



HRVATSKA NARODNA BANKA

EUROSUSTAV

Croatia as a new member of the euro area

IMAP Conference 2024

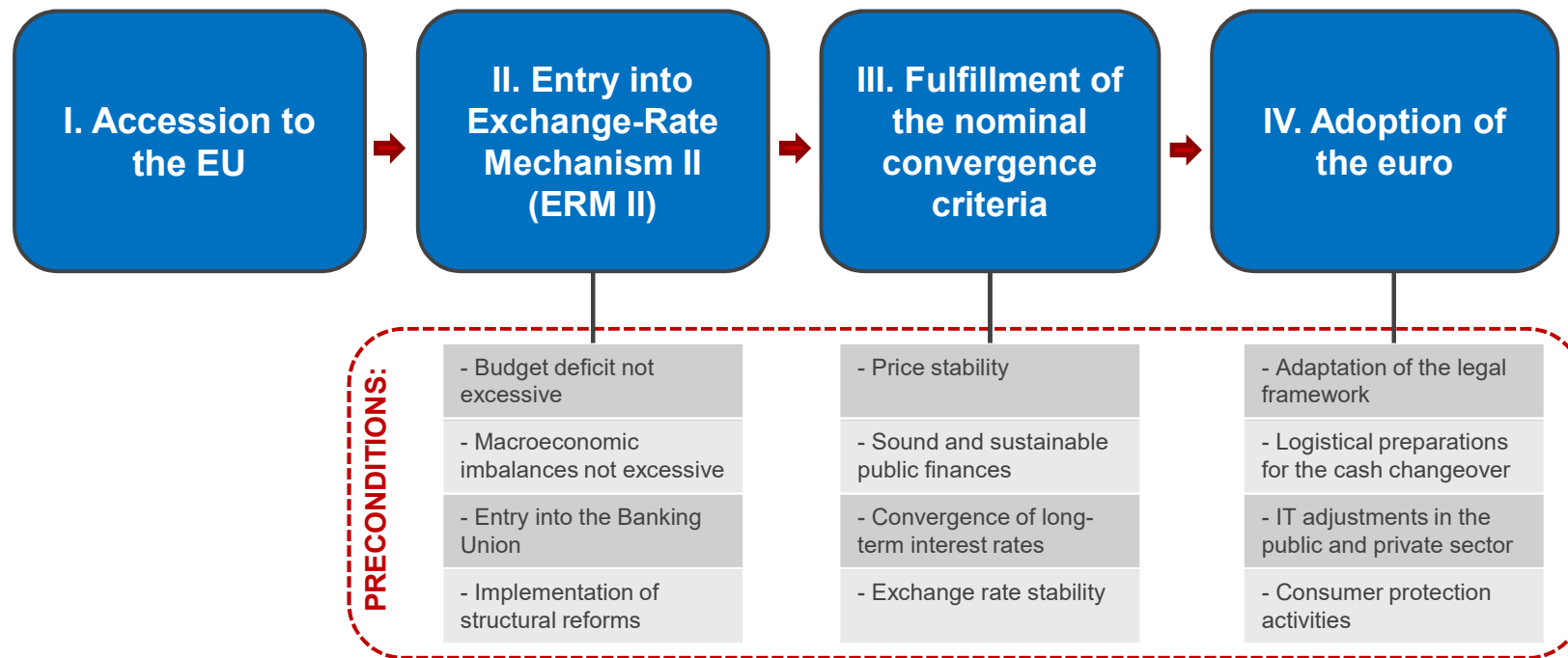
Boris Vujčić
Governor
Zagreb, 11 October 2024



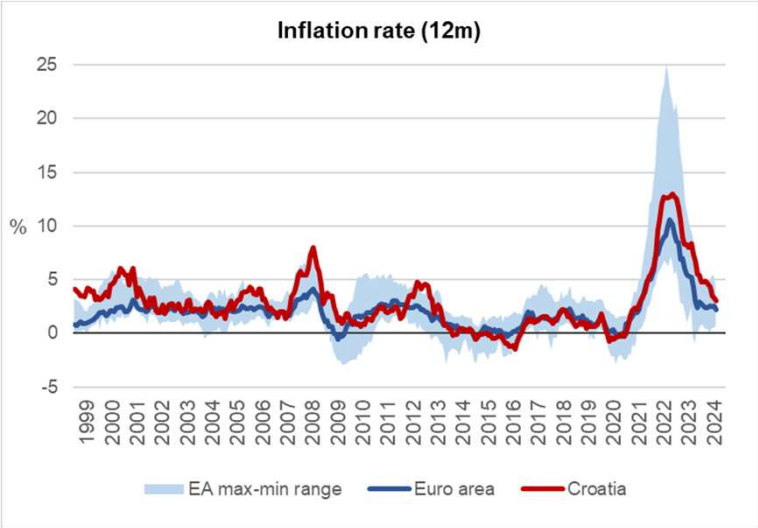
Overview

- Croatia's road to the euro – a brief overview
- Economic impact of the adoption of the euro

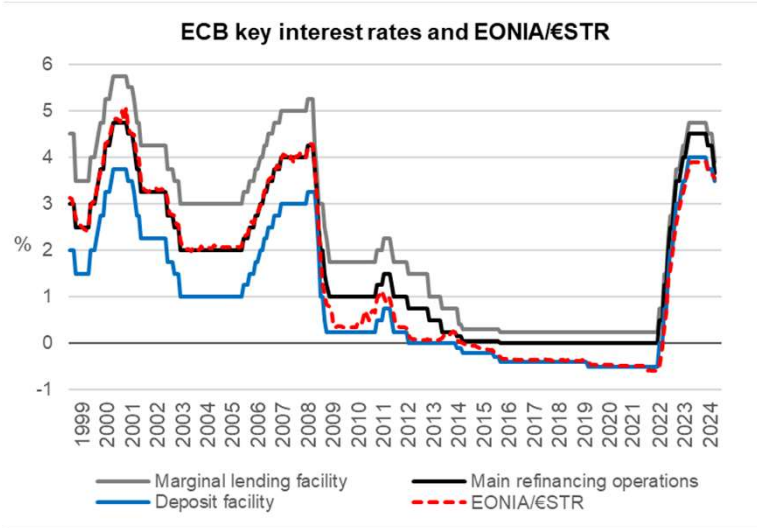
The euro adoption process was demanding and lengthy as various preconditions had to be fulfilled



Croatia adopted the euro in a challenging period marked by geopolitical tensions, high inflation and tight monetary policy

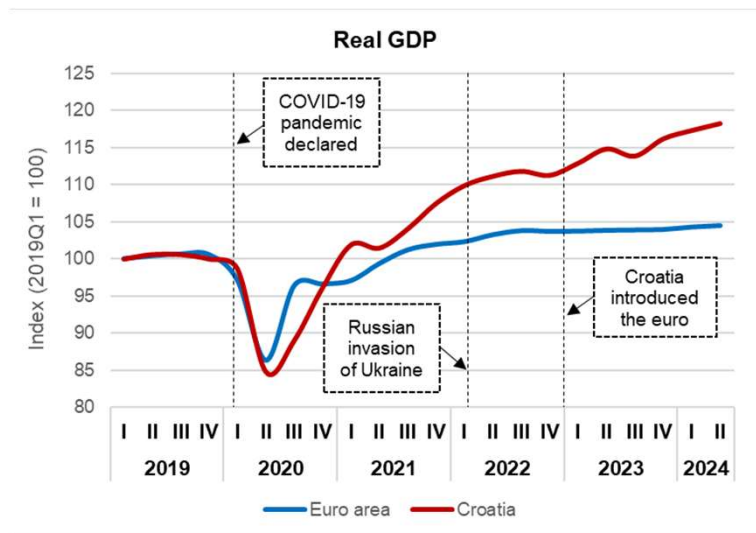


Source: Eurostat

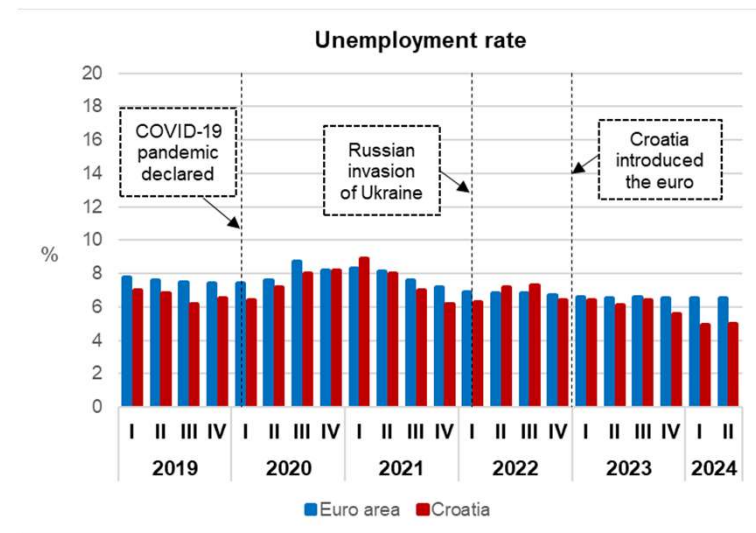


Source: ECB

Faced with these challenges, economic activity and the labor market proved remarkably resilient ...

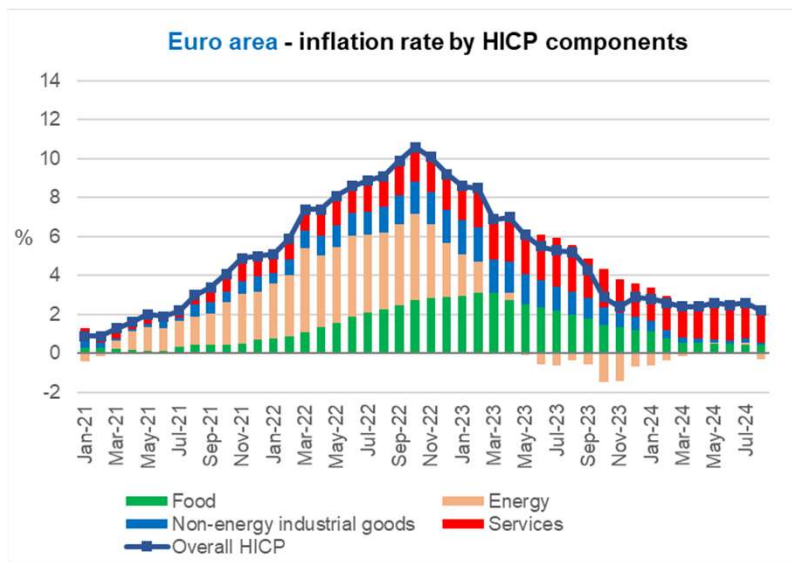


Source: Eurostat

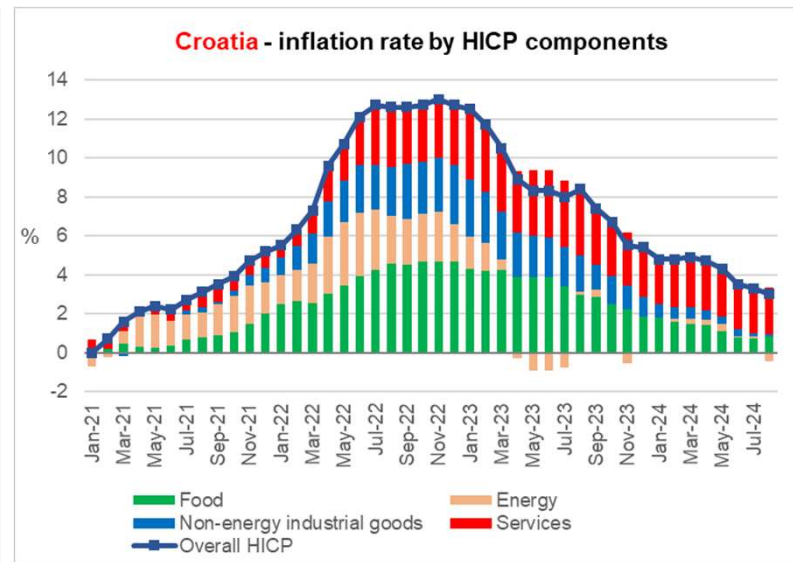


Source: Eurostat

... which in turn fueled a sustained increase in services prices



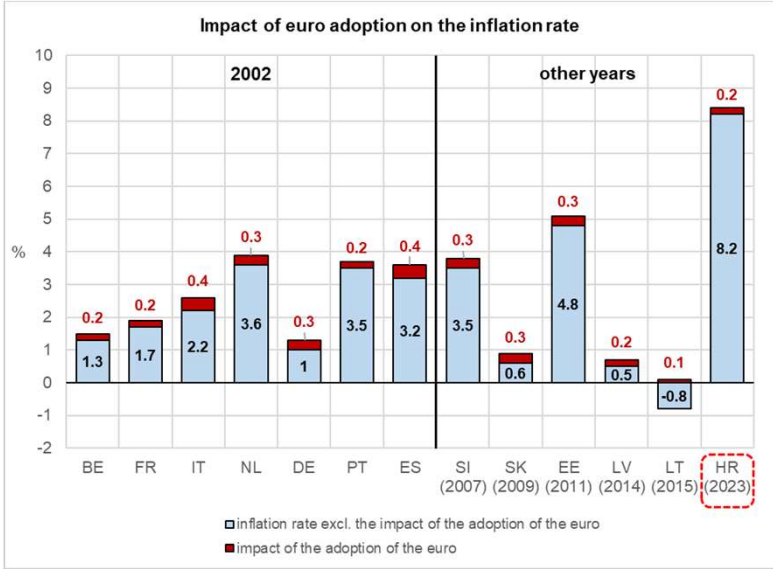
Source: Eurostat



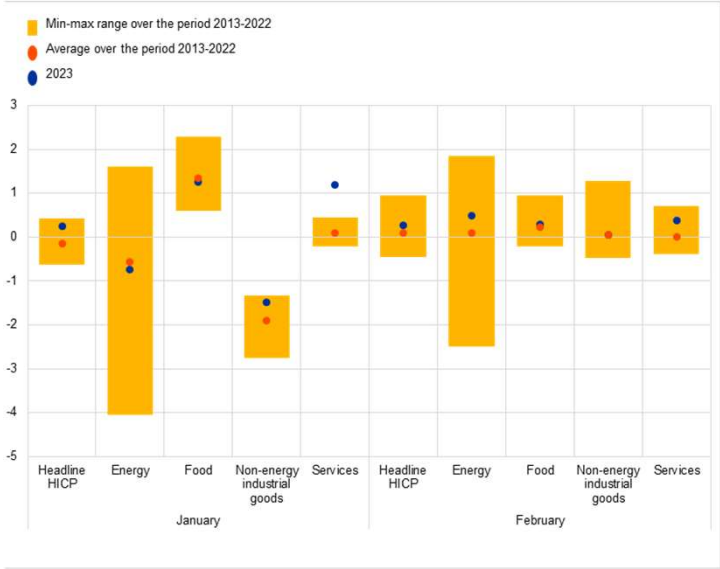
Source: Eurostat

The adoption of the euro itself had a mild impact on consumer prices

As in other countries in the past, the inflationary impact of the euro was very small on aggregate, although the prices of services did increase somewhat due to rounding up

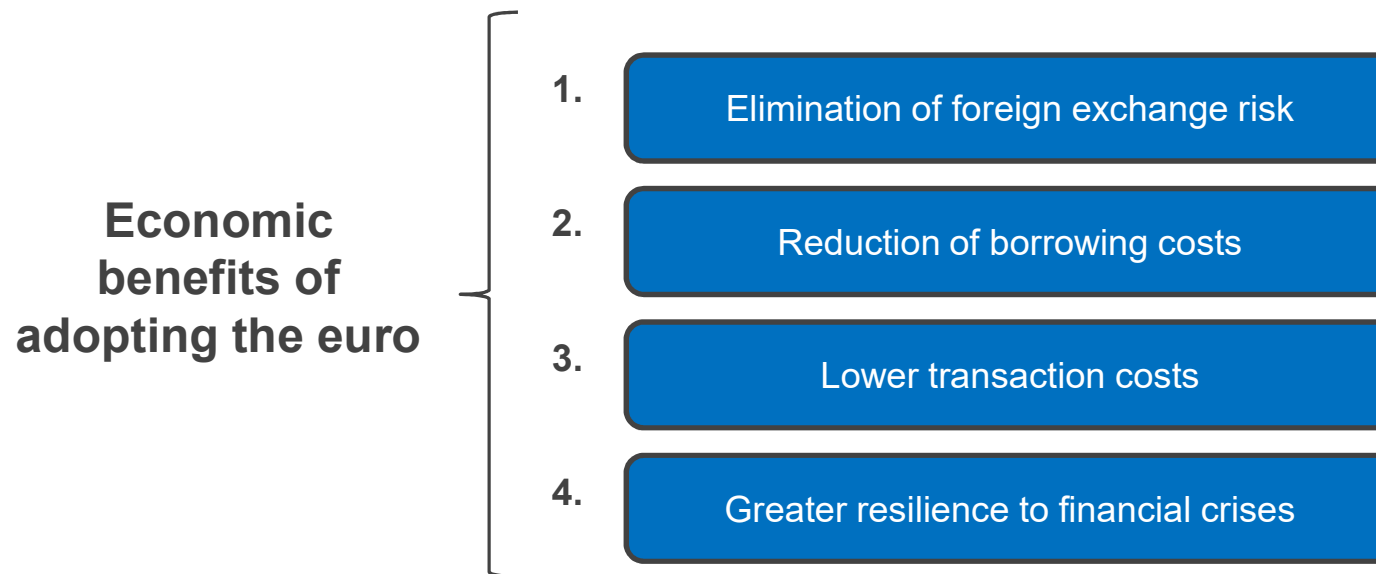


Sources: Eurostat, Pufnik (2017)



Source: Eurostat

Despite the challenging environment, all the expected positive effects of the adoption of the euro have materialized

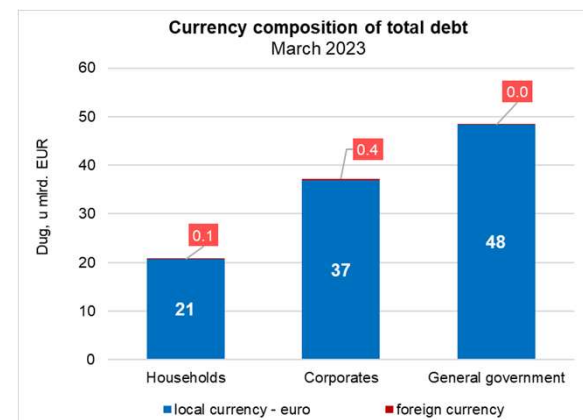
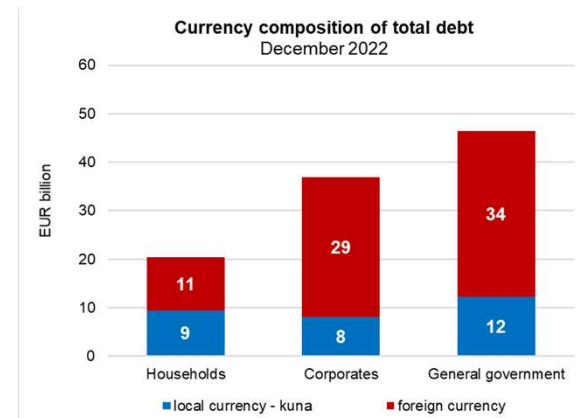


FX risk has been completely eliminated

- As a previously highly euroized country, Croatia has benefited significantly from the adoption of the euro as foreign exchange risk has disappeared completely

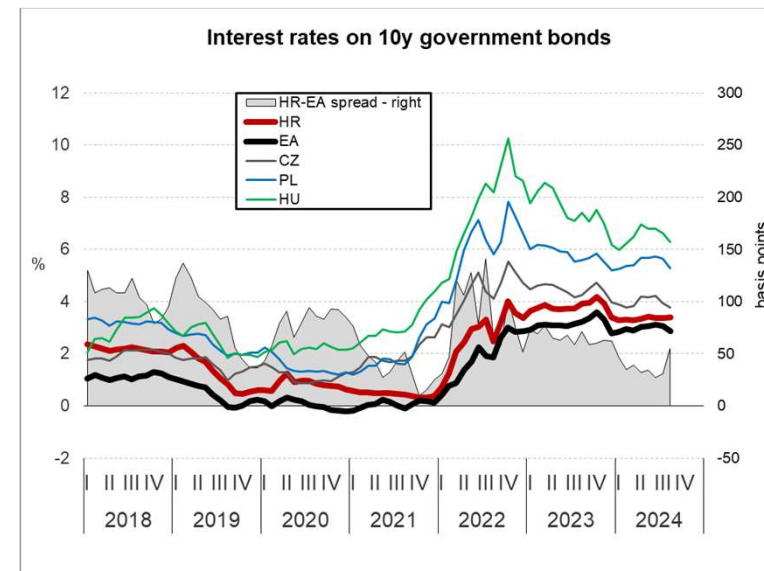
❖ in December 2022, foreign currency debt amounted to EUR 77 bln (**115% of GDP**)

❖ in March 2023, foreign currency debt amounted to only EUR 0.5 bln (**0.7% of GDP**)



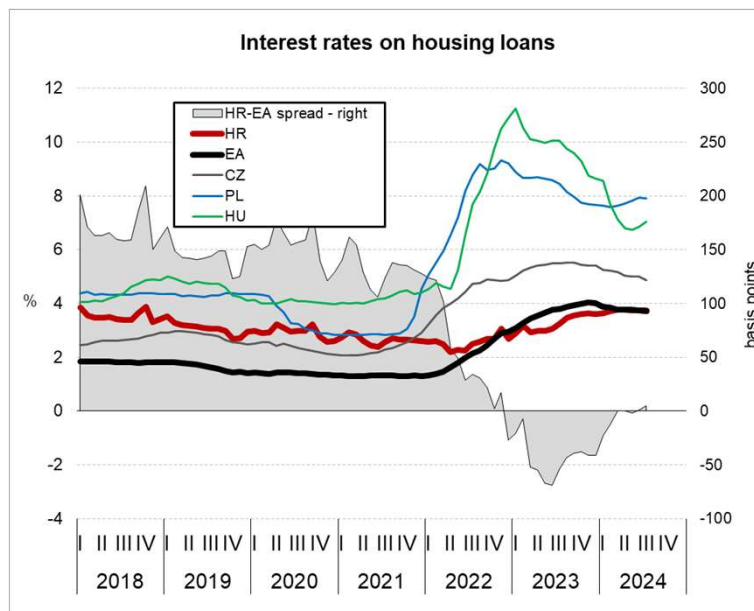
Borrowing costs are now very close to those prevailing in advanced euro area countries, which applies both to the public sector ...

- 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%

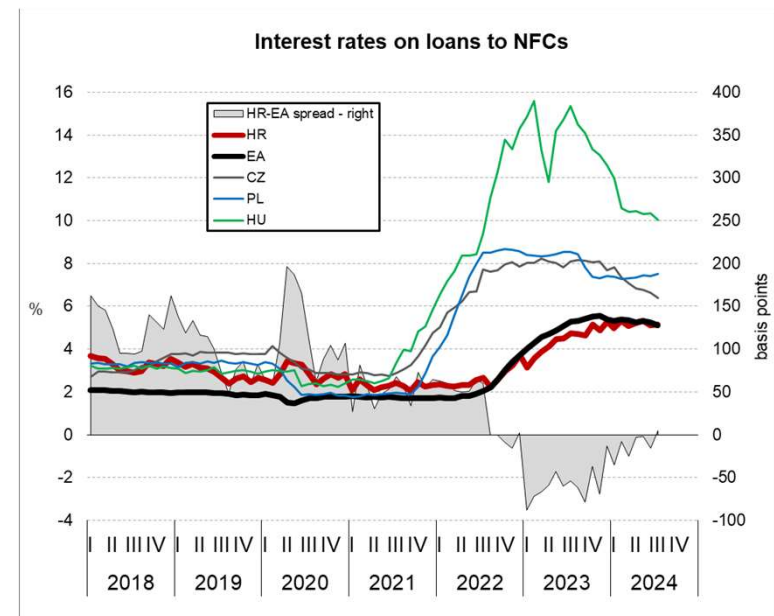


Source: Eurostat

... and the private sector borrowing costs



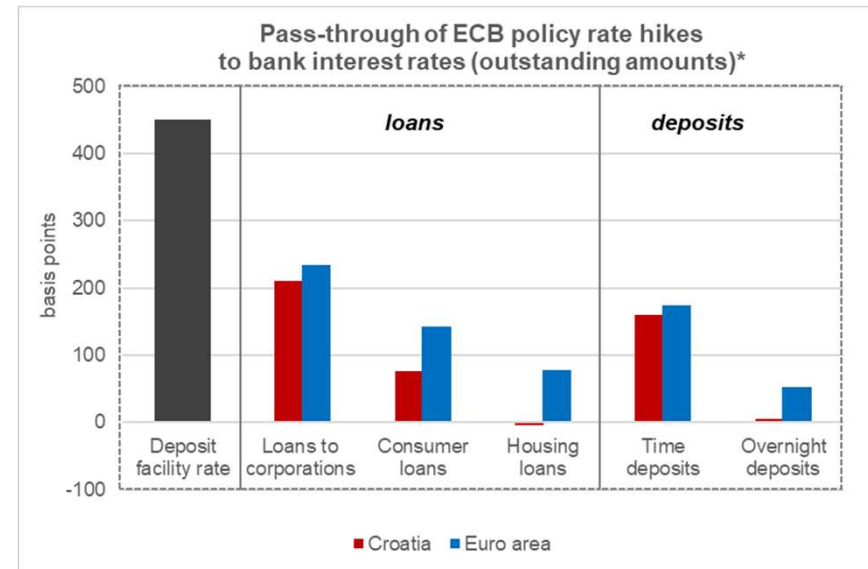
Source: ECB



Source: ECB

Interest rates rose since mid-2022 in line with ECB policy rates but less than in other euro area countries

- **Factors behind the relatively weak pass-through of ECB rate hikes in Croatia:**
 - effects of the adoption of the euro
 - additional increase in excess liquidity
 - reduction in the risk premium
 - relatively high share of loans with a fixed interest rate
 - variable-rate loans are linked mainly to the National Reference Rate, which is more stable over time than EURIBOR
 - legal provisions set a limit on how high interest rates on variable-rate loans to households can rise

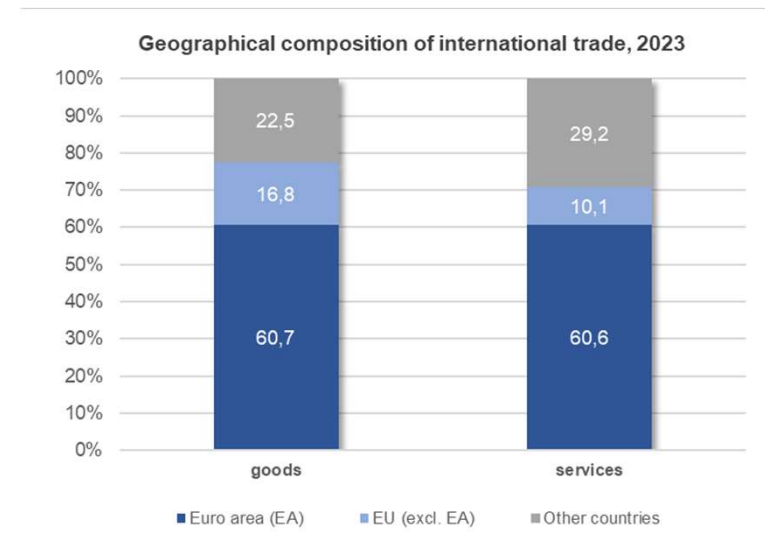


* Refers to the cumulative change between July 2022 and December 2023.

Source: ECB

Euro adoption has led to a reduction of transaction costs, which facilitates merchandise trade and tourism ...

- Merchandise trade with euro area countries is facilitated as there is no longer a need for currency conversion
- The competitiveness of tradable sectors, including tourism, has been further increased by the **entry into the Schengen area**
- Total annual savings for the non-financial sector due to the disappearance of currency conversion costs are estimated at **EUR 160 million** (HRK 1.2 billion)

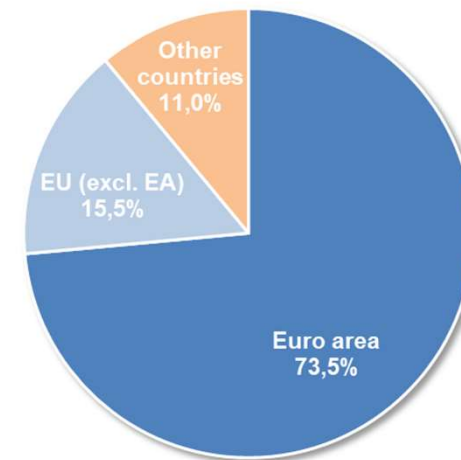


Source: Eurostat

... while in the medium to long run it may also support foreign investment

- Higher resilience of the Croatian economy and lower uncertainty for foreign investors due to the elimination of FX risk improve Croatia's reputation as a destination for foreign investment
- This applies both to FDI and portfolio investment, including investment in the government debt market
- In particular, euro area investors, who account for 3/4 of total FDI investment in Croatia, are now able to invest in their own currency

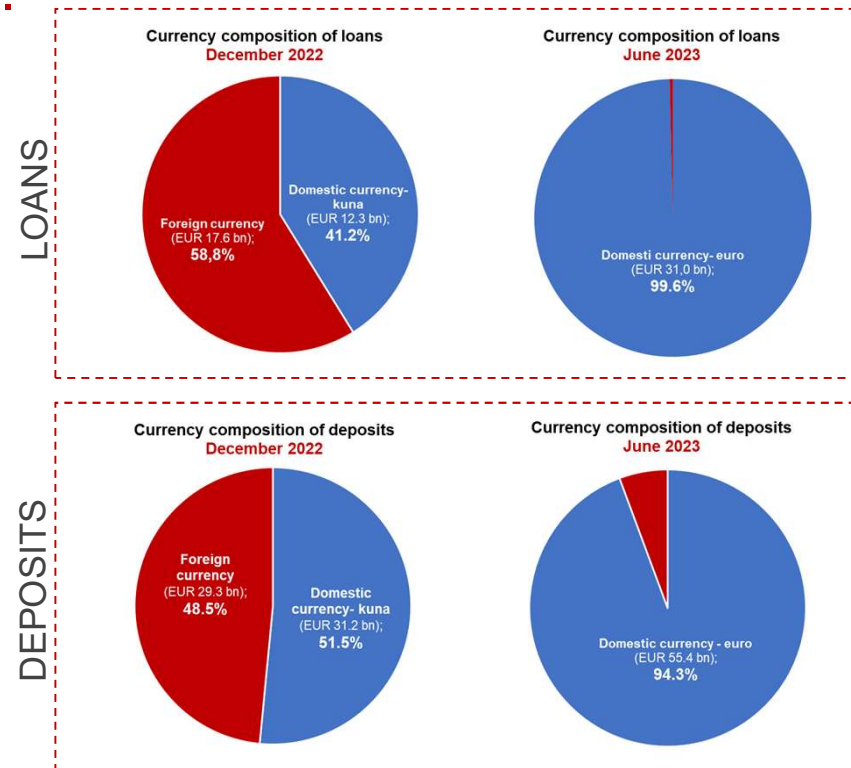
Structure of FDI inflows to Croatia in 1993-2023, by partner country



Source: Eurostat

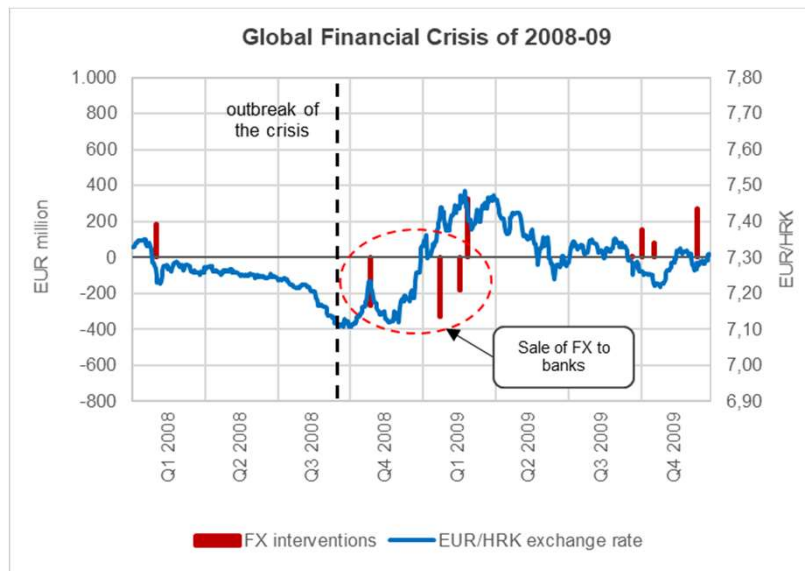
As a euro area member, Croatia is now much more resilient to financial crisis and external shocks ...

- Financial stability risks are significantly lower after the adoption of the euro:
 - the elimination of FX risk for borrowers led to increased resilience of the overall economy
 - FX-induced credit risk is eliminated as virtually all loans are now in domestic currency (**99,6%**)
 - almost all deposits (**94%**) are in domestic currency, which simplifies liquidity risk management in banks
 - as part of the Eurosystem, HNB can react more forcefully in case of turmoil – LOLR in full capacity
 - a harmful currency depreciation no longer possible
 - the government can borrow from the ESM in case of financial difficulties

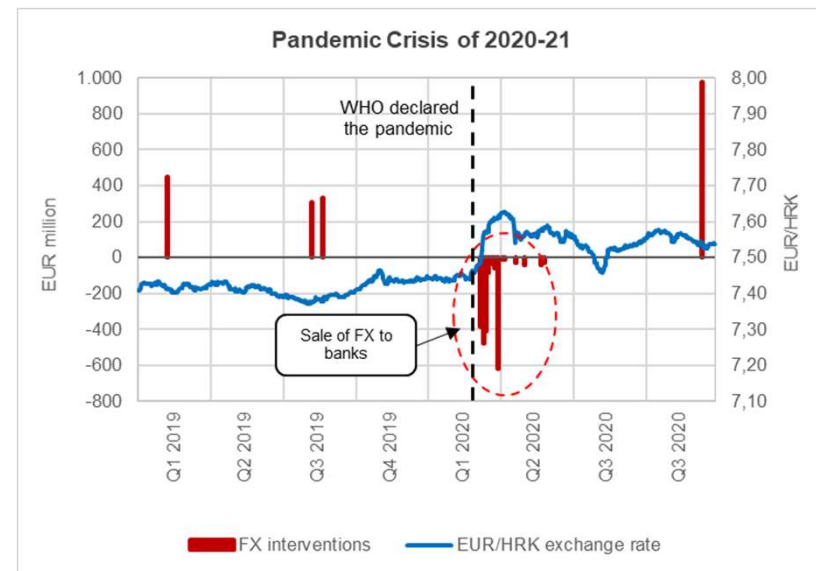


... than it was in the past when it had its own currency

In past crisis episodes, HNB had to intervene heavily to preserve currency stability

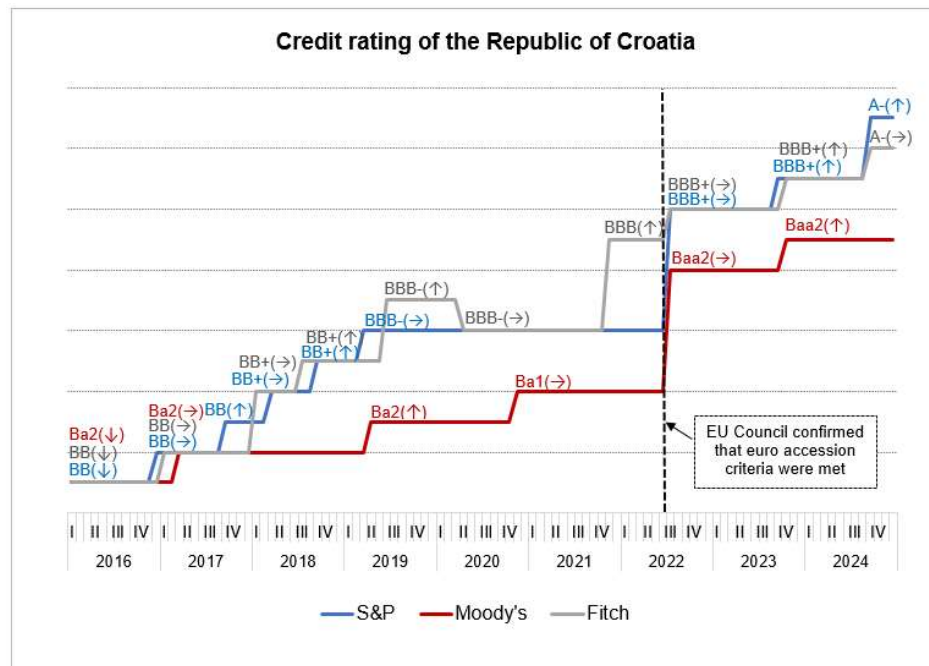


Source: HNB



Source: HNB

Croatia's higher macro-financial resilience has been acknowledged by credit rating agencies



Source: HNB

Key takeaways

- The adoption of the euro is a challenging, multi-stage process, which requires satisfying various economic and structural criteria, as well as preparing the economy for the currency changeover
- Croatia has already reaped significant benefits of euro adoption, in terms of higher macro-financial resilience, relatively lower borrowing costs and more efficient international trade
- The disappearance of the risks and costs associated with exchange rate movements and the generally improved macroeconomic performance are expected to encourage investments – both domestic and foreign – in the medium and long term

Thank you for your attention!