



CROATIAN NATIONAL BANK

EUROSYSTEM

Euro Introduction in Croatia and Macroeconomic Developments in the Euro Area

Boris Vujčić, Governor
New York, April 2023



Overview

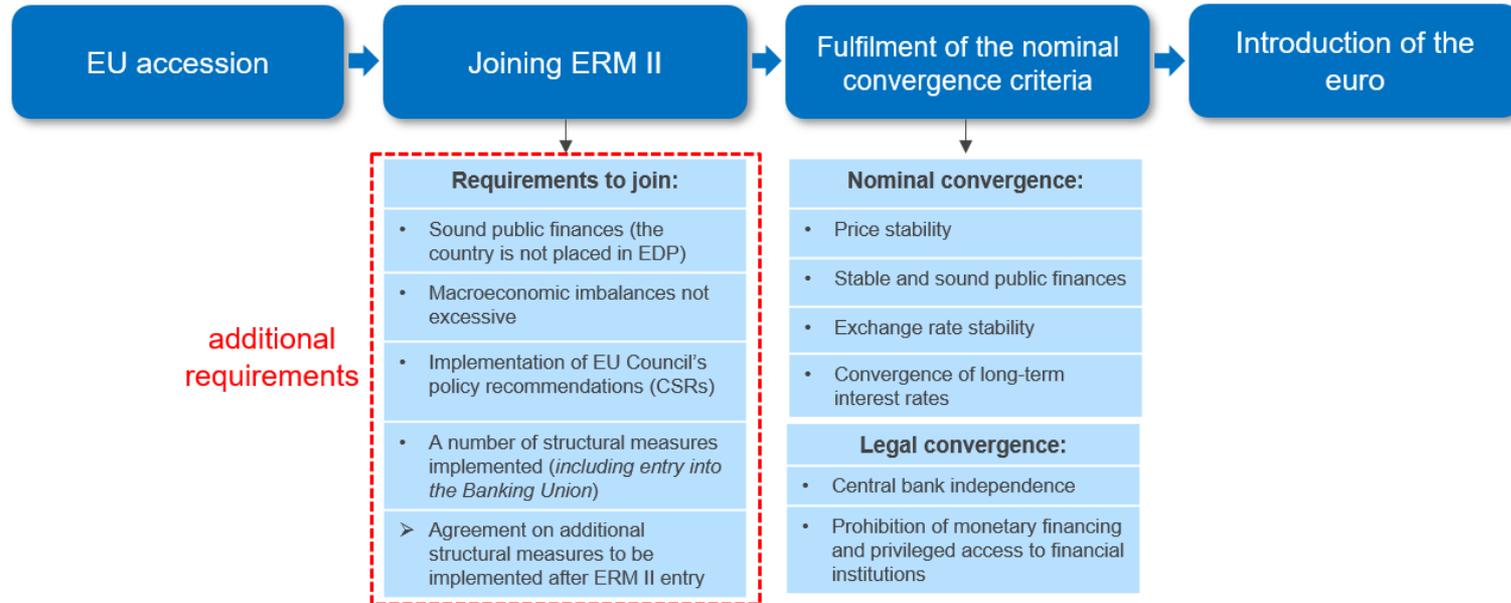
- **The euro adoption process:**
 - then and now
 - challenges in the context of high inflation
 - major benefits (observed already before the euro introduction)

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

The euro adoption process

The euro adoption process → then and now

... has become much more demanding after the global financial crisis



Given the more demanding procedure, Croatia had to take a number of steps in order to get the „green light” for the euro



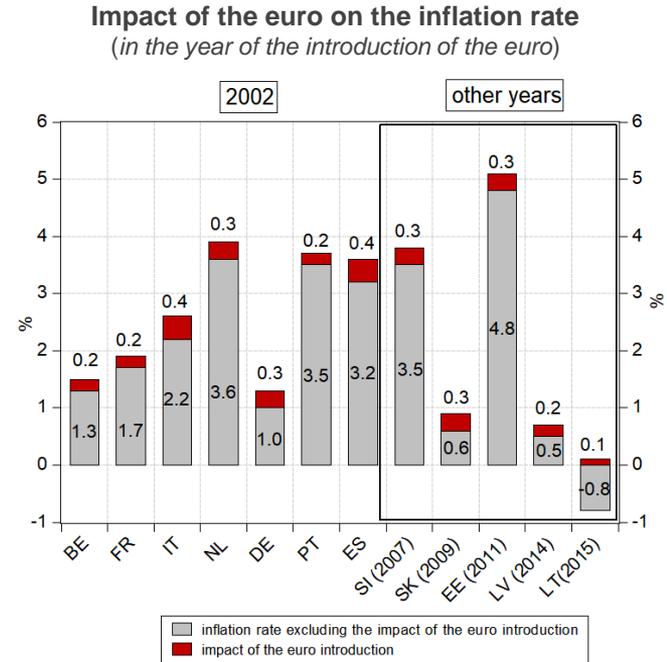
June 2017	May 2018	February 2019	May 2019	June 2019	June 2020	July 2020
Excessive Deficit Procedure (EDP) closed – decision by the Council of the EU	Government adopted the Euro adoption strategy	Excessive macro imbalances eliminated – confirmation by the Commission	Request for close cooperation with the ECB	Letter of intent for ERM II and commitments were taken (19 policy measures in 6 areas)	Commission and the ECB confirmed that all measures had been completed	Kuna included in ERM II and additional commitments were taken (8 measures in 4 areas)



October 2020	December 2020	March 2022	June 2022	July 2022	1 January 2023
Close cooperation with the ECB started	Government adopted the National Euro Changeover Plan	Additional commitments fully implemented	Commission and the ECB confirmed that all entry criteria had been met	EU Council adopted a decision on euro adoption in Croatia	Introduction of the euro

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

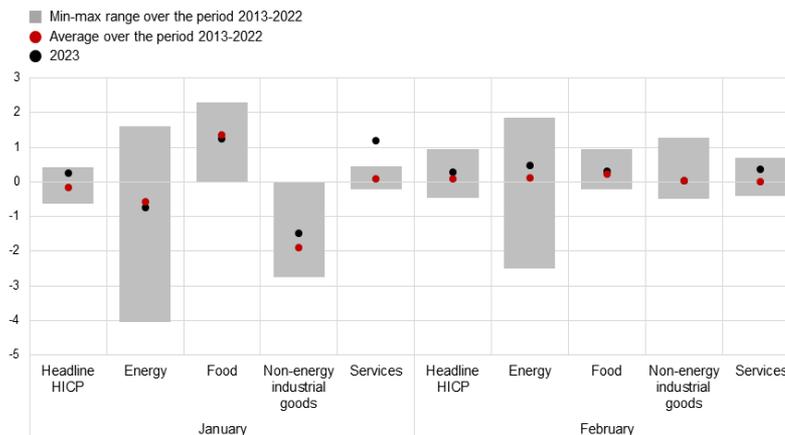


Sources: Eurostat; Pufnik, A. (2018.); IMF

Increase in consumer prices due to rounding observed primarily in services sectors ...

- Price developments in early 2023 did not deviate much from the typical seasonal pattern observed over the previous 10 years
- However, there was an unusually high m-o-m increase in prices of services in January 2023
 - bars, restaurants, hairdressers, dental and medical facilities have increased their prices the most
- According to an ECB-HNB simulation, if the prices of services had followed the same pattern as in the previous 10 years, the overall inflation rate in January 2023 would have been lower by **0.4 percentage points**

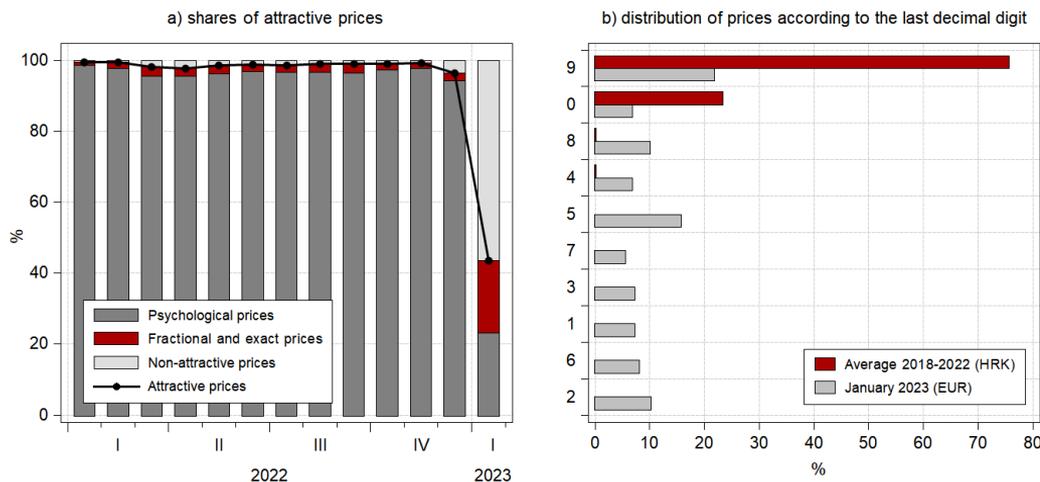
Headline HICP inflation and its main components in HR
(month-on-month percentage changes)



Source: ECB Blog „Has the euro changeover really caused extra inflation in Croatia?“ (March 2023).

... while retail chains have complied with the rules on the conversion and rounding of prices

Pricing strategy in big retail chains in Croatia before and after the euro changeover



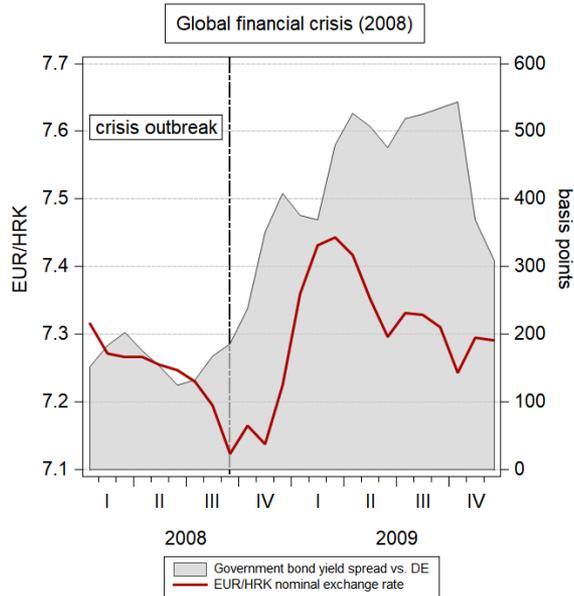
Source: CNB.

- **Prices of around 65% of products did not change after the euro changeover**
 - a strong decrease in the share of so-called "attractive" prices

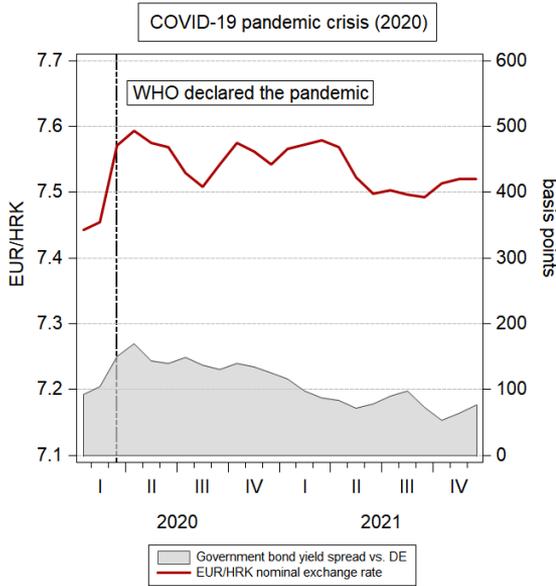
- **It is likely that retailers will gradually set their prices at new attractive levels**
 - these changes might occur as part of regular price adjustments
 - due to market competition and the obligation to display prices in both currencies by end-2023, the new attractive levels may not necessarily be higher

Benefits of the euro: Greater resilience to crises

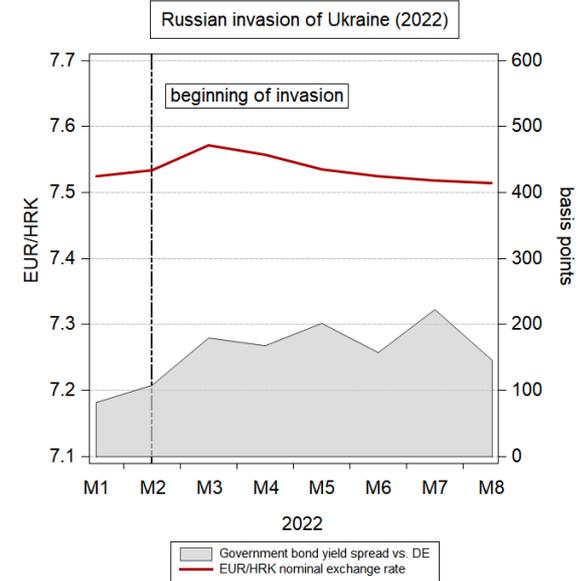
The euro adoption process itself made Croatia more resilient to shocks



Source: Eurostat.



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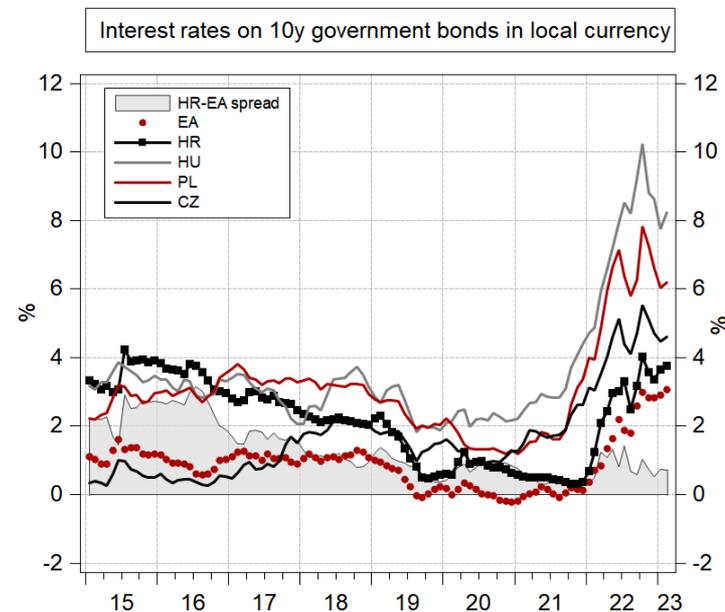


Source: Eurostat.

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
 - the minimum reserve requirement rate in the EA is only 1%

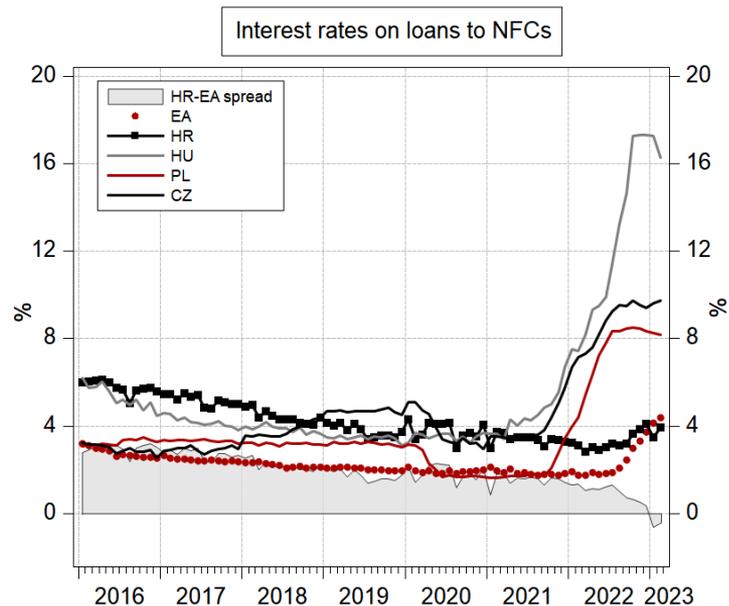
Croatia's sovereign yield spread has declined since 2016 supported by our progress towards the euro



Source: Eurostat.

Benefits of the euro: Lower borrowing costs (II)

Financing conditions have converged towards the euro area average

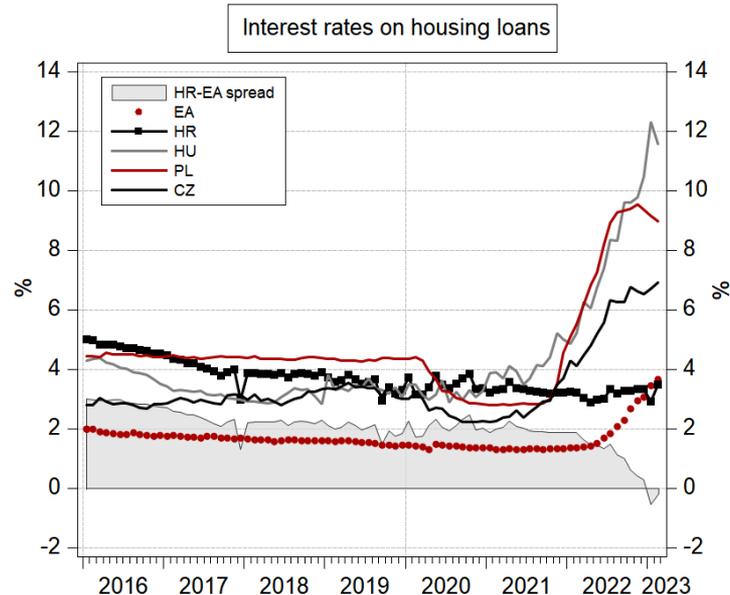


Note: Data refers to loans to corporations of up to EUR 0.25M with a floating rate and an IRF period of up to three months (new business).

Source: ECB.

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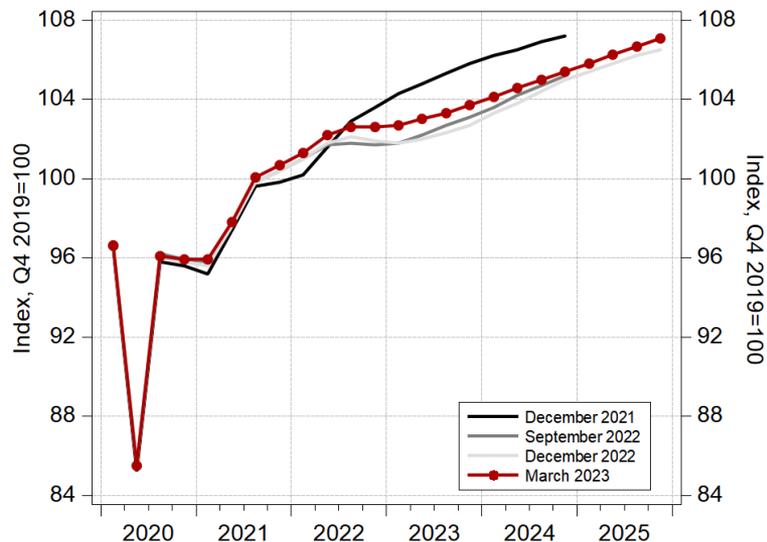
Note: Data refers to loans to households for house purchase with a floating rate and an IRF period of up to one year (new business).

Source: ECB.

Economic and monetary developments in the euro area

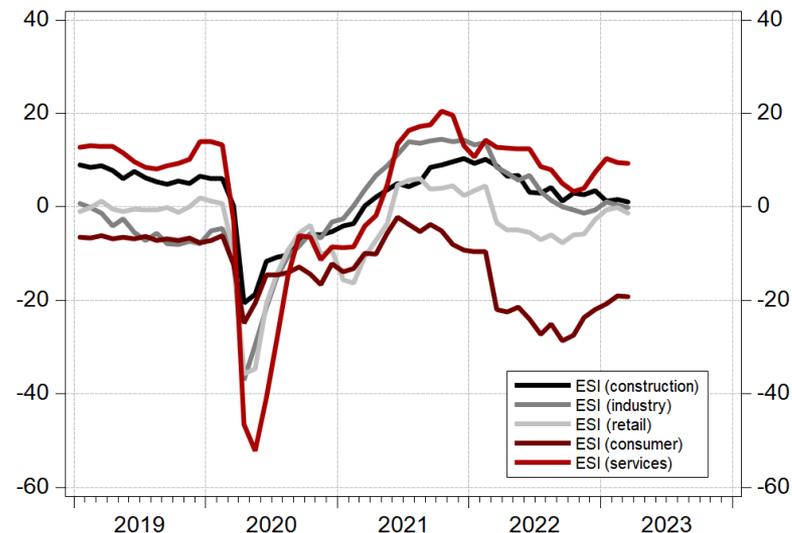
Economy has proved more resilient than feared

Real GDP forecast for EA



Source: ECB staff macroeconomic projections.

Economic sentiment indicators for EA

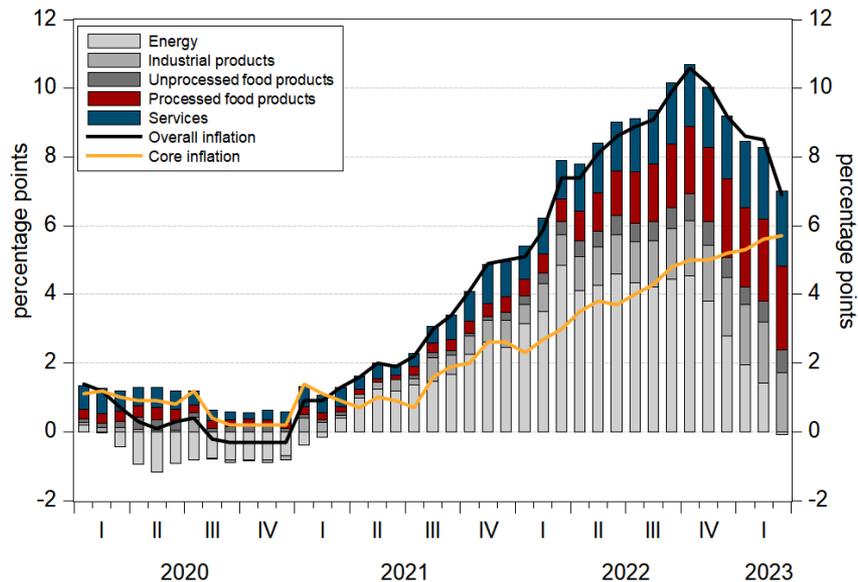


Note: Data up to March 2023.

Source: Eurostat.

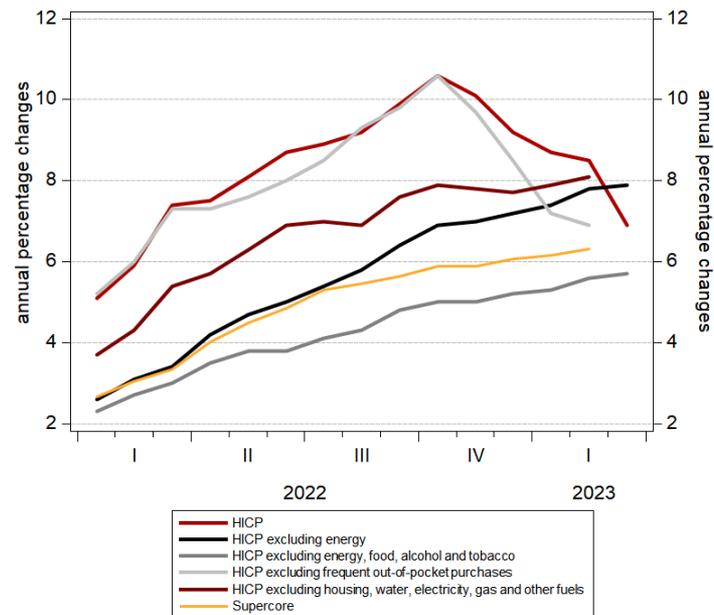
Headline inflation, as expected, coming down, but underlying pressures persist

Inflation and contribution of main sub-components in EA



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

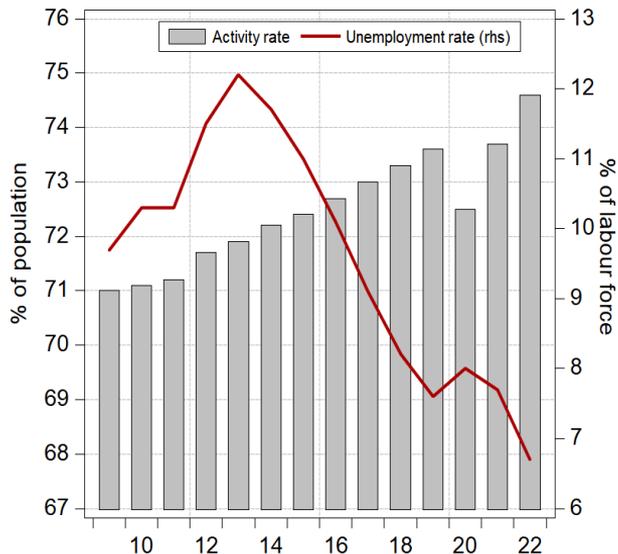
Indicators of underlying inflation in EA



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

Inflation dynamics affected by tight labour markets and increased profit margins

Activity rate & unemployment rate



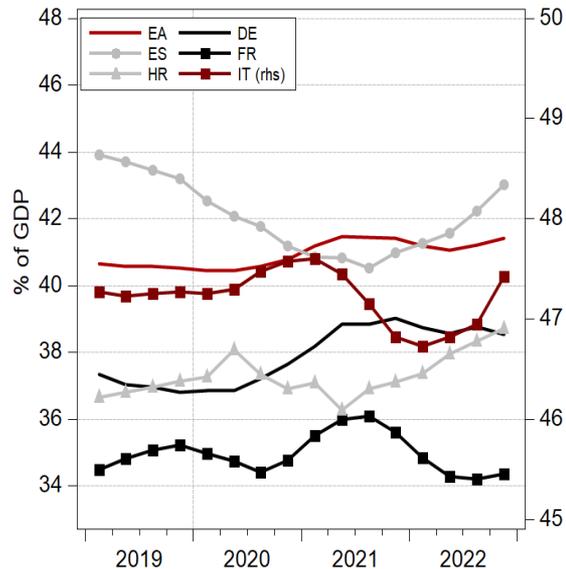
Note: Activity rate refers to the number of active persons in the 15-64 age group as a percent of total population. Unemployment rate refers to the number of unemployed persons in the 15-74 age group as a percent of population in the labour force.

Source: Eurostat.

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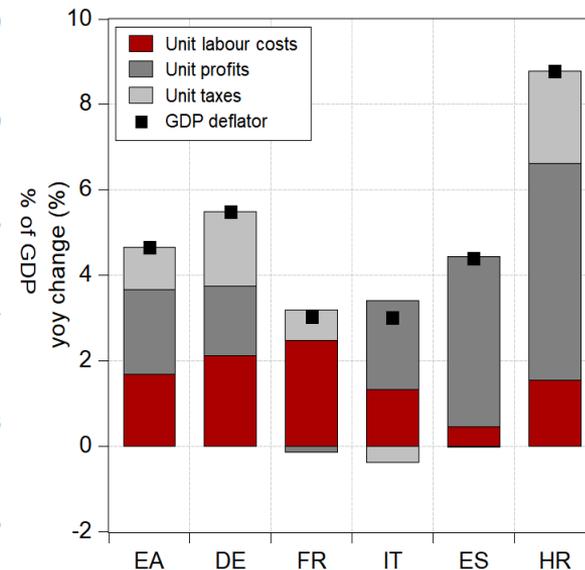
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Gross operating surplus and mixed income (4qma)



Source: Eurostat.

GDP deflator

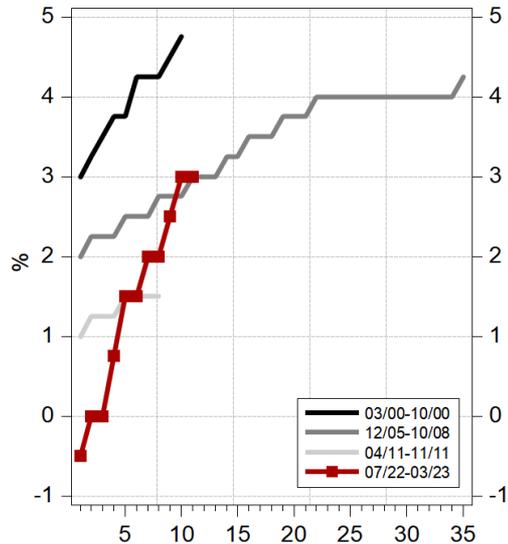


Note: Data refers to 2022.

Source: Eurostat.

Ongoing monetary policy tightening cycle is stronger than earlier episodes

Tightening cycles



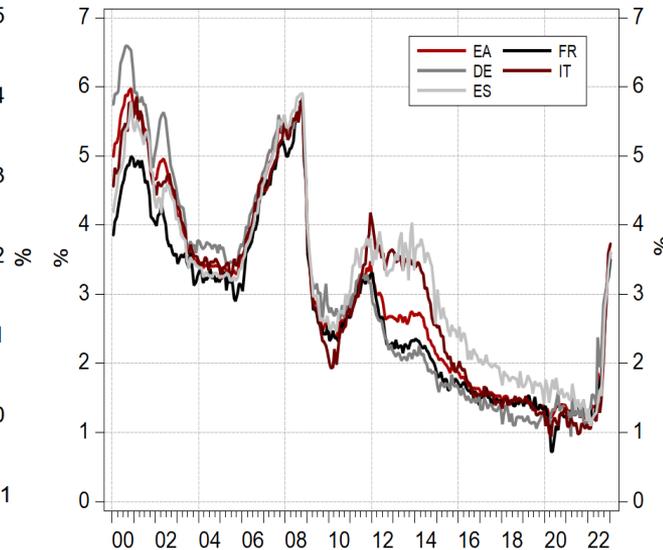
Note: X axis denotes number of months. Key rates refer to MRO, except for last cycle where DFR is shown.

Source: ECB; CNB calculations.

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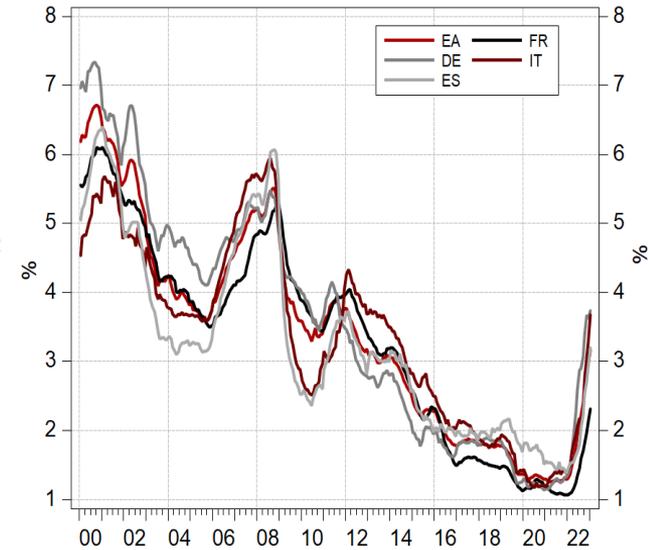
Interest rates on loans to NFCs



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

Source: ECB.

Interest rates on loans to HHs

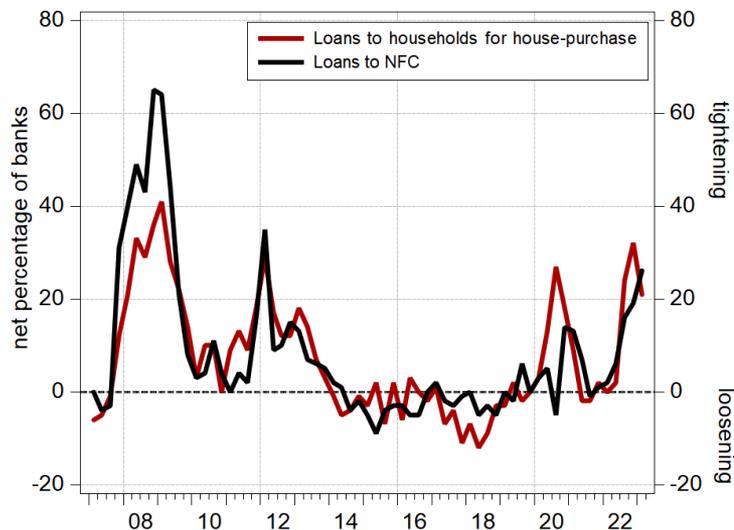


Note: Data refers to new business loans to households for house-purchase until Aug 2017, and pure new loans after.

Source: ECB.

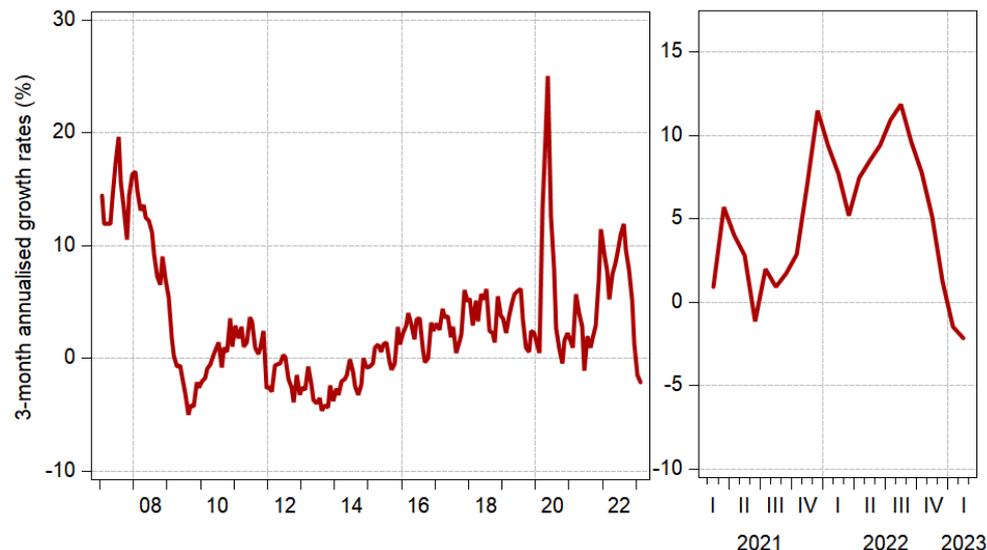
... and EA banks are tightening lending standards, slowing down the credit activity

Lending standards



Source: ECB (BLS).

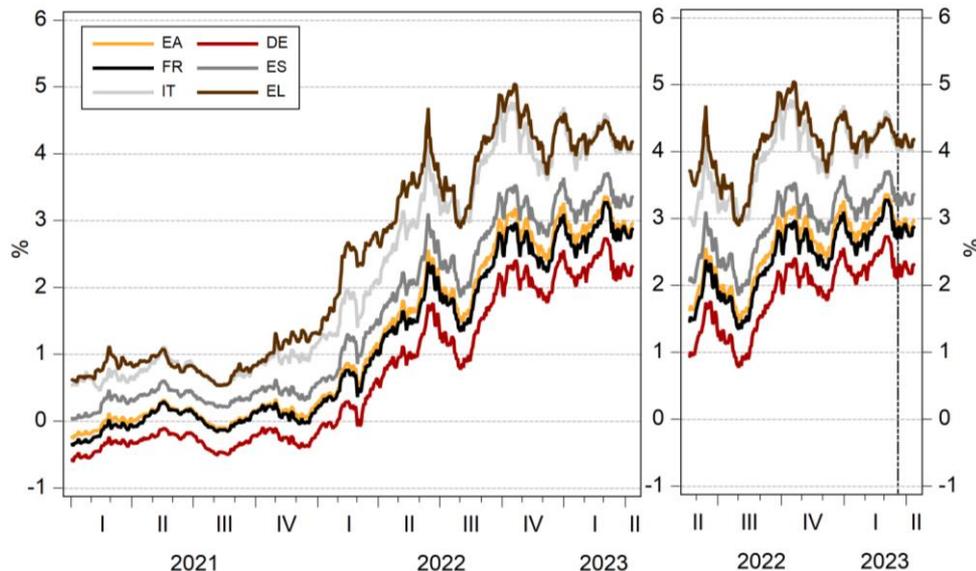
Credit momentum in EA



Note: Data up to February refers to transactions (flows) to NFC.
Source: ECB; CNB calculations.

Government bond yields remain stable while financial markets stress reverses following the banking turmoil

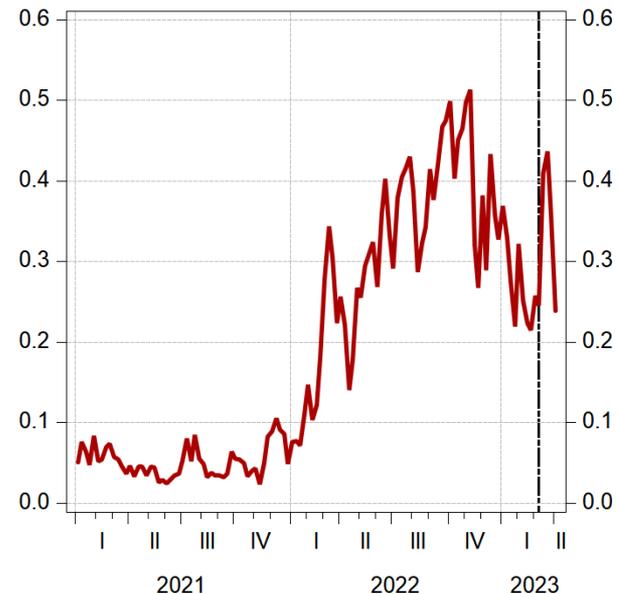
10y government bond yields



Note: Yields for the euro area are weighted by the share in GDP of the countries involved. The euro area does not include data for EE, LV, LU and MT. The vertical line refers to the volatility in the financial markets due to the situation with Credit Suisse (mid-March).

Source: Bloomberg; CNB calculations.

Composite systemic risk indicator (CISS)



Note: The vertical line refers to volatility in the financial markets due to the situation with Credit Suisse (mid-March).

Source: ECB



Thank you very much for your attention!