euro Area

Boris Vujčić, Governor
London, October 2023



Overview

- **The euro adoption process**
 - then and now
 - challenges in the context of high inflation
 - major economic benefits

- **Economic and monetary developments in the euro area**

The euro adoption process

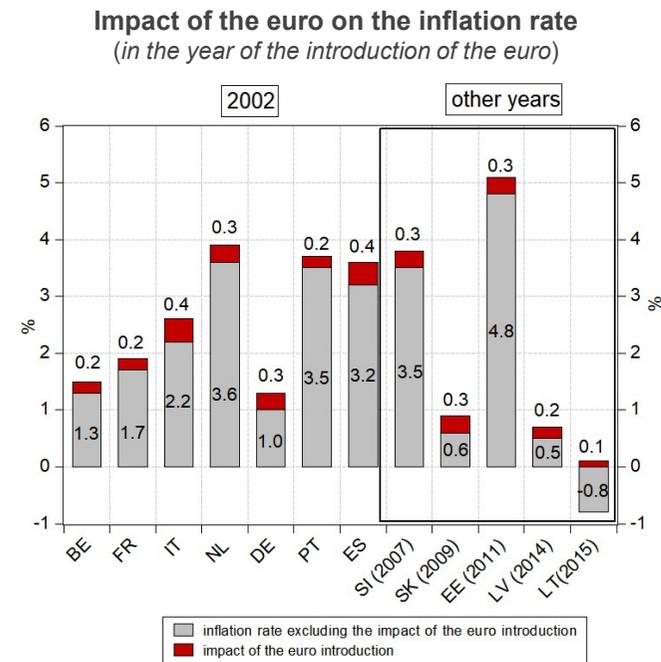
The euro adoption process → then and now

The process has become much more demanding after the global financial crisis



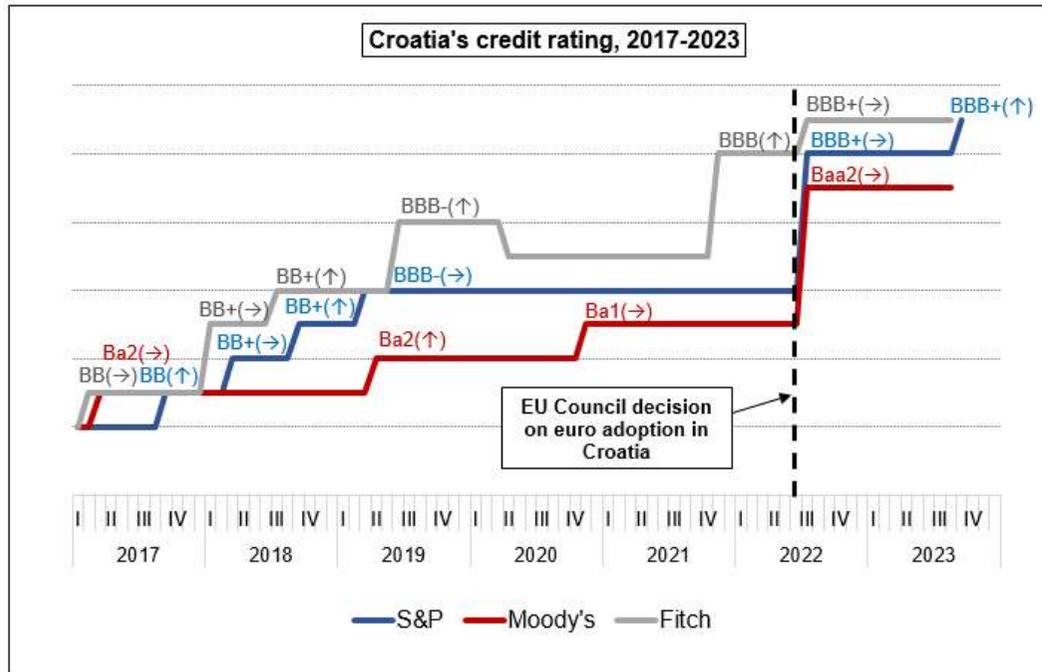
The impact of the euro on the aggregate price level was in line with the past experiences of other Member States

- Croatia is the only Member State that introduced the euro in a period of very high inflation
- Despite this, the estimated overall impact on prices was equally mild – **0.4 percentage points** – as in Member States that had adopted the euro in a low-inflation environment
 - in their case as well, services sectors were the main driver of the overall euro-induced increase in prices



Sources: Eurostat; Pufnik, A. (2018.); IMF

Benefits of the euro: Higher credit rating

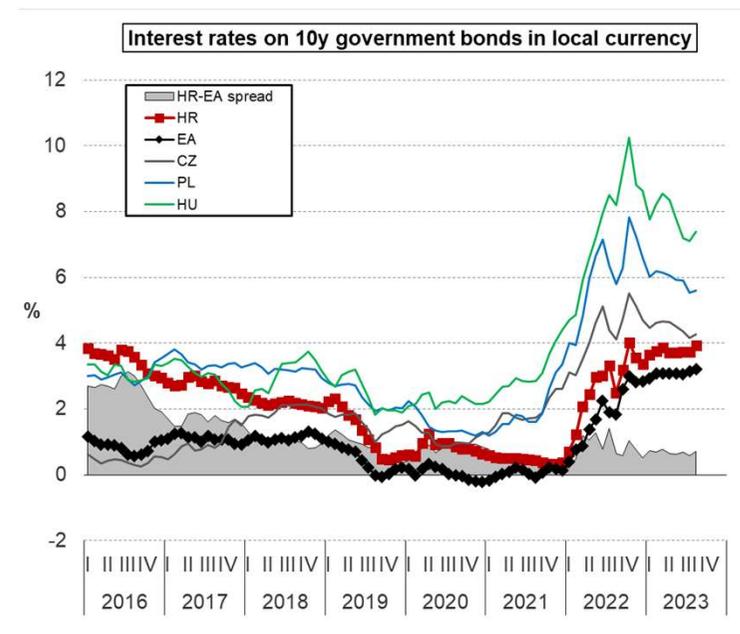


Source: HNB.

Benefits of the euro: Lower borrowing costs (I)

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

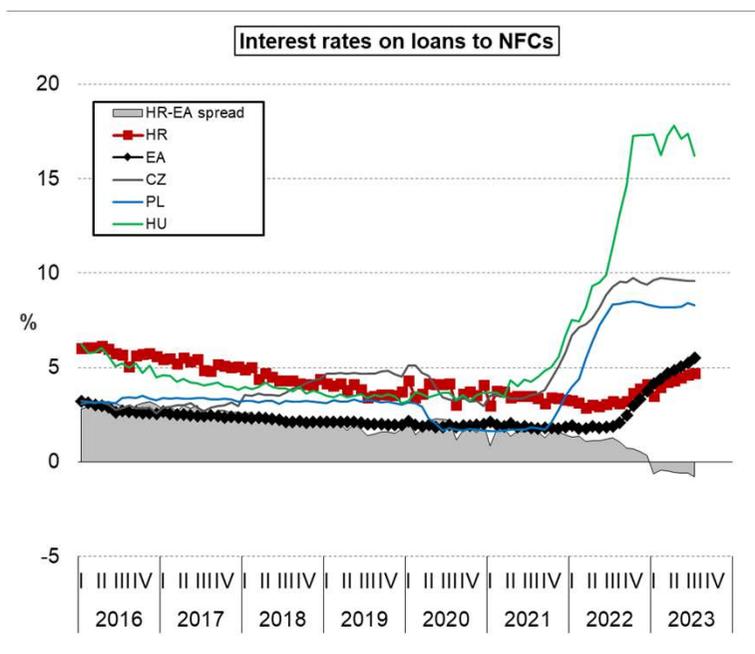
Croatia's sovereign yield spread has declined since 2016 supported by the progress towards the euro



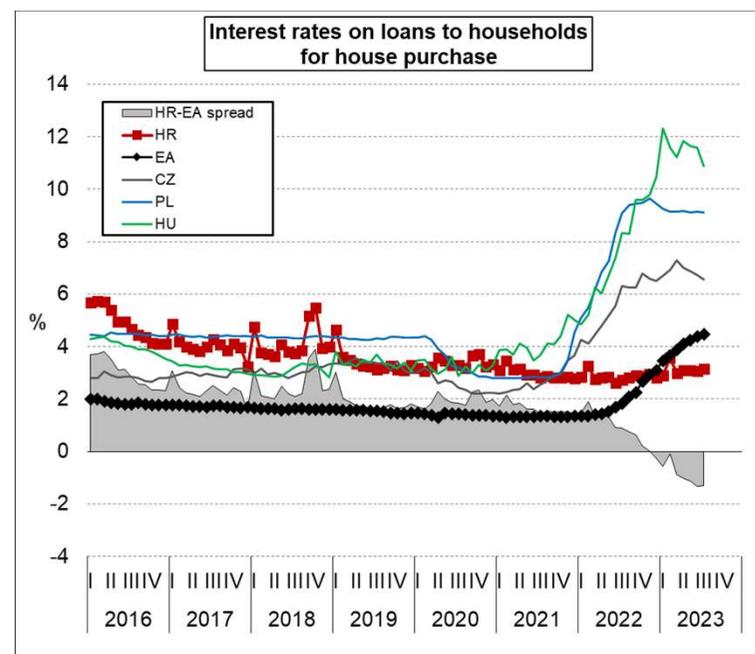
Source: Eurostat.

Benefits of the euro: Lower borrowing costs (II)

Bank lending rates have fallen below the euro area average



Source: ECB.

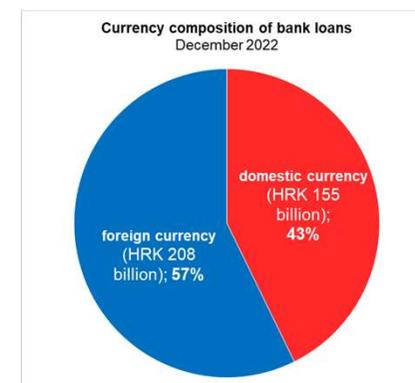
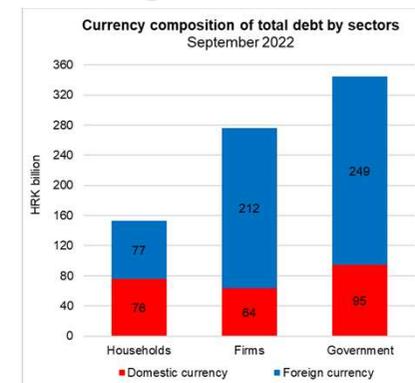
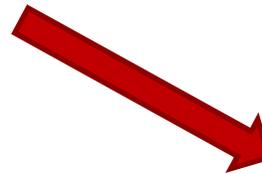
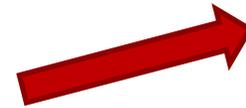


Source: ECB.

Benefits of the euro: Elimination of foreign exchange risk

- Following the adoption of the euro, risks for financial stability have been reduced:

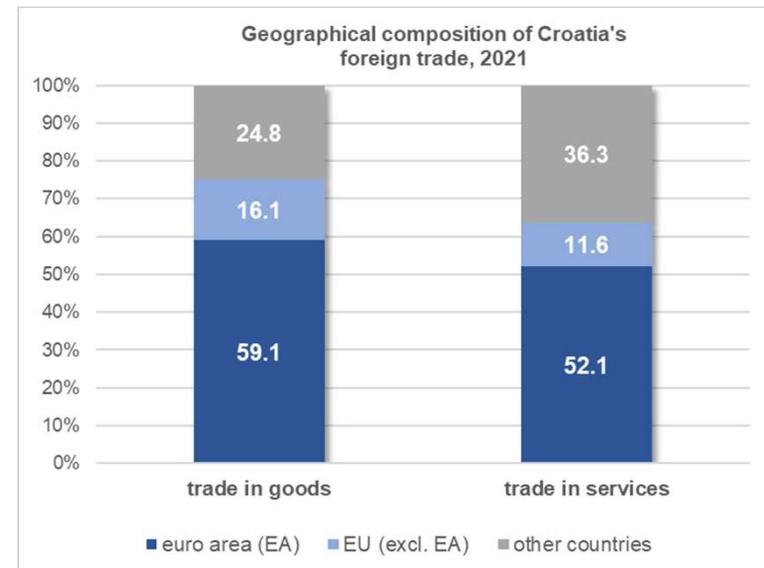
- **FX risk** for households, firms and the government has been largely eliminated
- **FX-induced** credit risk for banks has been largely eliminated
- as part of the Eurosystem, HNB can more easily manage liquidity crises
 - it can act as **LOLR at full capacity**



Source: HNB

Benefits of the euro: Lower transaction costs

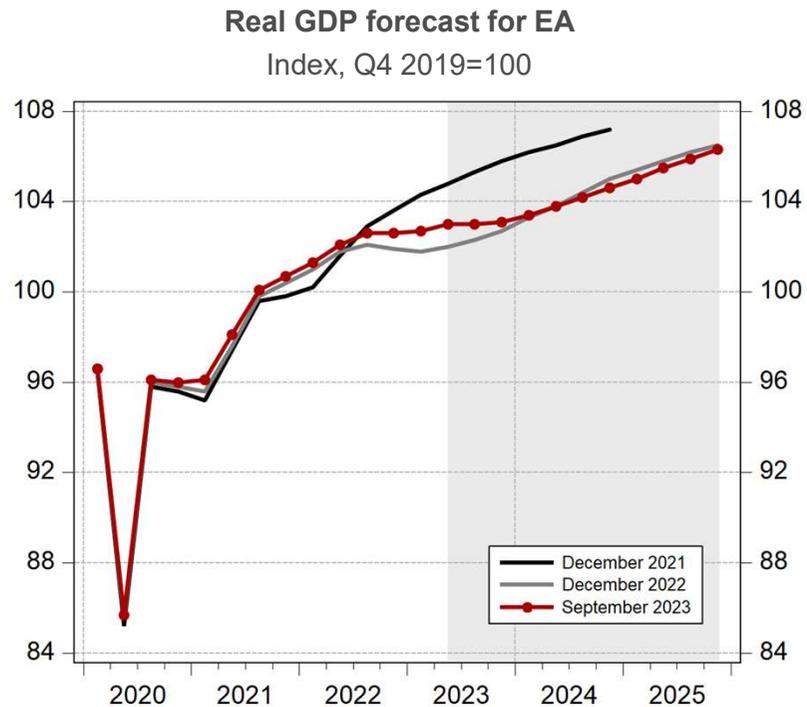
- Merchandise trade with euro area countries is facilitated as there is no longer a need for currency conversion
 - **58%** of Croatia's total merchandise trade refers to trade with euro area member states
 - **64%** of Croatia's merchandise trade with non-EU countries is settled in euros
- The competitiveness of the tourism sector has been further increased by the euro and entry into the Schengen area
 - **65%** of all tourist overnight stays in Croatia are made by residents of the euro area
- Total annual savings for the non-financial sector due to the disappearance of EUR/HRK currency conversion costs are estimated at **EUR 160 million** (HRK 1.2 billion)



Source: Eurostat

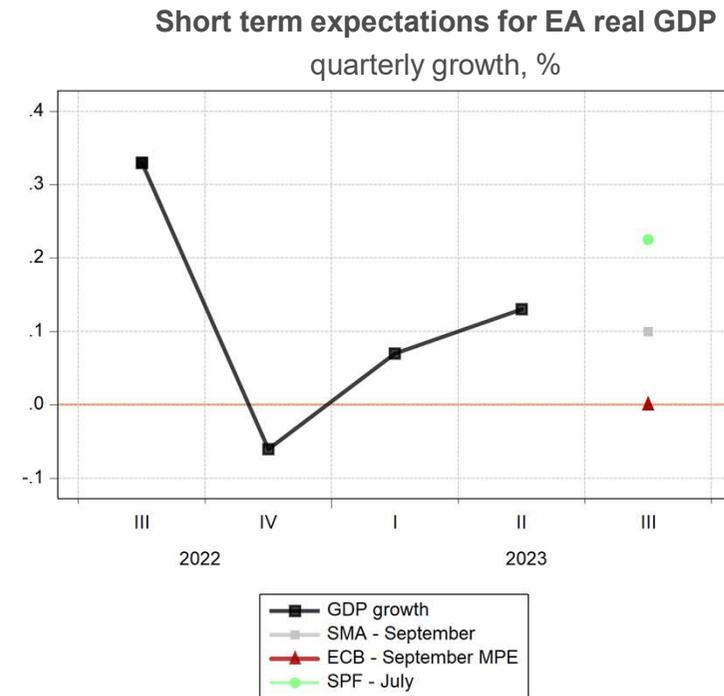
Economic and monetary developments in the euro area

Economy has thus far proved more resilient than feared but short term expectations are worsening



Source: ECB staff macroeconomic projections.

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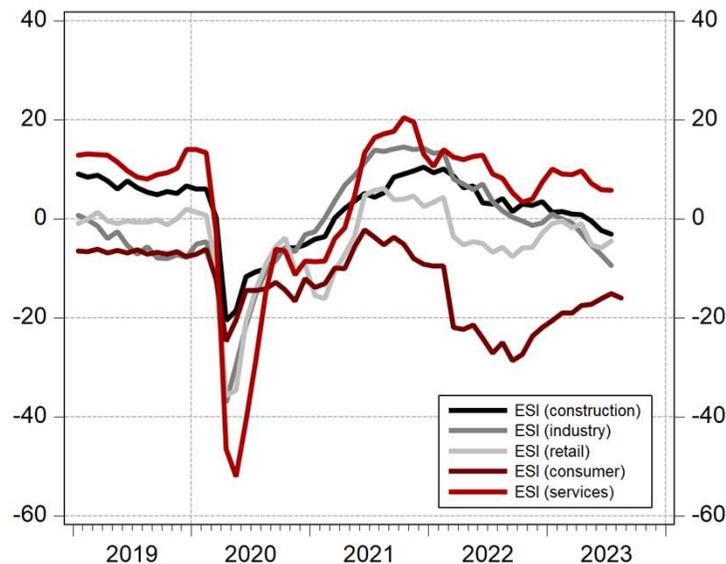


Note: SMA (Survey of Monetary Analysts) and SPF (Survey of Professional Forecasters) are ECB's surveys of market participants.

Sources: Eurostat; ECB

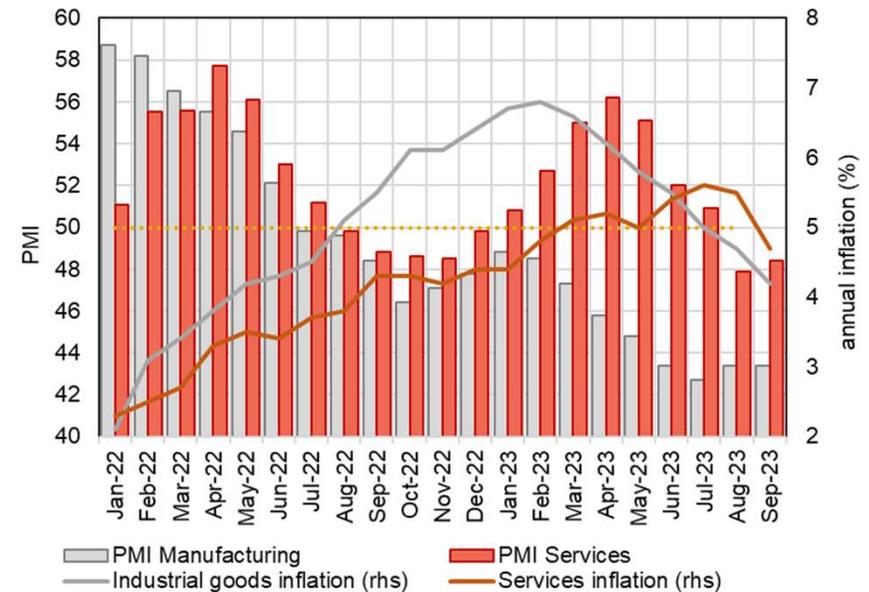
The most recent vintages of business and consumer surveys point to sharp softening of economic activity

Economic sentiment indicators for EA



Note: Data up to August 2023, flash estimate for consumer confidence as of September 2023.
Sources: Eurostat

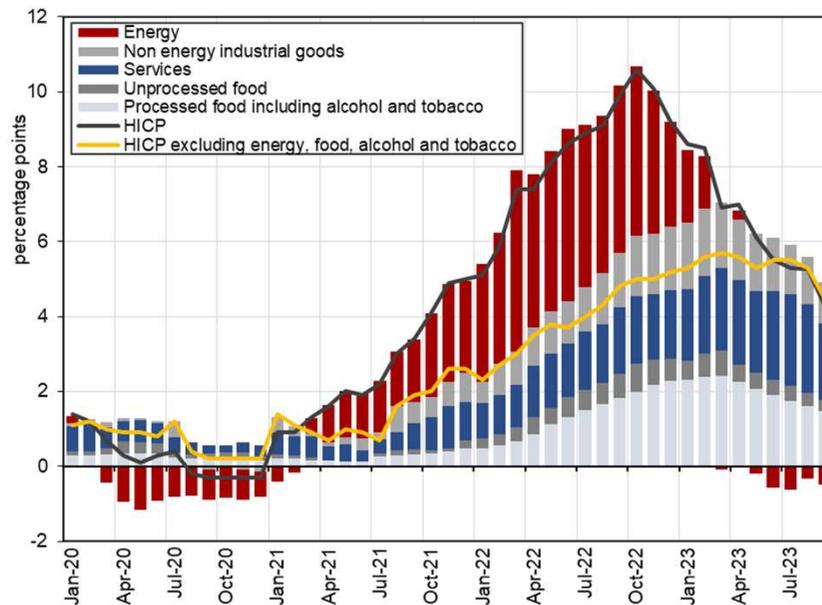
PMI and inflation in EA



Note: PMI above 50 represents an expansion, while PMI under 50 represents a contraction relative to the previous month.
Sources: S&P Global; Eurostat

Headline inflation is coming down as expected, but underlying pressures still present

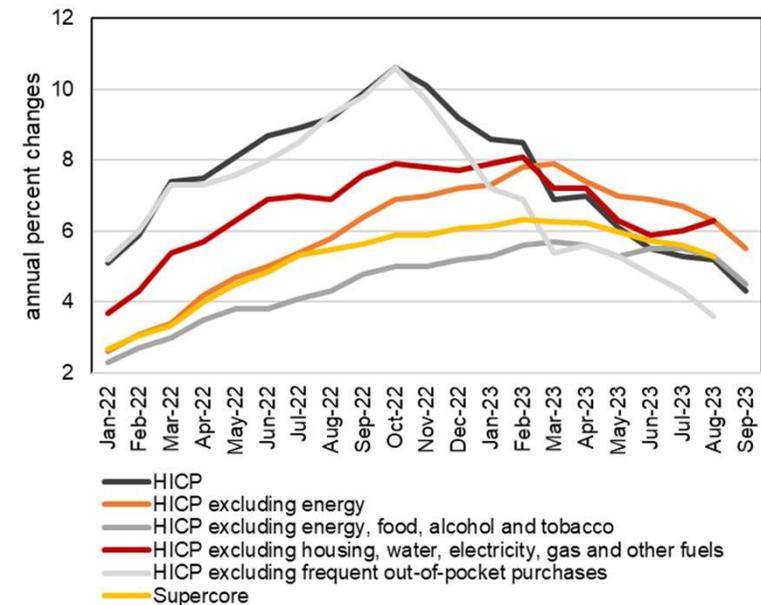
Inflation and contribution of main sub-components in EA



Note: Data up to September 2023.
Source: Eurostat.

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Indicators of underlying inflation in EA



Source: Eurostat.

External price pressures are gradually easing but remain elevated

EUR/USD and NEER
(lhs: level; rhs: index: 2015 = 100)

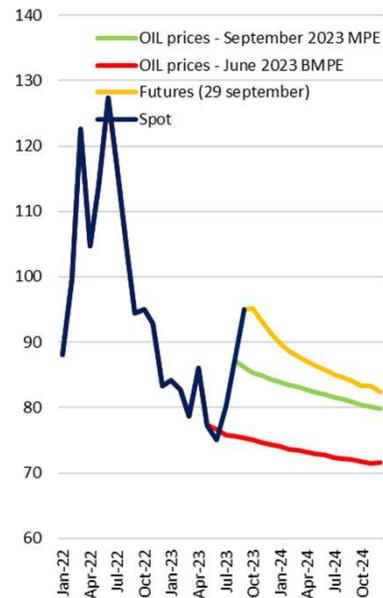


Note: Nominal effective exchangerate for 42 trading partners (NEER42).

Source: Eurostat

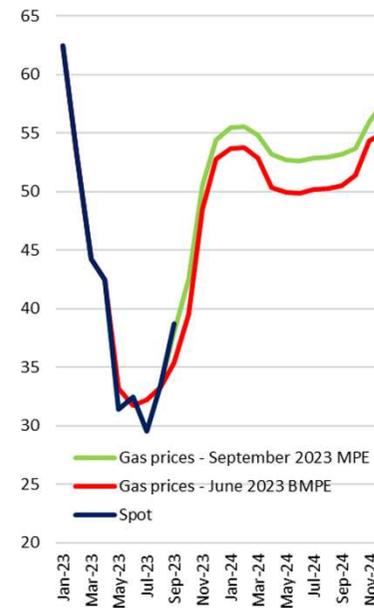
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Brent crude oil
(USD/barrel)



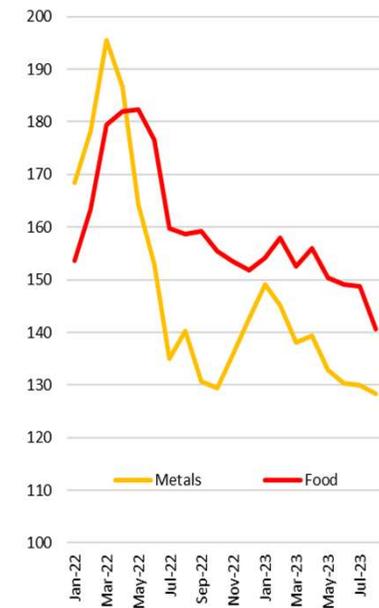
Sources: Bloomberg; ECB

Gas
(EUR/MWh)



Sources: Bloomberg; ECB

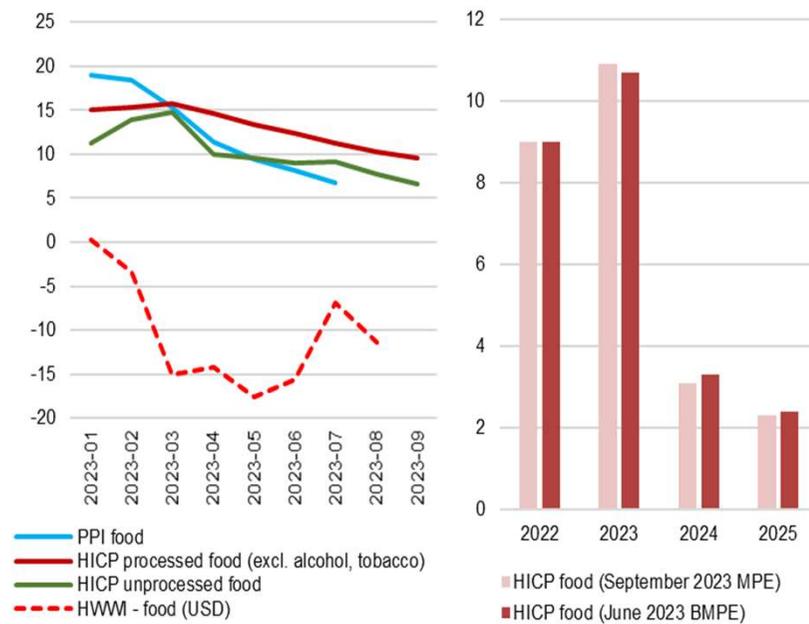
Non-energy commodities
(index: 2020 = 100)



Source: HWWI

Domestic price pressures are also abating

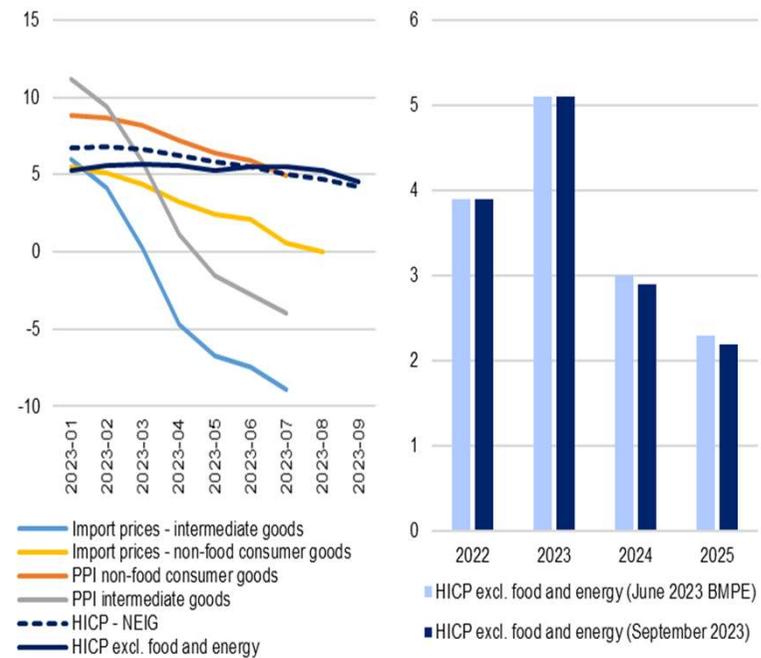
Pipeline pressures and indicators for food inflation
(annual percentage change)



Sources: Eurostat; HWWI; ECB macroeconomic projections.

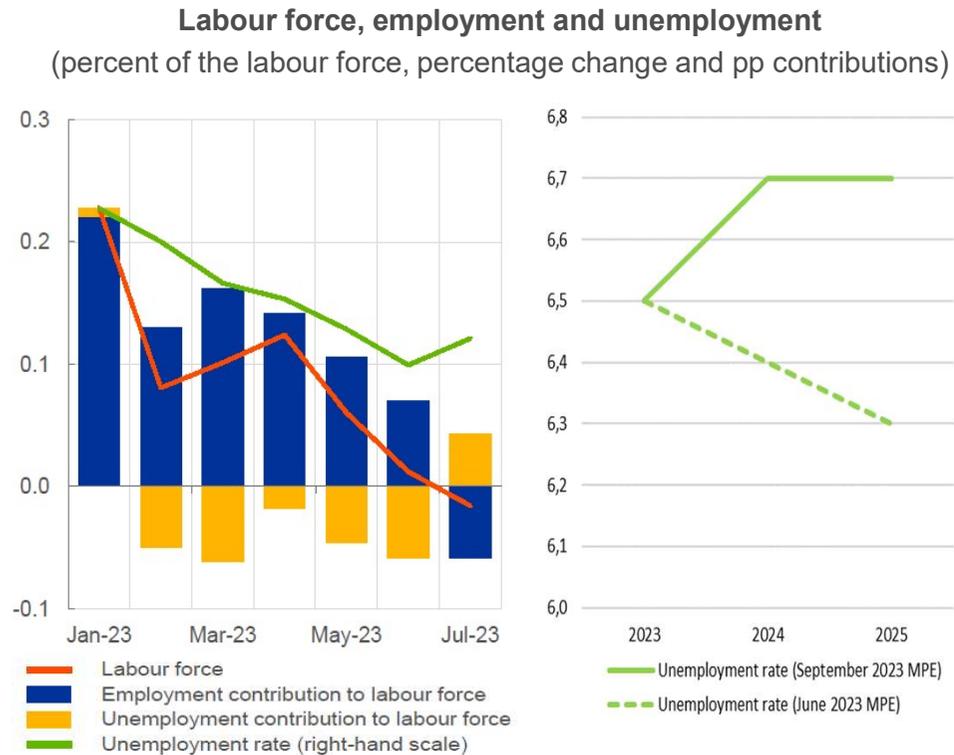
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Pipeline pressures and indicators for goods inflation
(annual percentage change)



Sources: Eurostat; ECB macroeconomic projections.

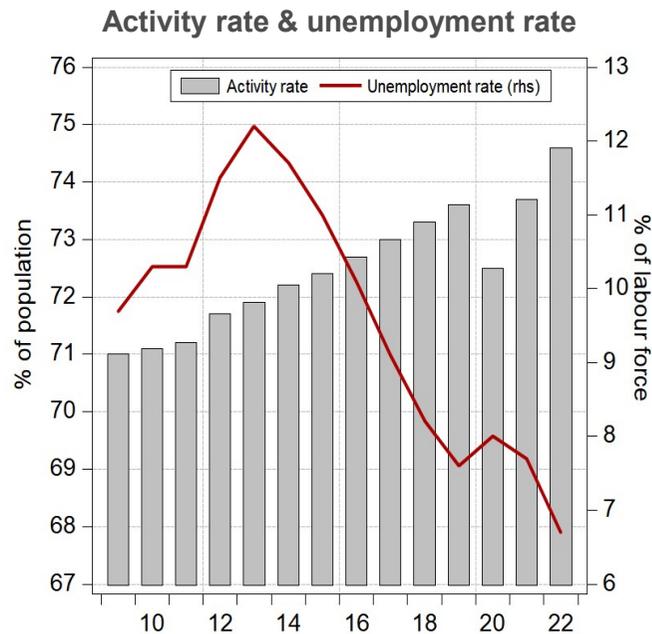
There are signs of softening in the labour market



Note: The labour force is derived from monthly unemployment data.
Source: Eurostat.

Sources: Eurostat; ECB macroeconomic projections.

But it remains very strong and adds to inflationary pressures

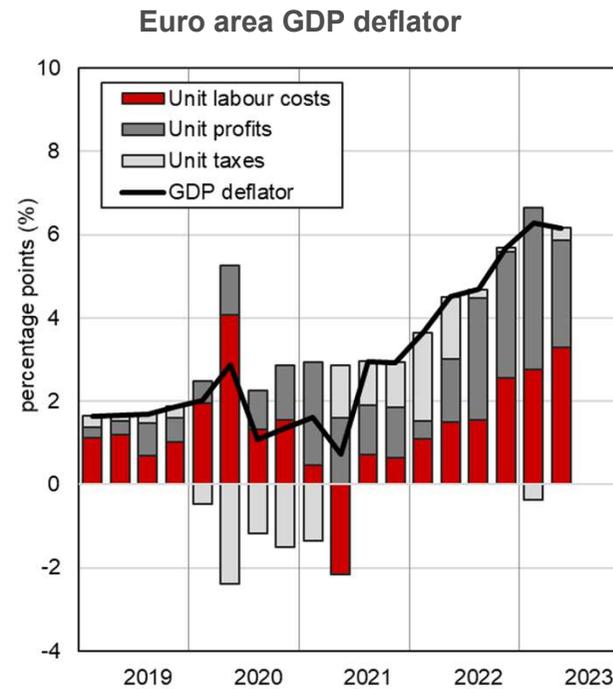


Note: Activity rate refers to the number of active persons in the 15-64 age group as a percent of total population. Unemployment rate refers to the number of unemployed persons in the 15-74 age group as a percent of population in the labour force.

Source: Eurostat.

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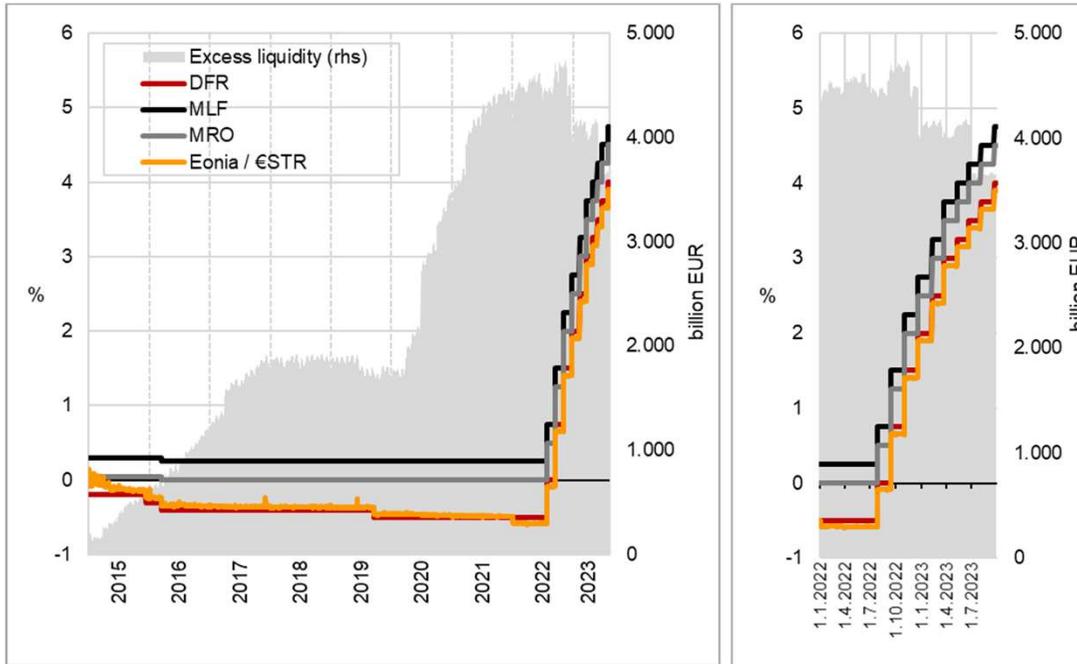
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Source: Eurostat.

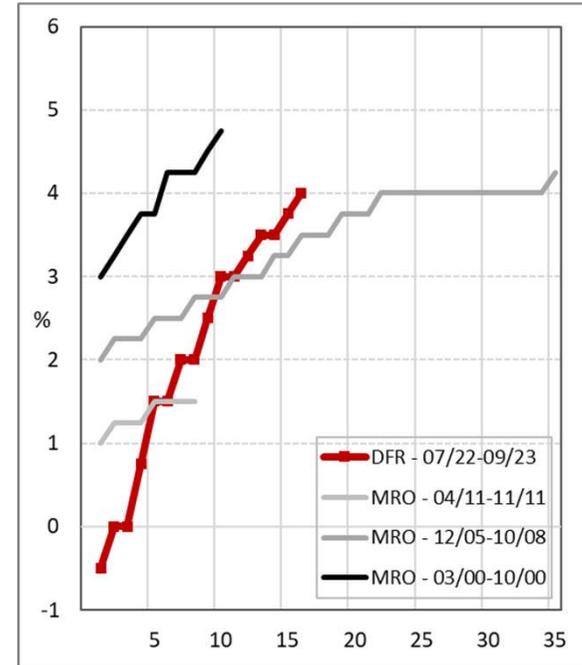
ECB's response to higher inflation – strongest monetary policy tightening cycle since the introduction of the euro

ECB key interest rates and excess liquidity



Note: DFR (deposit facility rate); MLF (marginal lending facility); MRO (main refinancing operations). Since the beginning of 2022 EONIA is replaced with €STR.
Source: ECB; CNB calculations.

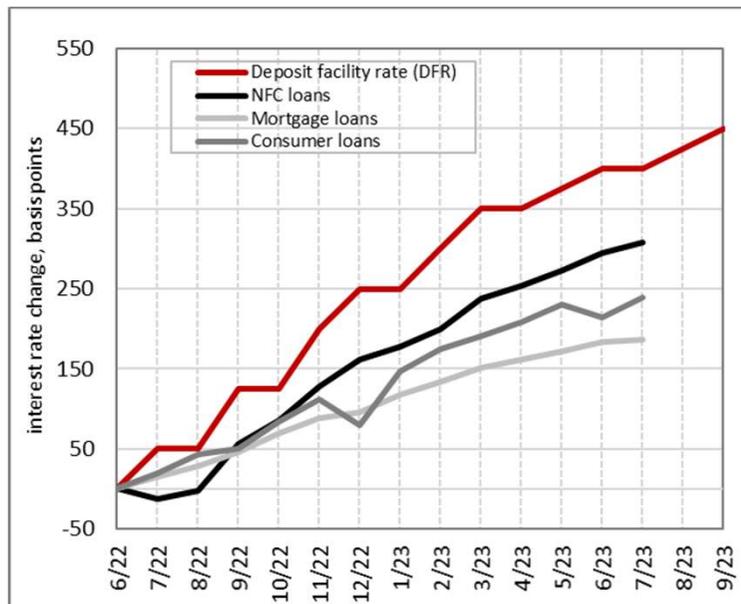
Tightening cycles



Note: x-axis denotes number of months. Key rates refer to MRO, except for last cycle where DFR is shown.
Source: ECB; CNB calculations.

Monetary policy transmission on interest rates in euro area is strong for loans and term deposits...

Transmission from key interest rates to interest rates on loans in EA

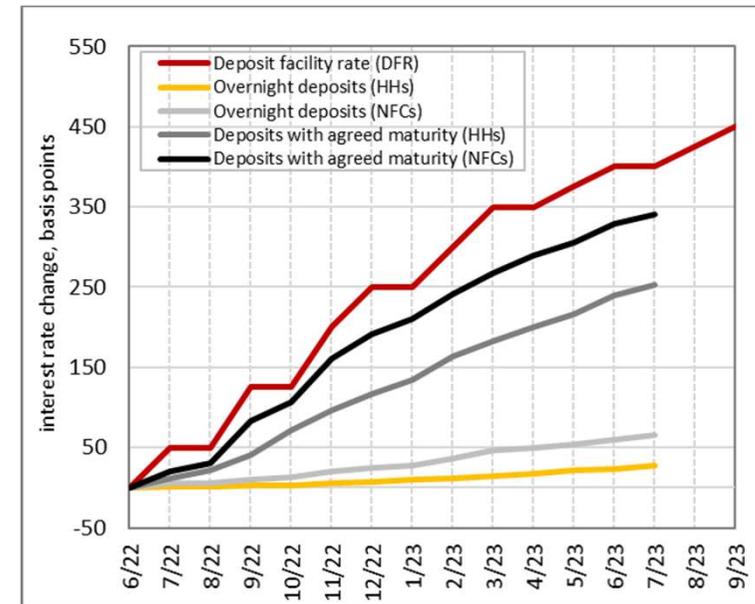


Note: x axis refers to months since the beginning of hiking cycle
Source: ECB, CNB calculations.

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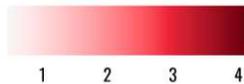
Transmission from key interest rates to interest rates on deposits in EA



Note: x axis refers to months since the beginning of hiking cycle
Source: ECB, CNB calculations.

...however, the rise in interest rates is not the same among euro area members

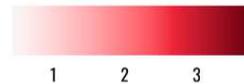
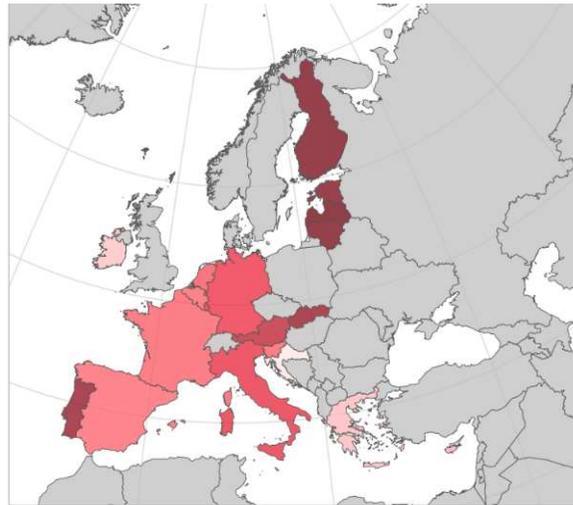
Interest rates change on loans to NFC



Note: Data refers to pure new loans. Interest rate change refers to change in interest rates between 07/2023 and 01/2022.
Source: ECB.

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Interest rates change on housing loans



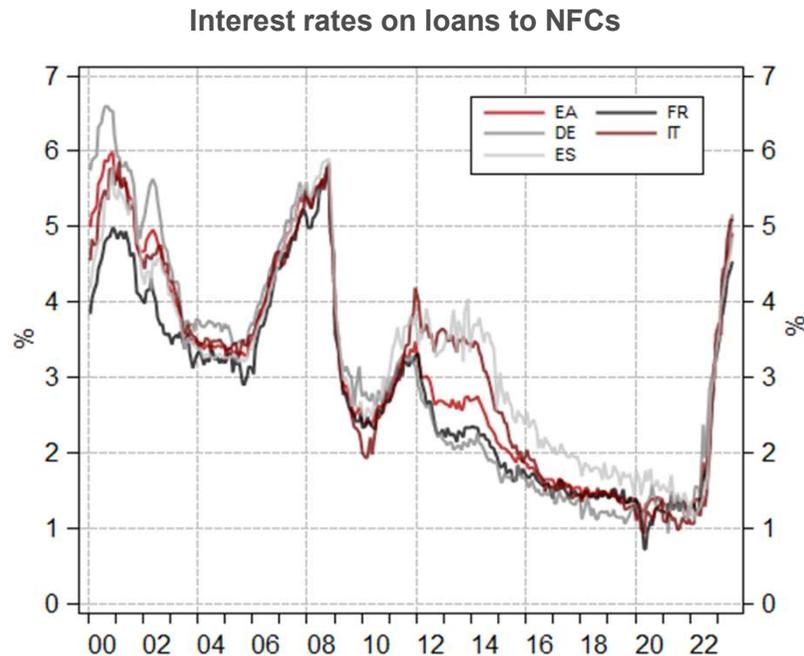
Note: Data refers to pure new loans. Interest rate change refers to change in interest rates between 07/2023 and 01/2022.
Source: ECB.

Interest rates change on consumer loans



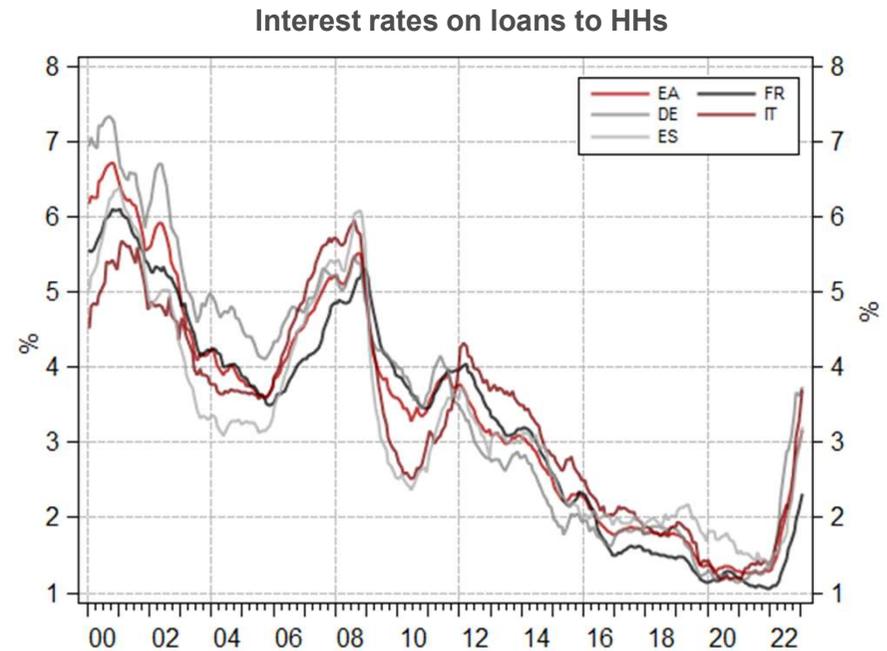
Note: Data refers to pure new loans. Interest rate shown is weighted interest rate on consumer and other loans excluding revolving loans and overdrafts, convenience and extended credit card debt. Interest rate change refers to change in interest rates between 07/2023 and 01/2022.
Source: ECB.

In all EA countries interest rates on new loans to NFCs are growing faster than on loans to households for house purchase...



Note: Data refers to new business loans until Aug 2017, and pure new loans after.
Source: ECB.

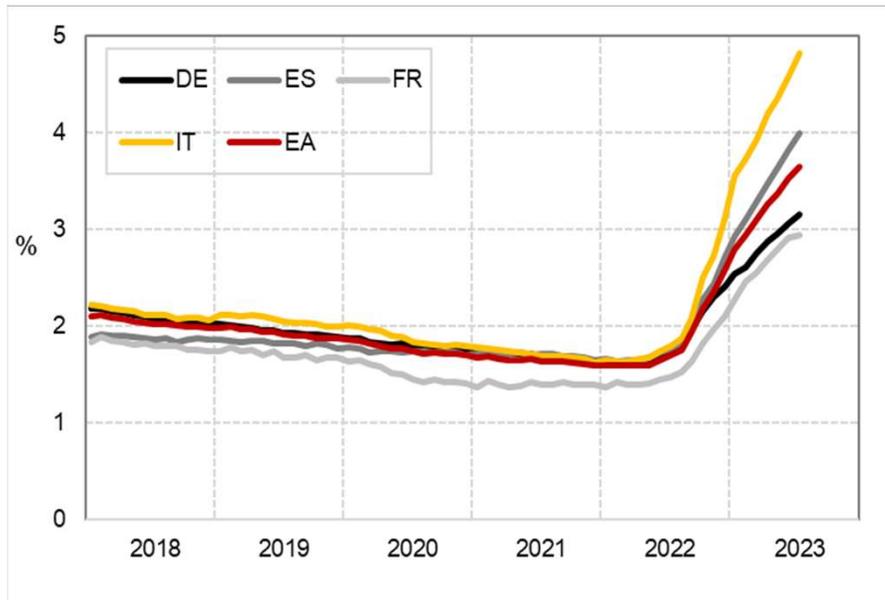
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Note: Data refers to new business loans to households for house purchase until Aug 2017, and pure new loans after.
Source: ECB.

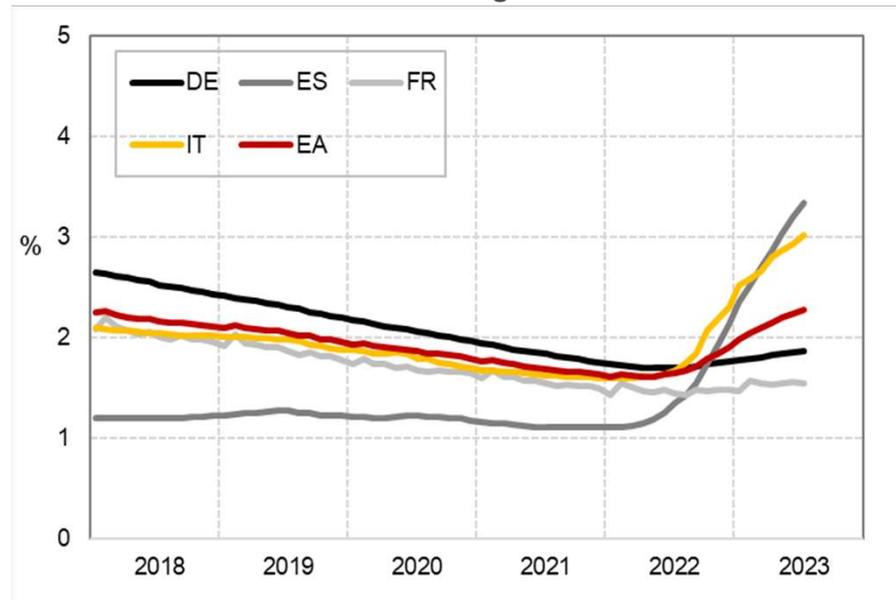
... while interest rates on existing loans are growing slowly, and in some countries very little

Interest rates on loans to NFC



Note Data refer to total stock of loans to NFC.
Source: ECB.

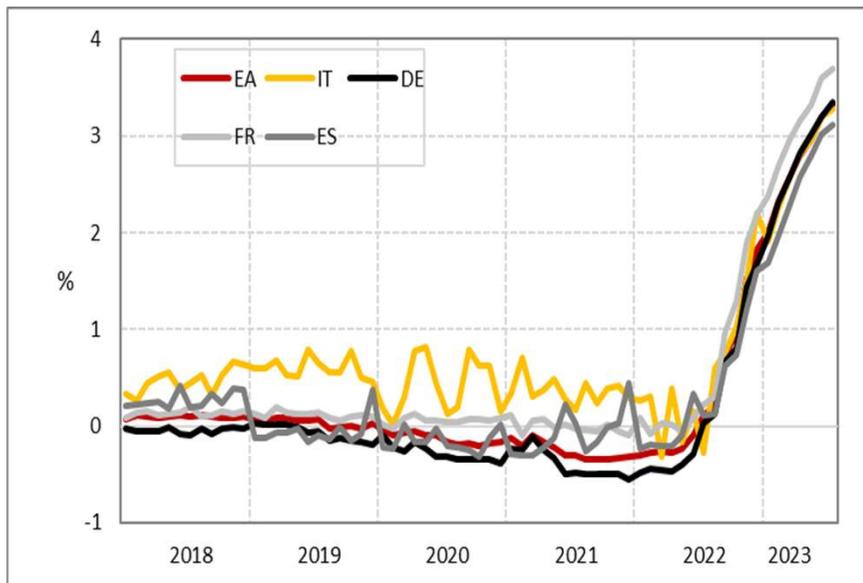
Interest rates on housing loans to HH's



Note Data refer to total stock of housing loans to HH's.
Source: ECB.

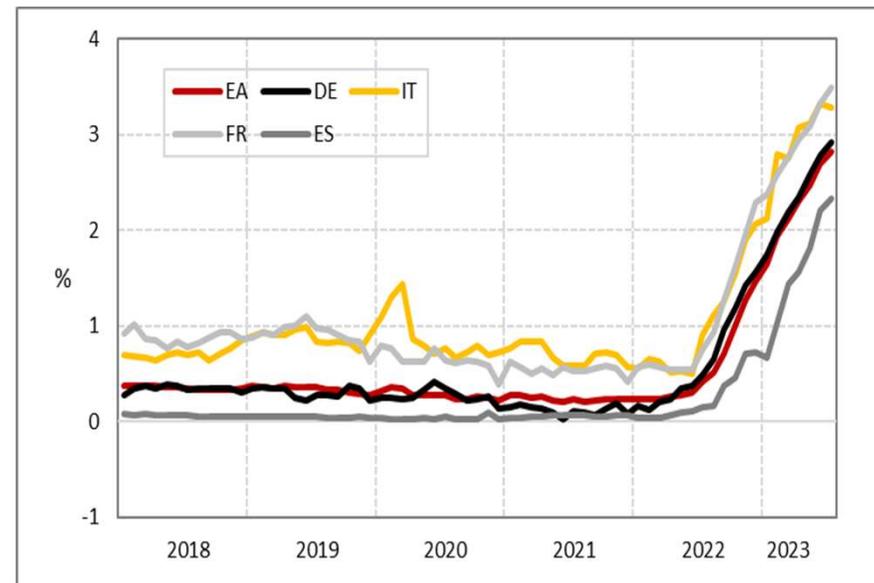
Rise in interest rates on household deposits is also slower than on NFC deposits...

Interest rates on NFC deposits with agreed maturity



Note Data refer to new business (include pure new business and renegotiated).
Source: ECB.

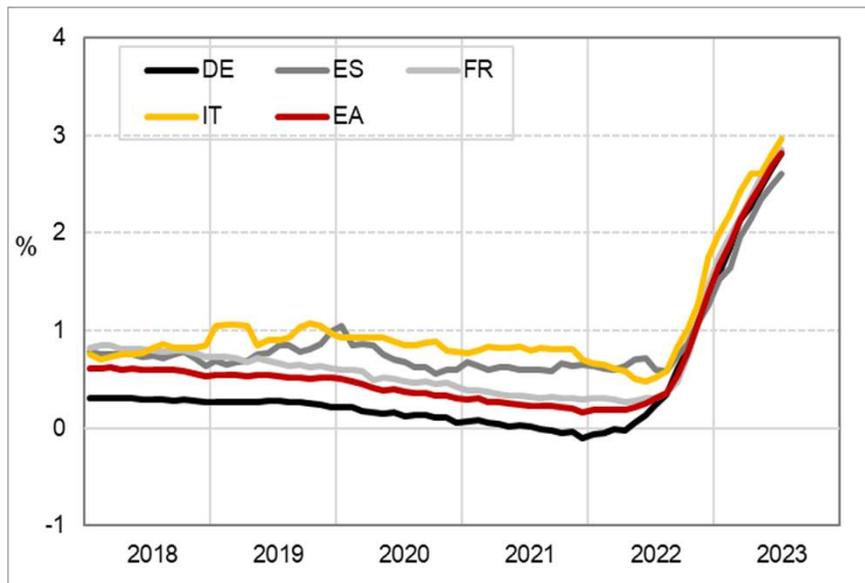
Interest rates on HH deposits with agreed maturity



Note Data refer to new business (include pure new business and renegotiated).
Source: ECB.

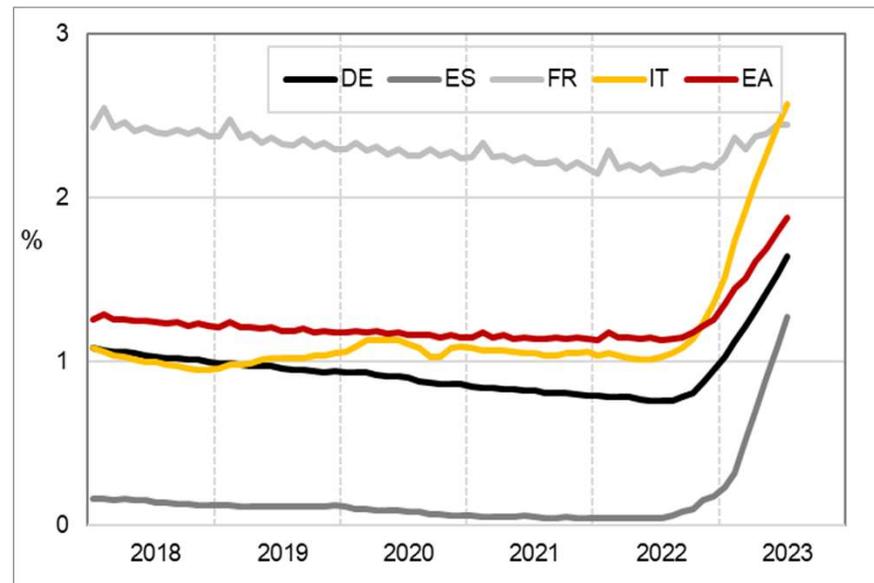
... while the growth of interest rates on already existing deposits is less pronounced

Interest rates on NFC deposits with agreed maturity



Note Data refer to total stock of NFC deposits with agreed maturity.
Source: ECB.

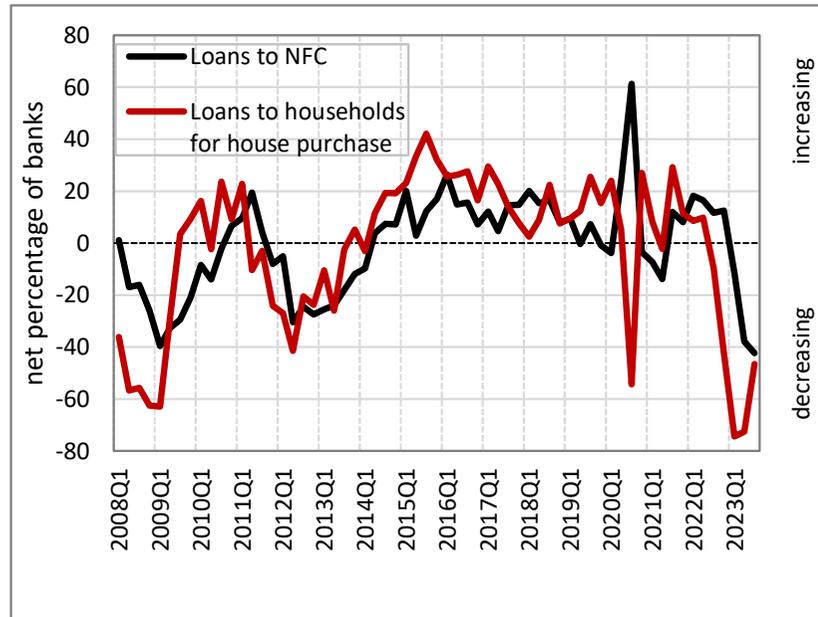
Interest rates on HH deposits with agreed maturity



Note Data refer to total stock of HH deposits with agreed maturity.
Source: ECB.

Credit conditions tighten significantly

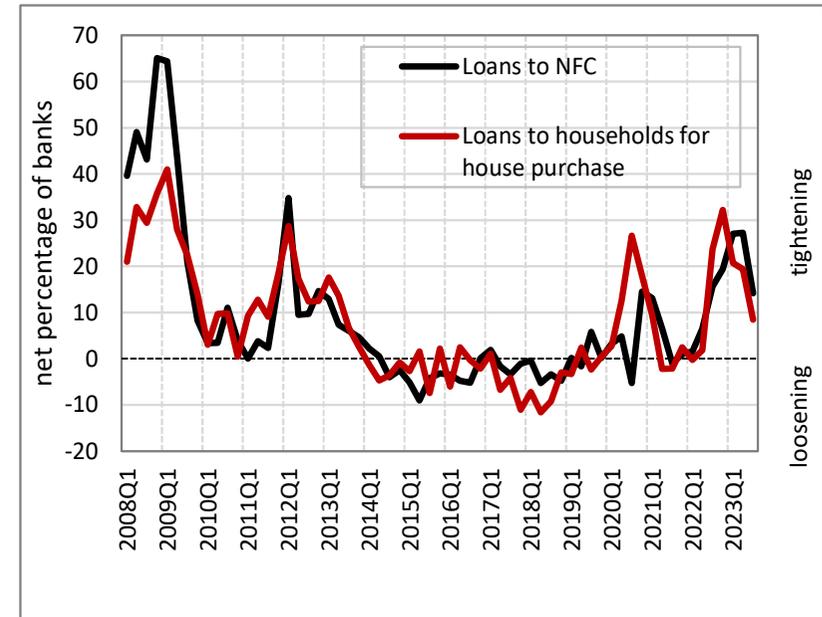
Credit demand



Source: ECB (BLS).

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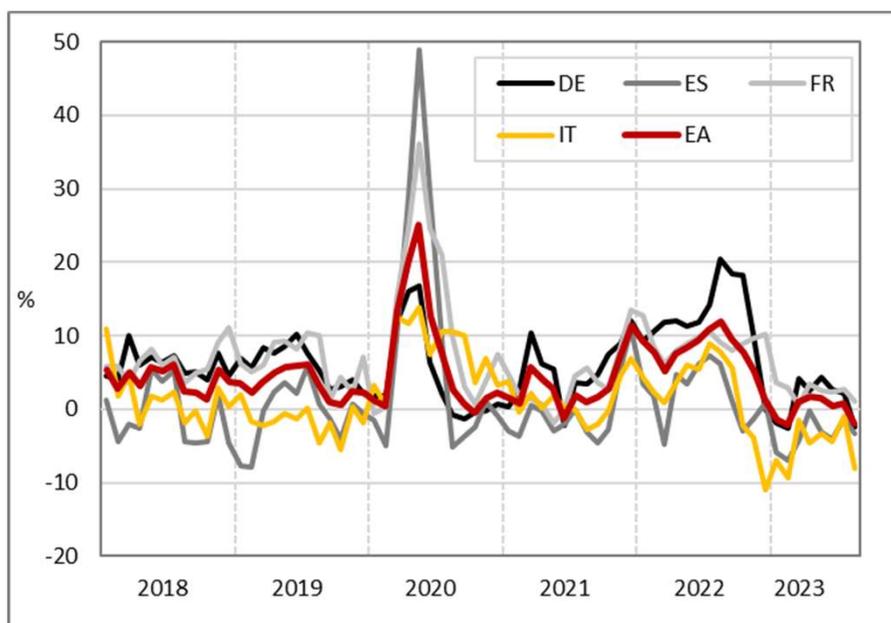
Credit standards



Source: ECB (BLS).

Subdued credit activity...

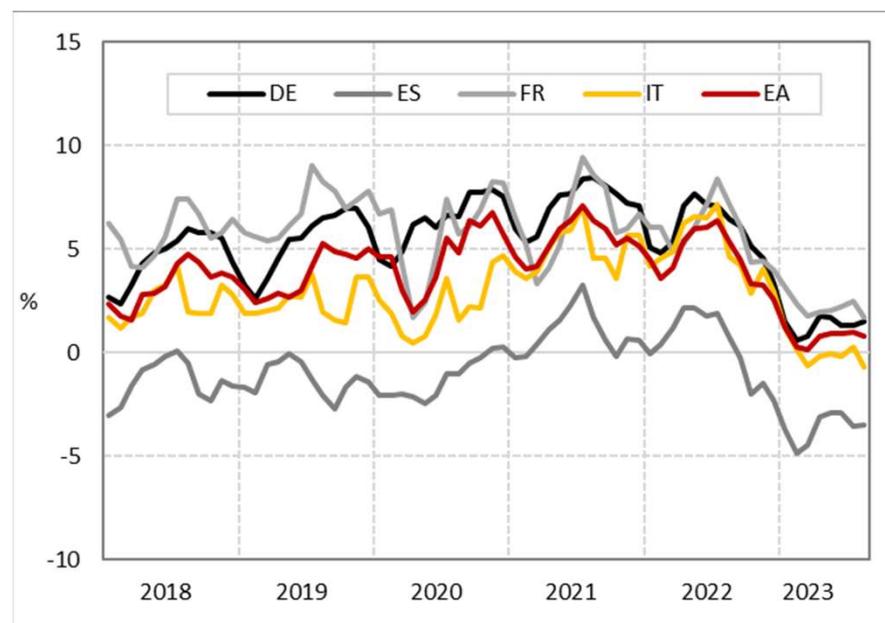
Loans to NFC
momentum



Source: ECB.

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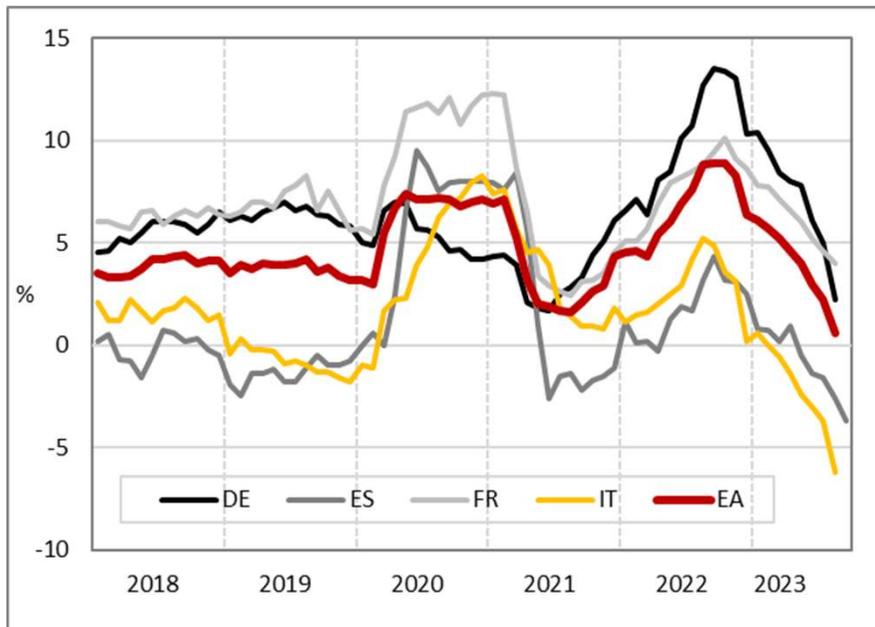
Loans to households, housing loans
momentum



Source: ECB.

... with annual growth decelerating but still positive

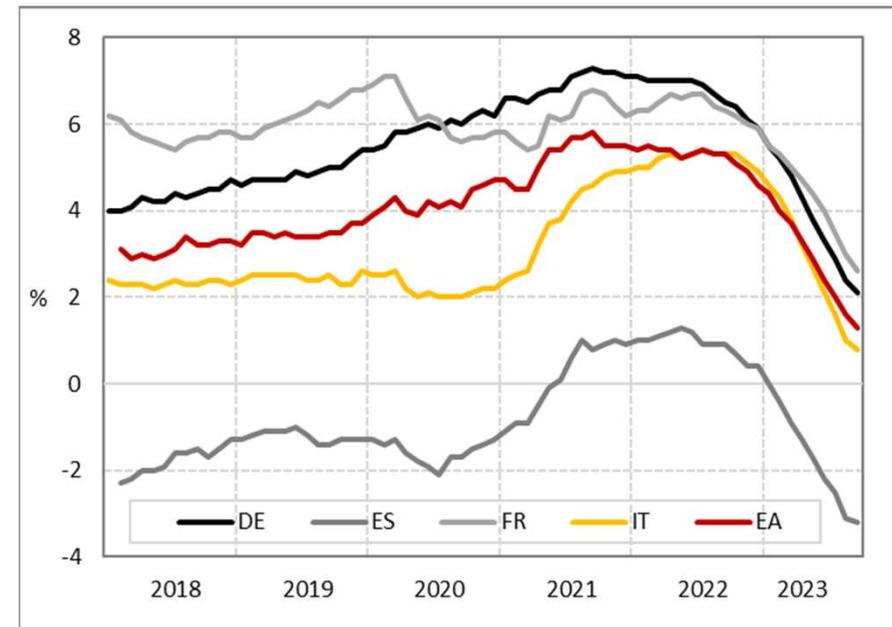
Loans to NFC
annual growth rates



Source: ECB.

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Loans to households, housing loans
annual growth rates



Source: ECB.

Still significant uncertainty about ...

- **Growth outlook**
- **Inflation outlook**
- **Financial stability**



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Thank you very much for your attention!

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