



CROATIAN NATIONAL BANK

EUROSYSTEM

Benefits and costs of adopting the euro: Croatia's experience

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Hrvatska narodna banka (HNB)

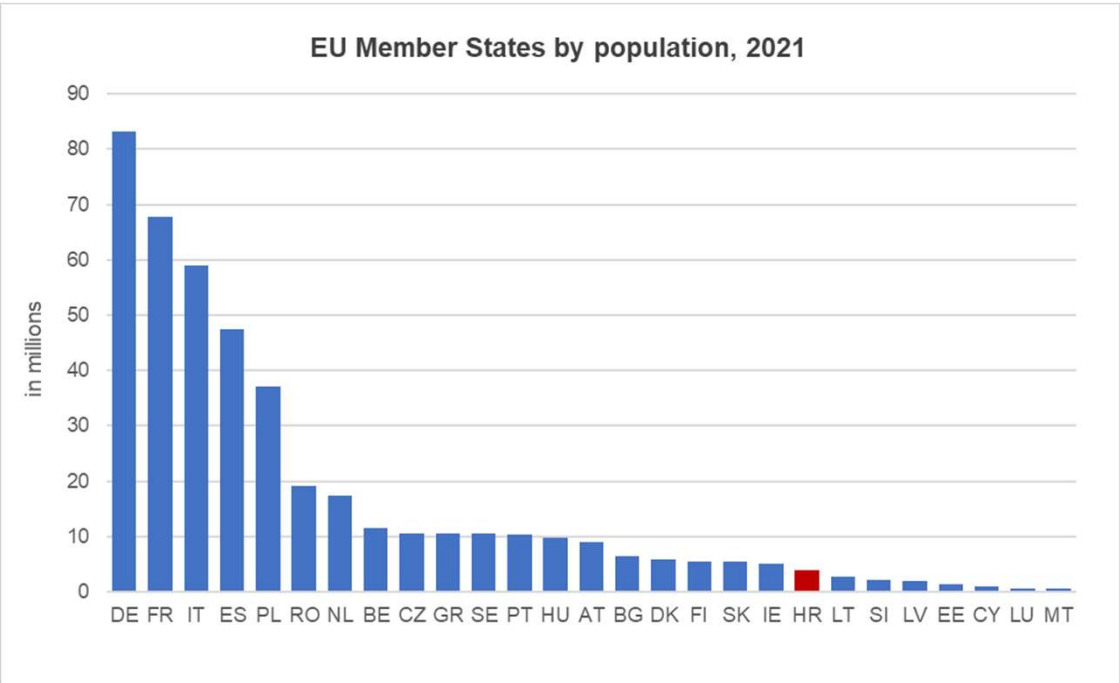
Warsaw, 25 March 2025



Overview

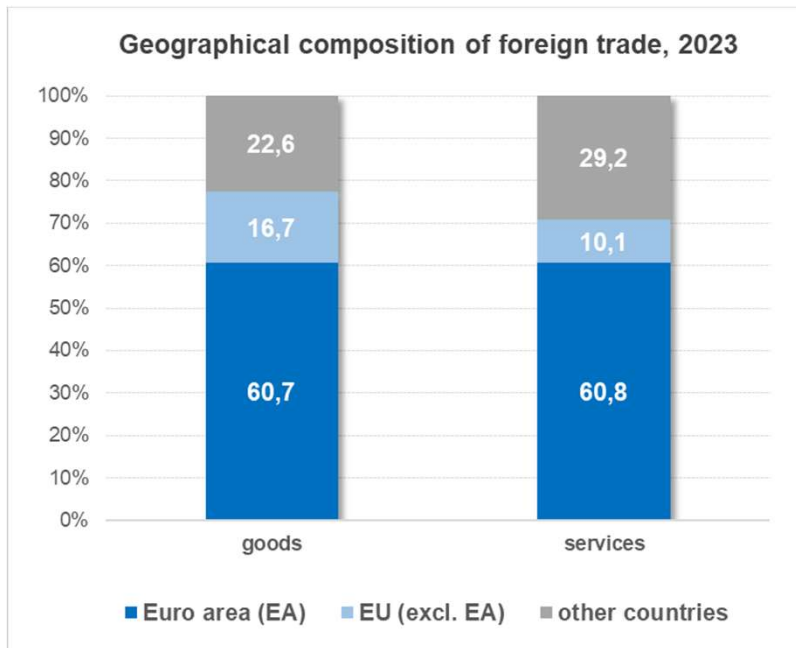
- Economic benefits and costs of euro adoption
- The Croatian economy after the adoption of the euro

Croatia is a small country ...

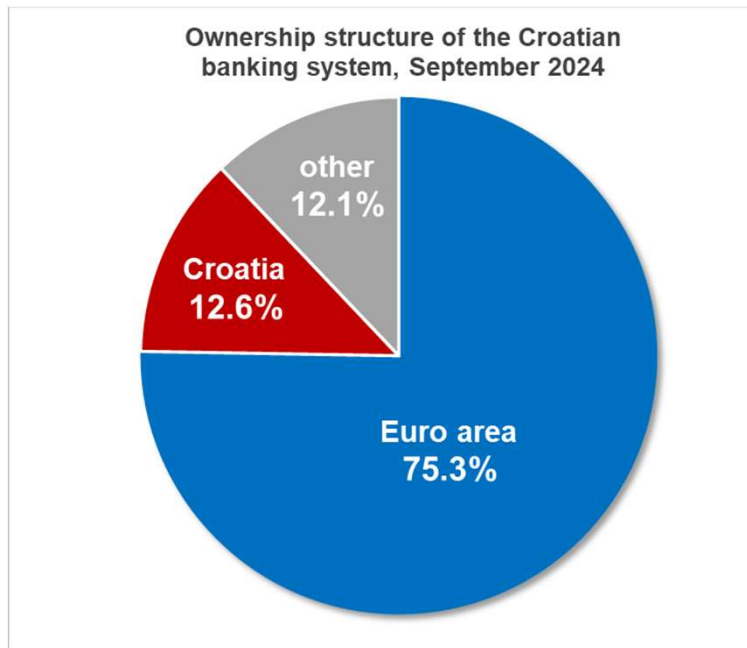


Source: Eurostat

... with strong economic and financial ties with the euro area

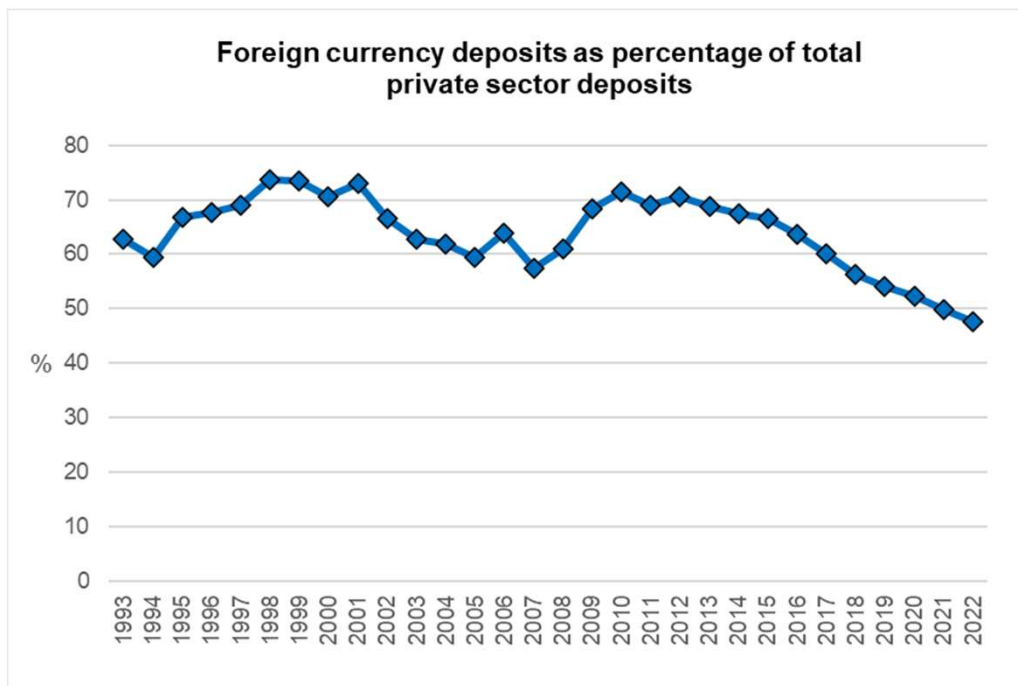


Source: Eurostat



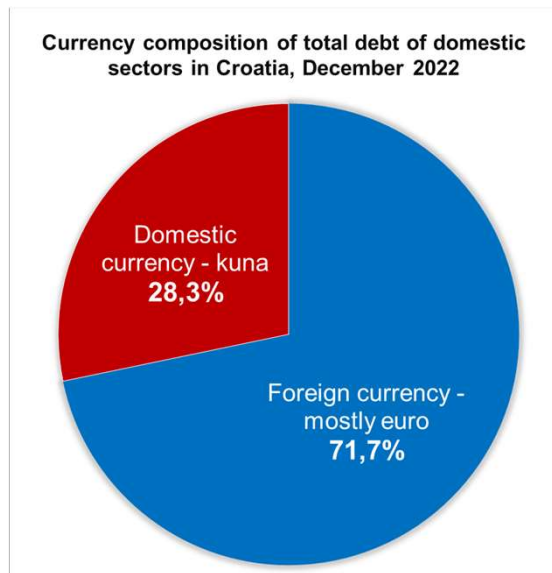
Source: HNB

Deposit euroization was persistently high

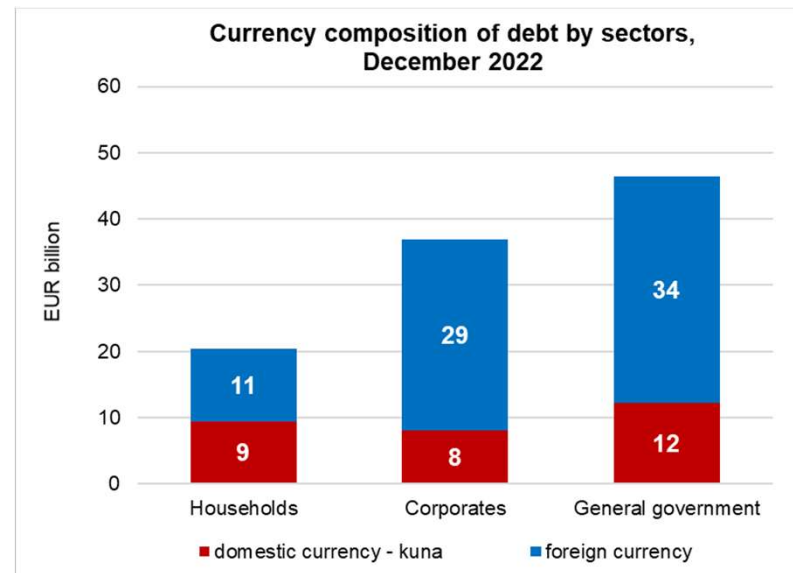


Source: HNB

Before the adoption of the euro, the Croatian economy was heavily exposed to foreign exchange risk



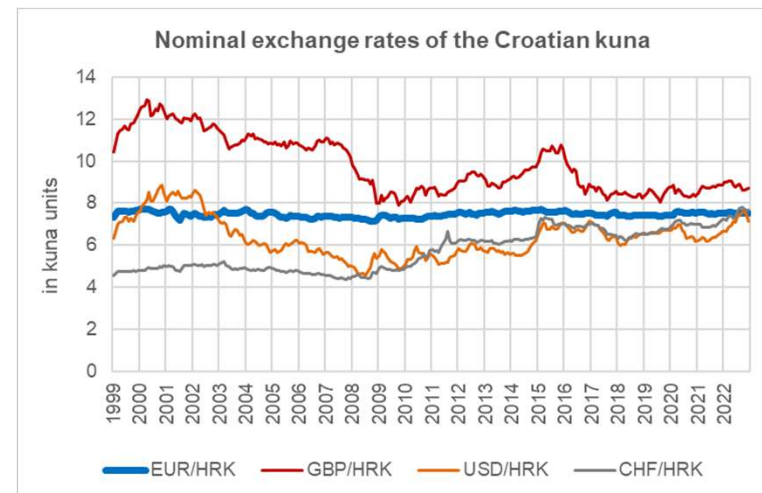
Source: HNB



Source: HNB

In such a context, the HNB operated an exchange rate-based monetary policy regime

- HNB fulfilled its primary objective – **price stability** – by maintaining a stable EUR/HRK exchange rate
 - this way, the HNB kept import prices stable and inflation expectations anchored, thereby ensuring a low and stable overall inflation
 - a stable EUR/HRK exchange rate was equally important to protect borrowers with unhedged liabilities in euros
 - there were no explicit targets for the exchange rate and the inflation rate



Source: HNB

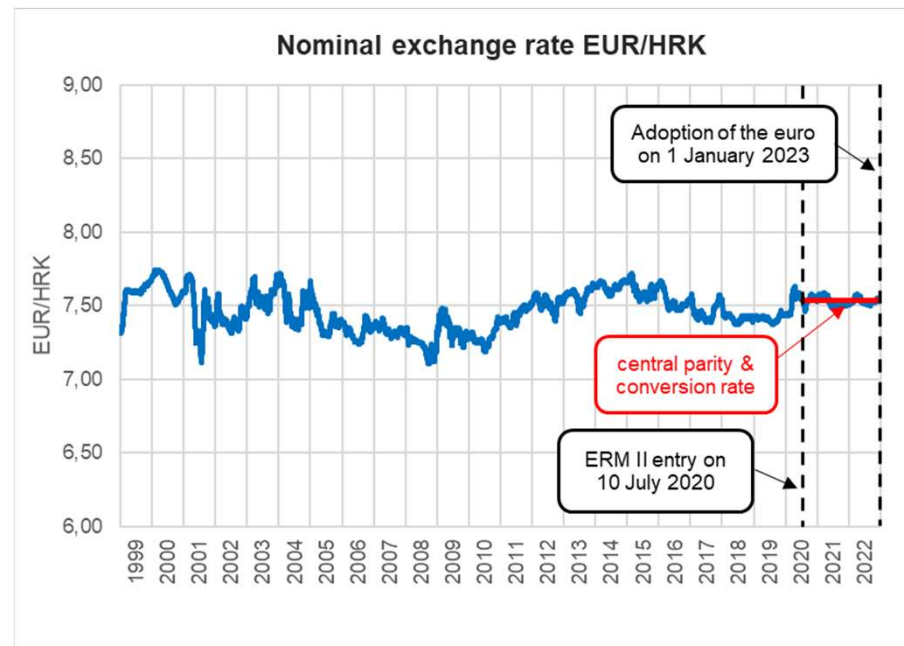
Against such background, the economic benefits of euro adoption by far outweigh the costs, even in the short run



I) Elimination of FX risk

The removal of foreign exchange risk was particularly important ...

- The euro was introduced at the exchange rate of 7.53450 kuna for 1 euro, which was close to the historical average of the EUR/HRK exchange rate
 - the same exchange rate was used as the **central parity** for ERM II participation which started in July 2020 ...
 - ... and as the official **conversion rate** for the adoption of the euro on 1 January 2023

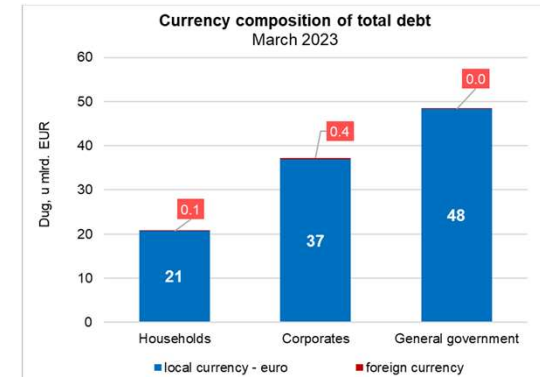
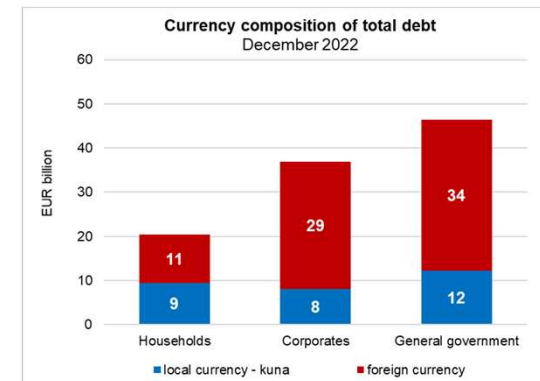


Source: HNB

I) Elimination of FX risk (cont.)

... due to Croatia's persistently high level of euroization

- 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**)
 - ❖ after the adoption of the euro, foreign currency debt was only EUR 0.5 bln (**0.7% of GDP**)

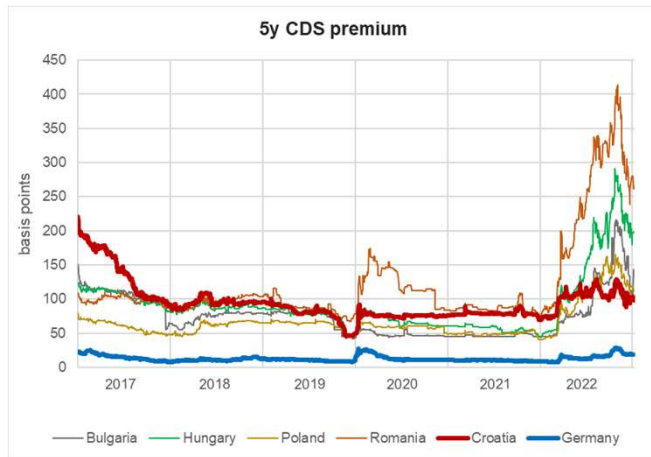


II) (Relative) reduction in borrowing costs

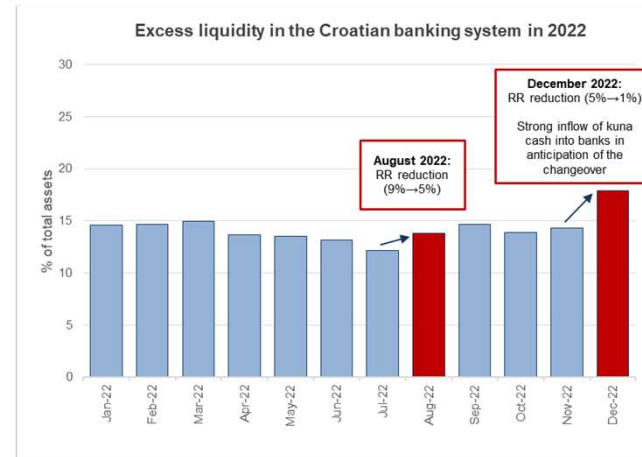
Interest rates have converged to those in the euro area

Euro adoption has affected interest rates in Croatia through **2 channels**:

- 1) a positive impact on the risk premium
- 2) an increase in the banking system liquidity



Source: Bloomberg

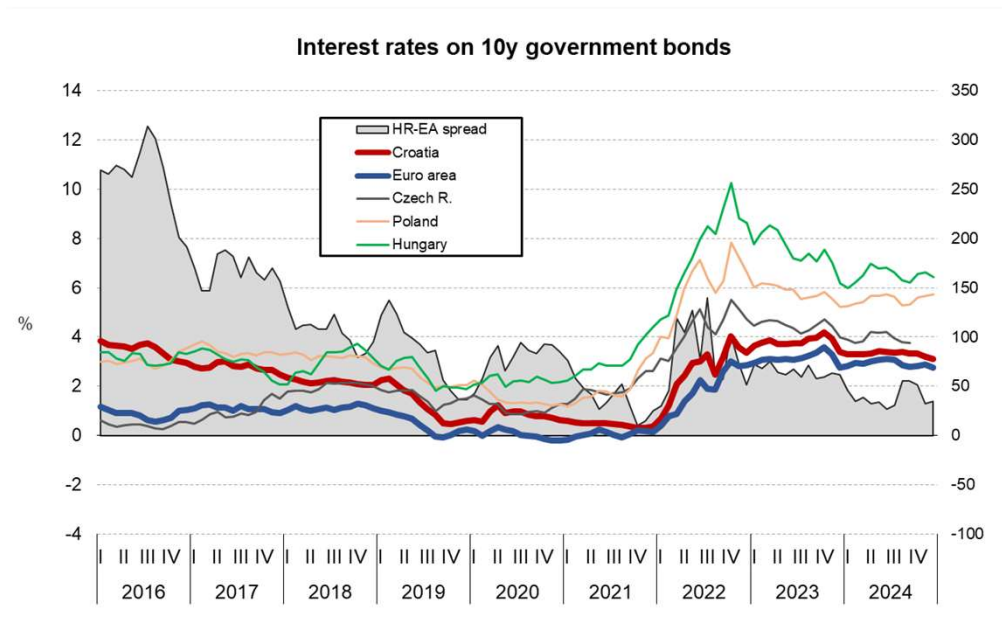


Source: HNB

- The impact of the ECB's tighter monetary policy on interest rates in Croatia was further mitigated by the fact that a majority of variable-rate loans were linked to the (more stable) national reference rate (**NRS**), instead of **EURIBOR**

II) (Relative) reduction in borrowing costs

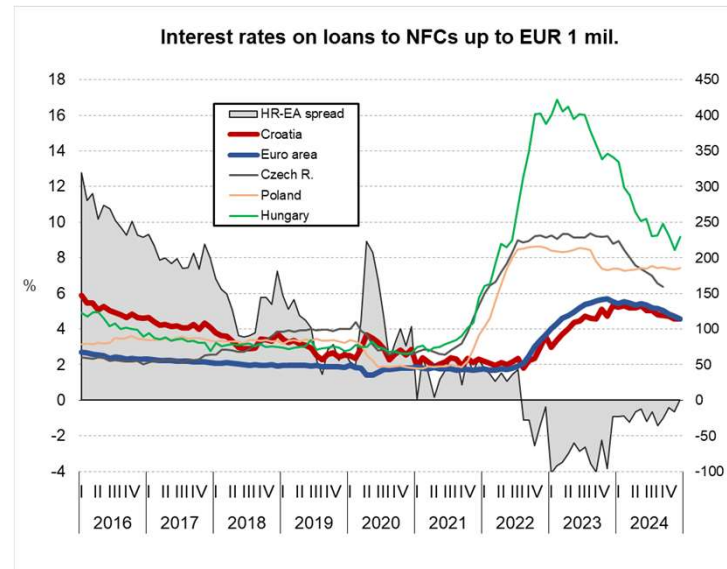
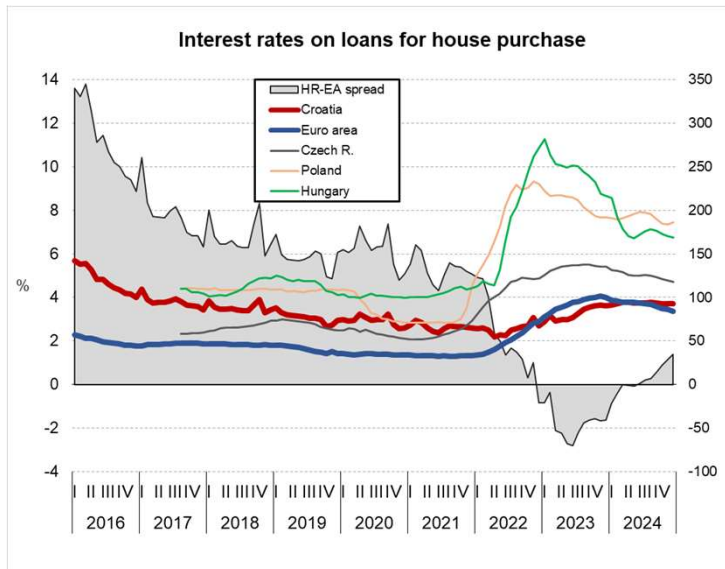
Interest rates have converged to those in the euro area (cont.)



Source: Eurostat

II) (Relative) reduction in borrowing costs

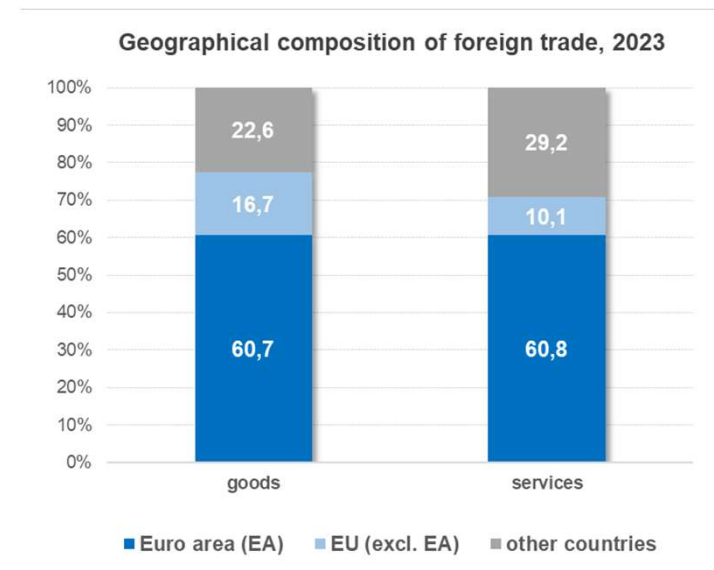
Interest rates have converged to those in the euro area (cont.)



III) Reduction of transaction costs

Euro adoption facilitates merchandise trade, tourism and investment

- Foreign 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**



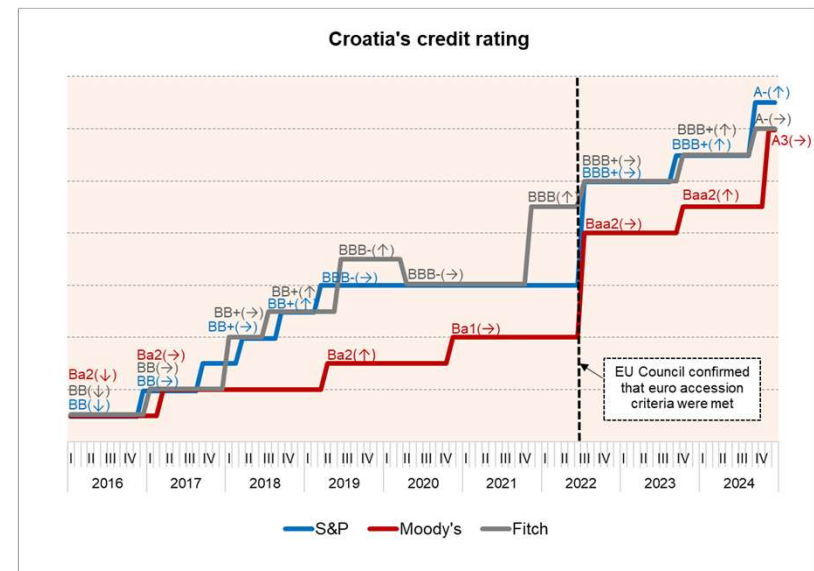
Source: Eurostat

IV) Greater resilience

Croatia now enjoys a much higher level of macro-financial resilience

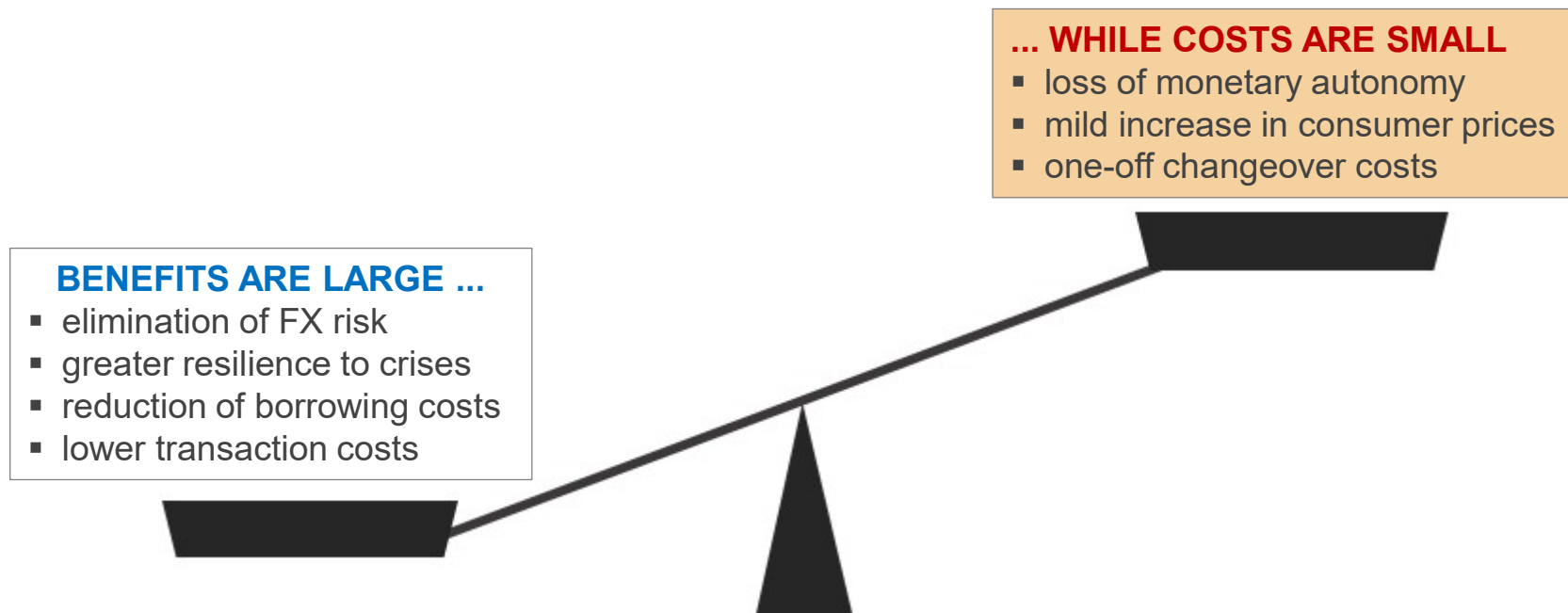
- **The resilience of the Croatian economy and the financial system is now greater for several reasons:**
 - harmful currency depreciation no longer possible
 - government debt is now entirely in domestic currency
 - households and corporations are no longer exposed to foreign exchange risk
 - banks are no longer indirectly exposed to foreign exchange risk
 - as part of the Eurosystem, HNB can more easily address liquidity problems in the banking system

Increased resilience has been reflected in significant credit rating upgrades



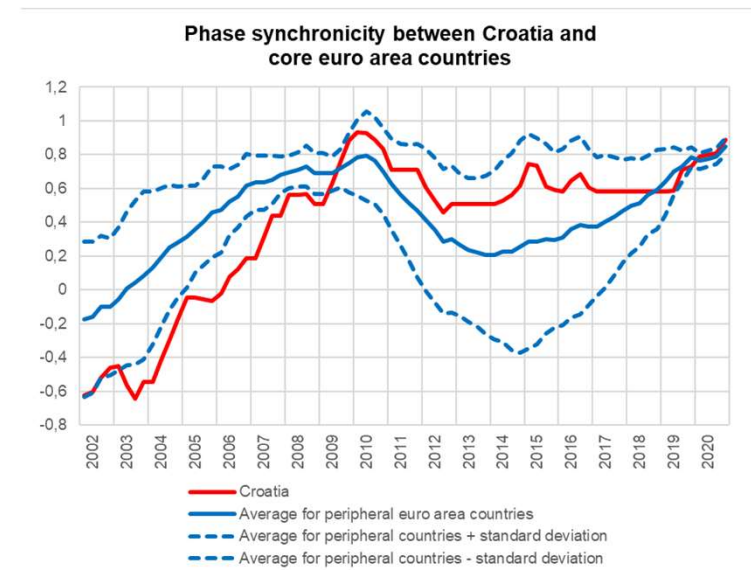
Source: ECB

In contrast, the costs were mostly small and one-off



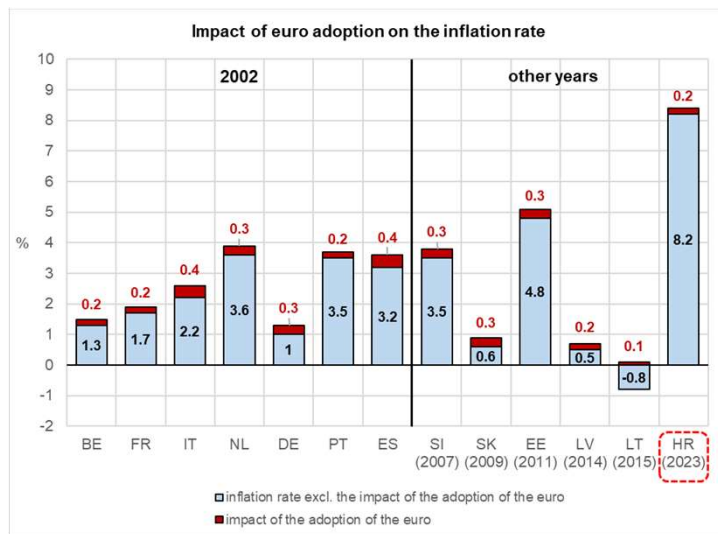
The loss of monetary autonomy was more a theoretical than a real cost for Croatia

- Prior to euro adoption, the effectiveness of monetary policy in Croatia was **constrained** due to several factors:
 - vulnerability to exchange rate depreciation due to a large stock of foreign currency debt
 - import dependence
 - strong presence of foreign-owned banks
- **Business cycle synchronization** vis-a-vis core euro area countries has increased over time and is comparable to those of other euro area countries
- In addition, with the adoption of the euro, HNB started to **directly influence financial conditions** in the euro area and at home, which was not the case before

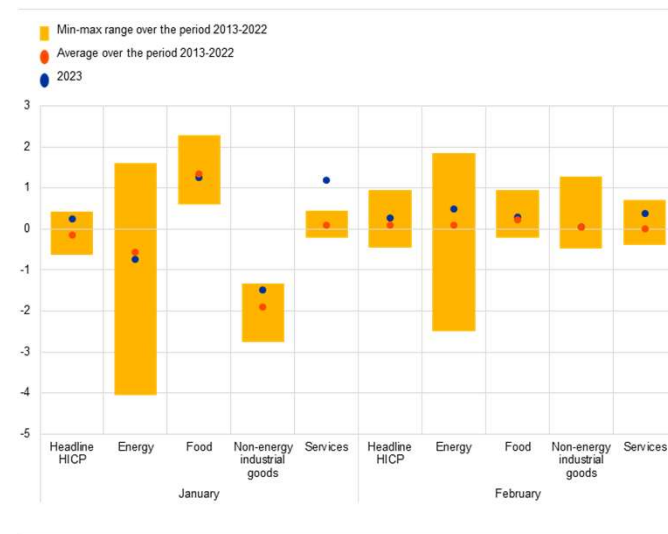


The adoption of the euro had a negligible one-off impact on prices, despite the high-inflation environment

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

Finally, there were also some one-off financial costs related to currency changeover

- Euro adoption requires certain **operational adjustments**, some of which are implemented by the state, and some by the private sector:
 - procurement/production of euro banknotes and coins
 - withdrawing legacy banknotes and coins and putting euro banknotes and coins into circulation
 - recalibrating ATMs and other adjustments in the financial sector
 - IT and administrative adjustments in the public and private sectors
 - information activities directed at citizens and entrepreneurs
 - transfer of funds to EU institutions
 - **68 mil. EUR** – paid into the capital of the ECB
 - **640 mil. EUR** – part of FX reserves transferred to the ECB
 - **422 mil. EUR** – paid into the capital of the ESM
- ➔ cost?

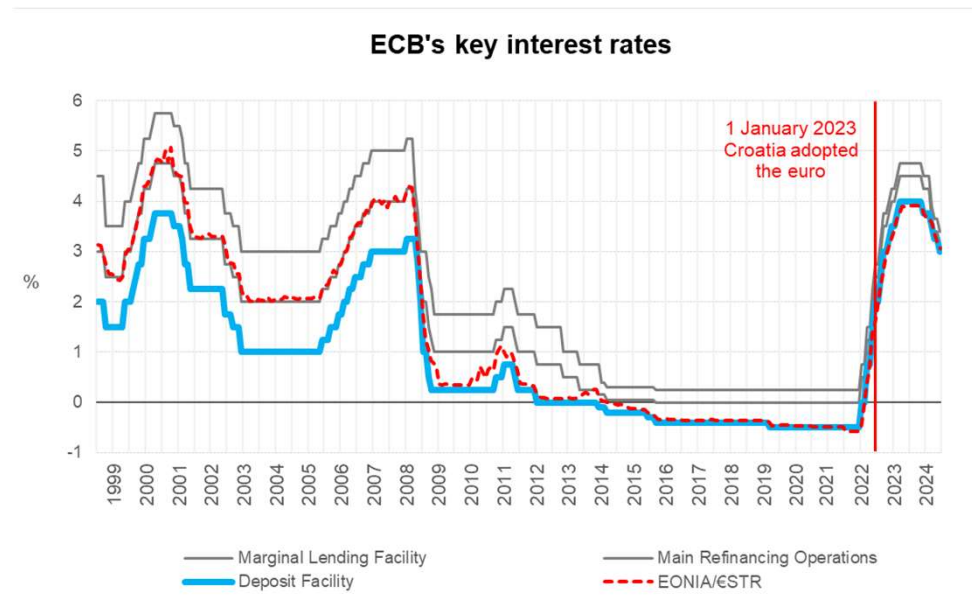
0,5-1,0% GDP

1,6% GDP



- The Croatian economy after the adoption of the euro

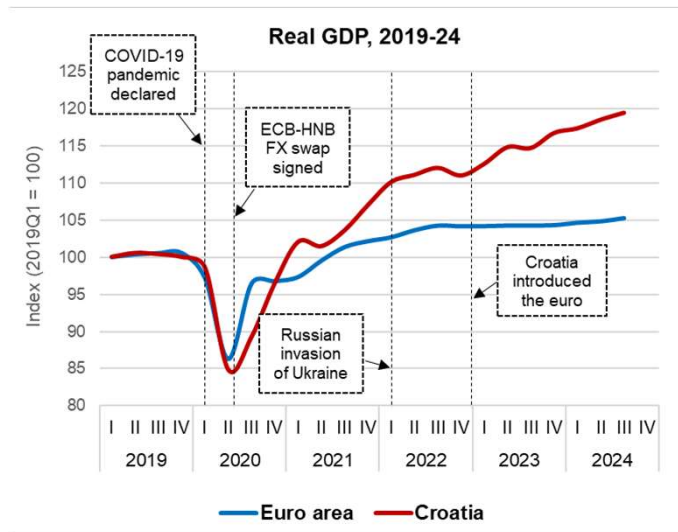
Croatia adopted the euro at a time of unusually high inflation, unprecedented tightening of monetary policy and rising geopolitical tensions



Source: ECB

Despite the delicate external environment, Croatia has performed very well supported by euro adoption and Schengen entry

Positive macro effects of euro area membership were felt even before the single currency was introduced



Source: Eurostat

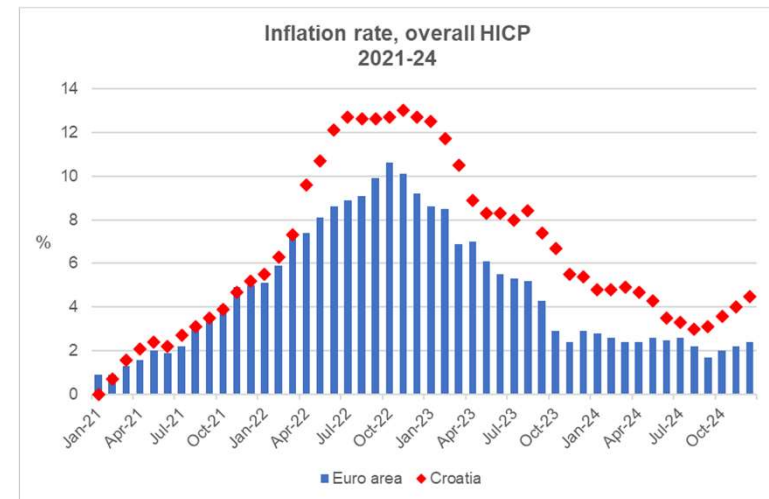
Croatia reports one of the highest GDP growth rates in the euro area



Source: Eurostat

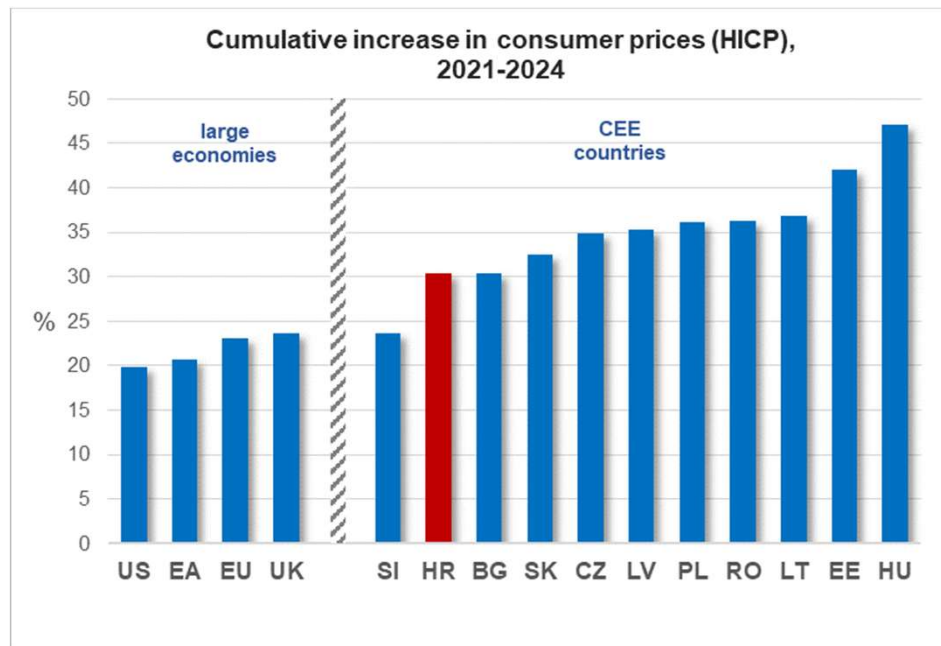
Stronger growth went hand in hand with a relatively higher inflation rate, compared to euro area average

- Factors behind higher inflation rates in Croatia:
 - **strong global demand for travel** after the COVID-19 pandemic
 - **composition of the consumer basket** (food accounts for a relatively large share of the overall basket)
 - **strong increase in public and private sector nominal wages**
 - **relatively weak pass-through** of higher ECB policy rates on bank lending rates in Croatia
 - Croatia is a **major beneficiary of EU funding**, which spurred investments



Source: Eurostat

Still, overall price increases in recent years have been weaker than in most other CEE countries



Source: Eurostat

Main messages

- The euro has brought significant and permanent economic benefits to Croatia, with greater macro-financial resilience, which is particularly important benefit in the current environment
- In contrast, the economic costs of adopting the euro were small and mostly one-off
- The Croatian economy has performed very well since joining the euro area despite the challenging external environment and tighter financial conditions
- Impact of the euro adoption on inflation was negligible and in line with experience of other countries which introduced euro prior to Croatia, irrespective of historically high-inflation environment

Thank you for your attention!