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## COVER NOTE

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| From:            | Ms Christine LAGARDE, President of the European Central Bank |
| date of receipt: | 24 June 2024   |
| To:              | Mr Vincent VAN PETEGHEM, President of the ECOFIN Council     |
| Subject:         | ECB Convergence Report 2024                                  |

Delegations will find attached the 2024 Convergence Report, pages 89–181 (2/2), by the European Central Bank.

2022. The koruna began to weaken against the euro in May 2023 and this depreciation continued following the ECB's monetary policy decisions as well as Česká národní banka's official announcement in August 2023 that it was ending its foreign exchange interventions. From February 2024 the koruna remained broadly stable before appreciating in May that year to levels close to those at the beginning of the reference period, owing mainly to the release of higher than expected inflation data for April. Short-term interest rate differentials against the three-month EURIBOR were high until the middle of 2023. Although declining, they remained sizeable and reached 2.3 percentage points in the three-month period ending in March 2024.

**Over the past ten years the Czech koruna has appreciated in HICP-based real effective terms (Chart 5.2.4).** Overall, this appreciation in real terms mainly reflected developments in the nominal effective exchange rate. However, the relatively high level of inflation following the sharp rise in energy prices in 2021, which was exacerbated in the wake of Russia's invasion of Ukraine in February 2022, put upward pressure on the real effective exchange rate. Looking ahead, this indicator should be interpreted with caution, as the Czech Republic has been subject to a process of economic convergence in terms of GDP per capita and price levels over the past few decades, which complicates any long-term assessment of real exchange rate developments.

**The combined current and capital account balance has recorded a modest surplus over the past ten years, while the country's net foreign liabilities have declined (Table 5.2.3).** The combined current and capital account deficit increased from 1.1% of GDP in 2021 to 4.2% of GDP in 2022, reflecting both a decline in the trade balance and a reduction in the capital account surplus. In 2023, however, it returned to positive territory, mainly reflecting a notable rebound in the goods balance. At the same time, the primary income deficit shrank significantly, albeit remaining large at 4.3% of GDP. On the financing side, the Czech Republic recorded positive net outflows of portfolio investment and other investment on average from 2019 to 2023. However, these net outflows were offset by net inflows of direct investment. The country's gross external debt continued to decline, falling from 75.7% in 2019 to 62.9% in 2023. At the same time, the country's net international investment position improved, rising from -29.1% of GDP on average in the period 2014-18 to -16.56% in the period 2019-23. Fiscal and structural policies continue to be important for supporting external sustainability and the competitiveness of the economy, especially in a more volatile environment characterised by geopolitical and commodity price shocks.

**The Czech economy is well integrated with the euro area through trade and investment linkages.** In 2023 exports of goods and services to the euro area constituted 62.4% of total Czech exports, whereas imports of goods and services from the euro area amounted to 49% of the country's total imports. In the same year the share of the euro area in the Czech Republic's stock of inward direct investment stood at 76% and its share in the country's stock of portfolio investment liabilities was 63.8%. The share of the Czech Republic's stock of foreign assets invested in the euro area amounted to 65.6% in the case of direct investment and 68.9% for portfolio investment in 2023.

## 5.2.4 Long-term interest rate developments

**Over the reference period from June 2023 to May 2024, long-term interest rates in the Czech Republic stood at 4.2% on average and were thus below the 4.8% reference value for the interest rate convergence criterion (Chart 5.2.5).**

**Long-term interest rates in the Czech Republic stood at 4.2% at the end of the reference period, about 180 basis points above the level seen at the start of 2014.** In the period 2014-16 long-term interest rates in the Czech Republic declined amid a gradual economic recovery, moderate inflation and Česká národní banka's highly accommodative monetary policy. In the light of rising inflationary pressures – which reflected global developments and an acceleration of economic growth that led to overheating in the domestic labour market – Česká národní banka began to gradually tighten monetary policy in mid-2017. Against this background, long-term interest rates also increased until late 2018. In 2019 the economic environment changed as signs of weakness in the global economic outlook emerged alongside geopolitical tensions such as the trade dispute between the United States and China and the perceived risks of a disorderly Brexit. The outbreak of the pandemic further fuelled the decline in long-term interest rates, which reached their lowest point in the summer of 2020. Furthermore, Česká národní banka implemented decisive interest rate cuts over the period from March to May 2020 that brought the two-week repo rate – the main policy rate – to its lowest level since August 2017. Between the last quarter of 2020 and October 2022, long-term interest rates increased steadily, owing to rising and persistent inflationary pressures driven by domestic demand, the increase in energy prices, the disruption to global supply chains and the risk that Russia's invasion of Ukraine would lead to higher and more persistent inflation than previously expected. During this period, Česká národní banka gradually and steadily tightened its monetary policy. Since December 2023 the central bank has cut the two-week repo rate four times, bringing it down from 7.0% in November 2023 to 5.25% in May 2024. Since the end of 2022 the moderation in domestic and global inflationary pressures was an important driver of the decline in long-term interest rates from 5.5% in October 2022 to 4.2% at the end of the reference period. The credit quality of Czech government debt remained rather favourable. Over the review period, credit default swap spreads for Czech government debt were stable at less than 50 basis points, remaining the lowest among the group of peer countries. The Czech Republic's government debt is rated high investment grade by all three main rating agencies (Moody's: Aa3; S&P: AA-; Fitch: AA-).

**The Czech Republic's long-term interest rate differential vis-à-vis the euro area average has declined from its historical peak of June 2022.** The long-term interest rate differential gradually increased from 2014 to reach a historical high in June 2022 (Chart 5.2.6). This was due to both the continuing decrease in the average long-term interest rate on euro area sovereign debt and the increase in the long-term interest rate on Czech debt, which was fuelled by a persistent and rising inflation differential between Czech and euro area HICP inflation. Since June 2022, when the interest rate differential stood at its peak of 2.9 percentage points (3.6 percentage points vis-à-vis the euro area AAA yield), an increase in euro area government debt yields has led to a

gradual decline of the interest rate differential, which stood at 1.1 percentage points in May 2024 (1.5 percentage points vis-à-vis the euro area AAA yield).

**Capital markets in the Czech Republic are smaller and much less developed than those in the euro area (Table 5.2.4).** Stock market capitalisation in the Czech Republic stood at 10.4% of GDP in 2023, which is below the average value recorded over the period 2014-23. Outstanding debt securities issued by non-financial institutions, a measure of market-based indebtedness, have continued to decrease in recent years and stood at 3.6% of GDP in 2023, after averaging over 7.0% in the period 2014-18. Meanwhile, debt securities issued by financial institutions have increased over the past decade to stand at 16.3% of GDP in 2023, which is higher than the average value observed during the period 2014-18. Financial intermediation, as measured by MFI credit to the non-government sector, remained in line with its average value for the period 2014-18 and stood at 54.2% of GDP in 2023, slightly over half the euro area average. In 2023 the Czech Republic's banking sector reduced the funding it obtains from euro area banks compared with previous years, with claims of euro area MFIs on resident MFIs standing at 13.1% of total liabilities of domestic MFIs. The development of the Czech Republic's capital markets in terms of size and intermediation capacity remains limited but is comparable with that of other non-euro area EU Member States in central and eastern Europe.

## 5.2.5 Statistical tables and charts

Czech Republic

## 5.3 Hungary

### 5.3.1 Price developments

**In May 2024 the 12-month average rate of HICP inflation in Hungary was 8.4%, i.e. considerably above the reference value of 3.3% for the criterion on price stability (Chart 5.3.1).** This rate is expected to decrease gradually over the coming months, driven by the past monetary policy tightening and the ongoing easing of pipeline pressures and supply bottlenecks.

**Over the past ten years the 12-month average rate of HICP inflation has fluctuated within a very wide range, from -0.3% to 22.5%.** In 2014 and 2015 the average annual rate of HICP inflation was very subdued, owing to utility price cuts, relatively muted wage growth and limited external price pressures. However, from 2016 it accelerated, to reach 3.4% – within the central bank's tolerance band – in 2019. This increase mainly reflected robust domestic demand and a tighter labour market that fuelled strong wage growth, as well as changes to indirect taxes, most notably excise duties on tobacco products. These factors were only partially offset by a reduction in social security contributions and VAT rates on some food items and services. In 2020 the authorities took strong fiscal, macroprudential and monetary policy measures to mitigate the economic impact of the COVID-19 pandemic. In particular, the Magyar Nemzeti Bank cut its key policy rate to a historical low of 0.6% and purchased government securities in the secondary market. Inflation remained elevated, albeit within the central bank's tolerance band, at 3.4% in 2020, but rose to 5.2% in 2021 on account of a strong rebound in activity, rising energy prices and the supply bottlenecks triggered by the pandemic. This led the central bank to start a cycle of interest rate hikes in June that year and to gradually phase out its quantitative easing schemes. In 2022 HICP inflation continued to rise, to reach 15.3% on average, largely owing to soaring energy and commodity prices in the wake of Russia's invasion of Ukraine in late February, drought-related increases in agricultural prices, significant fiscal loosening in the run-up to the elections, the depreciation of the exchange rate and robust wage growth mainly on the back of administrative wage increases alongside additional salary and pension benefits (Table 5.3.1). As with the other central and eastern European countries under review, Hungary has been particularly vulnerable to recent global shocks, owing mainly to certain structural features of its economy and its exposure to Russia (see Chapter 3). In order to further mitigate the effects of the energy crisis, the government also placed temporary price caps on motor fuels and selected basic food items. As inflation accelerated throughout 2022, the Magyar Nemzeti Bank tightened minimum reserve requirements, introduced new liquidity-absorbing facilities and continued its rate hiking cycle, bringing the central bank base rate to a peak of 13% in September that year. In October, following a rapid depreciation of the exchange rate, the central bank introduced one-day deposit quick tenders on a daily basis at an interest rate of 18.0%, which became its key rate for monetary policy. After peaking in February 2023, inflationary pressures abated gradually as energy prices started to decline. The Magyar Nemzeti Bank responded

by steadily reducing its central bank base rate, down to 10.75% by the end of 2023, and reinstating it as its key policy rate. HICP inflation averaged 17.0% in 2023.

**In May 2024 the annual rate of HICP inflation reached 3.9%.** Continuing on a downward trend that had started in 2023, HICP inflation fell further at the beginning of 2024. This decrease was largely due to lower energy and commodity prices, the past monetary policy tightening, the gradual withdrawal of fiscal support measures and the weakness in private consumption resulting from the erosion of households' purchasing power. Against this background, the Magyar Nemzeti Bank lowered its key policy rate on five occasions by a total of 350 basis points, down to 7.25%, in the first five months of 2024.

**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.** Since 2015 the Magyar Nemzeti Bank has defined its inflation target as an annual rate of consumer price inflation of 3% with an ex ante tolerance band of  $\pm 1$  percentage point. Under this inflation-targeting framework, the central bank has continuously adjusted its monetary policy toolkit to evolving macroeconomic challenges, which at times have been complicated by economic and fiscal policies. Economic policy measures that have had implications for the transmission of monetary policy include, for example, a cap on bank interest rates and on consumer prices for energy and food, and legal provisions restricting the purchase of debt instruments issued by the central bank and therefore its ability to absorb liquidity.

**Inflation is expected to decline gradually in the coming years, but over the longer term there are concerns about the sustainability of inflation convergence in Hungary.** According to the European Commission's Spring 2024 Economic Forecast, HICP inflation is projected to decelerate in 2024, to a high level of 4.1%, before falling further to 3.7% in 2025. This outlook is based on the expectation that energy prices will moderate as the economic recovery continues, with unemployment remaining at a historically low level and private consumption returning to being the main driver of growth. However, these forecasts are subject to considerable uncertainty about the evolution of energy prices and the geopolitical situation. Risks to the inflation outlook are tilted to the upside, as tensions in energy markets may continue to exacerbate inflationary pressures, and still loose fiscal policies and unfavourable exchange rate developments may add further to inflation. In addition, labour market conditions remain tight, with unit labour costs having grown by 34.0% over the period from 2020 to 2023 – well above the euro area rate of 9.5% – challenging the competitiveness of the Hungarian economy (Table 3.2). Looking further ahead, unless counteracted by an appreciation of the nominal exchange rate, 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 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.** Further improving the quality of public institutions and ensuring that they are free from undue political interference, implementing adequate product market policies and safeguarding the rule of law, are prerequisites for private sector-led economic growth. 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. In this respect, it is still of utmost importance that the authorities address the concerns over the rule of law expressed by the European Commission under the general regime of conditionality for the protection of the Union budget, to facilitate the full disbursement of EU funds. With regard to macroeconomic imbalances, the European Commission selected Hungary for an in-depth review in its Alert Mechanism Report 2024 based on concerns related to significant price and cost pressures, both government and external financing needs, and house price developments.

**Financial sector policies should be aimed at safeguarding financial stability – and ultimately the functioning of monetary policy transmission – as well as ensuring that the financial sector makes a sound contribution to sustainable economic growth.** Efforts to strengthen banks' balance sheets over the past years have borne fruit, and the banking sector overall has relatively large capital and liquidity buffers. Banks' profitability has improved and non-performing loan ratios have declined further. Looking ahead, tighter financial conditions, in combination with previously strong private sector credit growth, may nevertheless pose a number of risks. For example, the decline in households' real disposable incomes, together with the higher level of interest rates, may dampen demand for new loans and thus weigh on banks' profitability. At the same time, as house prices continue to rise, the risk of overvaluation in the real estate market, particularly in Hungary's capital region, alongside declining real incomes of borrowers and higher interest rates, may result in increasing debt servicing difficulties. Interest rate caps and mortgage rate freezes distort borrowers' incentives, squeeze banks' profitability further and complicate the transmission of monetary policy. Moreover, lending to corporates in foreign currency may lead to significant currency mismatches and heighten banks' credit risk. In turn, the deterioration in the quality of loan portfolios could put additional pressure on banks' profitability, which is also being hampered by the slow improvement in the low cost efficiency of the Hungarian banking sector. Boosting the profitability of the banking sector in the long term will also require consolidation in the sector and more financial deepening. In this respect, it remains important to closely monitor macro-financial developments. In order to bolster confidence in the financial system, the national competent authorities should continue to improve their supervisory practices, among other things, by following the applicable recommendations from the relevant international and European bodies, and by collaborating closely with other national supervisors of EU Member States within the supervisory colleges.

### 5.3.2 Fiscal developments

**Hungary's general government budget deficit was significantly above the 3% reference value in 2023 and its debt was above the 60% reference value.** In the reference year 2023, the general government budget balance recorded a deficit of



6.7% of GDP, i.e. significantly above the 3% reference value. The general government gross debt-to-GDP ratio was 73.5%, i.e. above the 60% reference value (Table 5.3.2). Compared with the previous year, the deficit ratio increased by 0.5 percentage points of GDP and the debt ratio declined moderately by 0.6 percentage points. With regard to other fiscal factors, the deficit ratio exceeded the ratio of public investment to GDP in 2023 by 1.6 percentage points. The budget deficits in 2022 and 2023 were affected by the economic impact of Russia's war against Ukraine and the discretionary fiscal policy measures taken in response to the related high energy prices.

**In June 2024, the European Commission found that Hungary did not fulfil the deficit criterion of the Stability and Growth Pact.** On 19 June 2024, the European Commission published a report prepared in accordance with Article 126(3) of the Treaty for 12 Member States, including Hungary, which found that Hungary had exceeded the deficit reference value in 2023 and was planning for its deficit in 2024 to be above 3% of GDP. These deficits levels were above, and not close, to the reference value and the excess was not assessed to be either temporary or exceptional. The report's analysis suggested that Hungary did not fulfil the deficit criterion of the Stability and Growth Pact. Based on the conclusions of its report, the Commission announced its intention to propose to the Council, in July, that a decision be adopted under Article 126(6) establishing the existence of an excessive deficit situation in Hungary. During the period in which the general escape clause under the Stability and Growth Pact applied (due to the pandemic and the invasion of Ukraine by Russia), the European Commission found, in May 2023, May 2022 and June 2021, that the general government deficit-to-GDP ratio in 2022, 2021 and 2020, respectively, had been above and not close to the reference value of 3%. In all three cases, the Commission's analysis suggested that the deficit criterion had not been fulfilled. Moreover, the European Commission found, in May 2023 and May 2022, that the debt reduction benchmark had not been respected in 2022 and 2021, respectively, and therefore the Commission's analysis suggested that, in both cases, the debt criterion had not been fulfilled. However, given the high uncertainty surrounding the macroeconomic outlook, the Commission considered that at that juncture a decision on whether to place Member States under the excessive deficit procedure should not be taken. Hungary was once subject to an excessive deficit procedure, which was opened in 2004 based on the deficit in 2003, but which was closed in 2013.

**Both cyclical and non-cyclical factors relating to the pandemic contributed to a deterioration in the budget balance over the period 2019-21, which was only partly reversed by 2023.** Since 2012 and up until the outbreak of the pandemic, the budget deficit had stood at relatively stable levels of between 1.5% and 3% of GDP, and at 2.0% of GDP in 2019, equating to a structural deficit of 3.9%. As a result of the pandemic, the budget balance declined in 2020 by 5.6 percentage points, to reach a deficit of 7.6% of GDP. This was due to cyclical factors, as well as the deterioration in the structural deficit which rose by 3.2 percentage points between 2019 and 2021, reflecting a sharp increase in expenditure to address the impact of the pandemic. Between 2021 and 2023, the budget deficit decreased by 0.5 percentage points on account of an improving structural balance, whereas cyclical factors contributed negatively. The budget balance in 2023 was 4.7% of GDP higher than in 2019, i.e. the



year before the outbreak of the pandemic. This was due to a deterioration in the cyclical component, as well as a 2.1 percentage point higher structural deficit.

**The government debt-to-GDP ratio has remained above 60% of GDP since 2005.**

In the lead-up to the pandemic, the debt ratio followed a downward path, underpinned largely by a favourable interest-growth differential and a primary surplus. Having declined by 11.2 percentage points since 2014, the debt ratio reached a trough of 65.3% of GDP in 2019. It then increased markedly on account of the impact of the pandemic, rising by 14 percentage points to reach 79.3% in 2020. Since then, it has declined by 5.8 percentage points on account of economic growth and high inflation, both of which have counterbalanced the primary deficits and the unfavourable deficit-debt adjustments. The debt ratio in 2023 was 8.2 percentage points higher than in 2019.

**The level and structure of government debt indicate that fiscal balances are sensitive to interest rate fluctuations and to exchange rate movements.** In 2023, the share of debt with a short-term maturity amounted to 7.4%, with an average residual maturity of 5.9 years. However, the share of debt with variable interest rates increased substantially, from 10.6% of the total debt in 2021 to 21.3% in 2023. Therefore, fiscal balances remain sensitive to interest rates changes. Moreover, Hungary increased its proportion of foreign currency-denominated government debt from 20.5% in 2019 to 29.7% in 2023, which is exclusively denominated in euro. Consequently, fiscal balances remain sensitive to changes in the exchange rate vis-à-vis the euro.

**The European Commission's Spring 2024 Economic Forecast foresees an improvement in the budget balance and a slight increase in the debt ratio.**

According to the European Commission's latest forecast under a no policy change assumption, the headline deficit is expected to decrease, reaching a deficit of 5.4% of GDP in 2024 and 4.5% of GDP in 2025, therefore remaining above 3%. The debt ratio is projected to increase slightly to 74.3% of GDP in 2024 and to stand at 73.8% of GDP in 2025, therefore remaining above the 60% reference value.

**Despite some progress in reforming the fiscal framework, there is scope for further improvement.** The latest changes to the national fiscal rules were made in December 2019 when the Hungarian Parliament adopted amendments aimed at increasing their transparency and enhancing their implementation. According to the debt ratio rule, if the general government debt ratio exceeds 50% of GDP, the Parliament may only adopt an act on the central budget which leads to a reduction in the debt level of at least 0.1% of GDP during normal economic times. In spite of this, Hungary's national fiscal rules and medium-term budgetary framework are among the weakest according to the EU fiscal governance indicator. Stronger emphasis should still be placed on the multi-annual dimension of the budget process. In particular, the incentives to systematically spend budget reserves before the end of the calendar year should be removed, as they can lower the quality of public spending. Furthermore, neither are there any constraints on possible deviations from medium-term plans nor well-defined corrective actions in place in this respect.

**Hungary faces medium sustainability risks over the medium term and the long term, mainly due to the debt level being projected to remain above but close to the 60% reference value, but also due to the ageing population.** The European Commission's 2023 Debt Sustainability Monitor points to medium risks both in the medium term and the long term with a projected decline in the debt ratio over the forecast period. This lower medium-term risk compared with the 2021 assessment is driven by the notable decrease in the debt-to-GDP ratio. The debt ratio was expected to stand at 75.2% of GDP in 2023 under the baseline scenario in the 2021 Fiscal Sustainability Report, but in the most recent Debt Sustainability report, it was expected to stand at 69.9% of GDP (i.e. below the actual outcome of 73.5% of GDP in 2023). Looking at the longer term, according to the 2024 Ageing Report prepared by the Ageing Working Group (AWG) of the EU's Economic Policy Committee,<sup>156</sup> Hungary would experience a significant rise in age-related expenditure of 5.2 percentage points by 2070 under the baseline from a level of 19.0% of GDP in 2022 to a level of 21.3% of GDP in 2070, which is 1.2 percentage points lower than in the previous report. Under the AWG's risk scenario, this increase is projected to be 4.0 percentage points higher than under the baseline (arising mainly from increases of 3.1% and 1.0% of GDP in long-term care and healthcare respectively), which is significantly above the EU average. All these factors suggest that reforms are needed to improve the long-term sustainability of public finances.

**Looking ahead, a prudent and credible fiscal policy, as well as further structural reforms, are needed to ensure a downward debt path and compliance with the Stability and Growth Pact.** A prudent fiscal policy is needed to safeguard the sustainability of public finances. A consistent and prudent fiscal policy will also ensure that Hungary complies with the Stability and Growth Pact, reduces its public debt level and maintains buffers to alleviate adverse shocks. Policies aimed at improving tax collection and reducing the informal economy should continue to be pursued. Distortive tax measures should be avoided. Reinforcing multi-annual fiscal planning could mitigate the procyclicality of fiscal policy and increase the effectiveness of public spending. Structural reforms to the pension system, as well as the health and long-term care systems, are also necessary to address longer-term risks to fiscal sustainability. In addition, the Next Generation EU programme needs to be implemented efficiently and effectively in order to support the potential for growth and to adjust to the structural changes that are under way. Finally, growth-friendly fiscal adjustments are important, based on reversing the downward trend in government investment.

### 5.3.3 Exchange rate developments

**Over the reference period from 20 June 2022 to 19 June 2024, 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 was often significantly

<sup>156</sup> European Commission and Economic Policy Committee, "The 2024 Ageing Report: Economic & Budgetary Projections for the 28 EU Member States (2019-2070)", *European Economy Institutional Paper*, No 279, European Commission, 2024.

weaker than its June 2022 average exchange rate against the euro of 396.66 forints per euro, which is used as a benchmark for illustrative purposes in the absence of an ERM II central rate (Chart 5.3.3). The maximum upward deviation from this benchmark was 7.2%, while the maximum downward deviation amounted to 8.6%. On 19 June 2024 the exchange rate stood at 396.3400 forints per euro, i.e. the forint was trading almost at the same level (0.1%) as its average level in June 2022. The Magyar Nemzeti Bank entered a repo line arrangement with the ECB in June 2020, under which it could borrow up to €4 billion against high-quality euro-denominated collateral to provide euro liquidity to Hungarian financial institutions in order to address possible needs owing to the pandemic. This agreement remained in place over the reference period as it was extended again in January 2024. As this arrangement helped to reduce the potential risk of financial vulnerabilities, it may also have had an impact on exchange rate developments over the reference period. Over the past ten years the exchange rate of the Hungarian forint against the euro has depreciated by 29.6%.

**The exchange rate of the Hungarian forint against the euro exhibited, on average, a very high degree of volatility over the reference period.** Between June and October 2022 the Hungarian forint continued to weaken – a trend that had started with Russia's invasion of Ukraine – against the background of rapidly rising energy prices, a deteriorating external balance, ensuing inflationary pressures, the worsening economic outlook, and deteriorating international investor sentiment towards the region. The Magyar Nemzeti Bank responded by continuing the rate-hiking cycle it had started in mid-2021, raising its key policy rate on five occasions, by a total of 710 basis points, to stand at 13% at the end of September 2022. In the last quarter of 2022 the forint recovered some of its losses as energy prices receded somewhat from their record highs, while the Magyar Nemzeti Bank maintained its restrictive monetary policy stance and conducted daily overnight deposit tenders at a rate of 18%, and short-term interest rate differentials against the three-month EURIBOR peaked at 14.5 percentage points. The exchange rate of the forint continued to display a very high degree of volatility throughout most of 2023, reflecting the continued uncertainty in financial markets about the evolution of the energy crisis and regarding macroeconomic vulnerabilities in Hungary. The forint started to stabilise towards the end of 2023 as exchange rate volatility declined. In May that year, the Magyar Nemzeti Bank started to cut interest rates. This led to a decline in short-term interest rate differentials, down to 4.0%, and prompted the Magyar Nemzeti Bank to reinstate its central bank base rate as its key policy rate, which it gradually reduced from 13% in September 2023 to 7.0% at the end of June 2024.

**The HICP-based real effective exchange rate of the Hungarian forint has appreciated slightly over the past ten years (Chart 5.3.4).** While the real effective exchange rate depreciated between 2014 and 2021, mainly reflecting the depreciation of the nominal exchange rate in effective terms, it began to appreciate sharply from 2022. This was because the very high level of inflation following the sharp rise in energy prices in 2021, which was exacerbated in the wake of Russia's invasion of Ukraine in February 2022, put upward pressure on the real effective exchange rate. Looking ahead, this indicator should be interpreted with caution, as Hungary is subject to a process of economic convergence, which complicates any long-term assessment of real exchange rate developments.

**Over the past ten years Hungary's combined current and capital account balance has remained in surplus and contributed to a reduction in the country's net foreign liabilities, which, however, remain high (Table 5.3.3).** Between 2014 and 2018 Hungary recorded robust combined current and capital account surpluses, averaging 4.3% of GDP over the period. This reflected both a large trade surplus – which more than offset the deficit on income payments – as well as a sizeable capital account surplus which was due to large transfers from the EU budget. In 2019 and 2020 the combined current and capital account balance narrowed to about 1% of GDP, owing to very robust domestic demand which caused the balance of the current account to turn negative. In 2021 the current account deficit widened further, to 4.1% of GDP, as exports declined more than imports during the pandemic, pushing the combined current and capital account into a deficit of 1.6% of GDP. Primarily as a result of the large increases in energy prices following Russia's invasion of Ukraine, Hungary's current account deficit increased further in 2022, to 8.3% of GDP. However, it moved into slightly positive territory in 2023, standing at 0.3% of GDP, as a result of energy prices receding from their peak levels and adjustments in energy consumption and domestic investment and consumption expenditure. Until 2019 Hungary's current and capital account surplus had been mirrored in net financial outflows. Since 2019 the country's current account deficit has been financed by net inflows of portfolio and direct investment as well as other investment. Against this background, gross external debt gradually decreased from an average of 119.6% of GDP over the period 2014-18 to stand at 98.9% of GDP in 2019. In 2020 gross external debt increased sharply to 156.6% of GDP, largely owing to transactions by a major special-purpose entity – which also led to an approximately equal increase in the country's gross external assets – and in 2023 it stood at 129.3% of GDP on account of fast nominal GDP growth in the high inflation environment. As a result, Hungary's net foreign liabilities declined from an average of above 60% of GDP in the period 2014-18 to around 50% in the period since 2019. The international investment position reached -46.6% of GDP in 2023. The country's net foreign liabilities remain high. Fiscal and structural policies therefore continue to be important for supporting external sustainability and the competitiveness of the economy, especially in a more volatile environment characterised by geopolitical tensions and commodity price shocks.

**The Hungarian economy is well integrated with the euro area through trade and investment linkages.** In 2023 exports of goods and services to the euro area constituted 58.8% of total exports, while the corresponding figure for imports was marginally lower, at 55.1%. In the same year the share of the euro area in Hungary's stock of inward direct investment stood at 47.9% and its share in the country's stock of portfolio investment liabilities was 50.9%. The share of Hungary's stock of foreign assets invested in the euro area amounted to 38.7% in the case of direct investment and 65.4% for portfolio investment in 2023.

#### 5.3.4 Long-term interest rate developments

**Over the reference period from June 2023 to May 2024, long-term interest rates in Hungary stood at 6.8% on average and were thus above the 4.8% reference value for the interest rate convergence criterion (Chart 5.3.5).**

**The downward path in long-term interest rates in Hungary observed since 2014 was interrupted after the pandemic.** Until 2017 domestic factors, such as the improvement in general macroeconomic conditions amid lower global risk aversion, had contributed to the decline in long-term interest rates. During this period, monetary policy contributed to an easing of financing conditions and, therefore, to a decline in long-term rates as the Magyar Nemzeti Bank introduced foreign exchange and long-term interest rate swaps, purchased corporate, mortgage and government bonds, and provided cheap financing for small and medium-sized enterprises through its various Funding for Growth measures. Long-term interest rates in Hungary declined from around 6% in early 2014 to around 2% in December 2017. After increasing temporarily in 2018 owing to the rebound in economic activity and a resurgence of inflationary pressures, long-term interest rates resumed their decline in 2019. This reflected the deterioration in the global economic outlook as well as the decline in global yields that was driven by higher levels of global risk aversion, which favoured global portfolio flows into low-risk assets, including Hungarian fixed income assets. In 2020 long-term interest rates fluctuated around 2%, supported by the quantitative easing measures taken by the Magyar Nemzeti Bank. These sought to improve financing conditions in the economy and, in turn, dampen the high financial market volatility caused by the impact of the pandemic and ensure the proper functioning of the monetary policy transmission mechanism. In addition, to counter the negative impact of the pandemic on the economic outlook, the central bank reduced its main policy rate from 0.9% to 0.6% in July 2020. From mid-2021 – following a robust recovery of the economy and, more recently, the acceleration in inflation dynamics, which was also related to Russia's invasion of Ukraine in February 2022 – the Magyar Nemzeti Bank tightened monetary policy by increasing the policy rate and scaling back its quantitative easing measures. Domestic and global disinflationary pressures from September 2023 led the Magyar Nemzeti Bank to start cutting the key policy rate in October 2023. It stood at 7.0% in June 2024. Long-term interest rates in Hungary peaked at 10% in October 2022 before falling to 6.8% in May 2024. Ten-year credit default swap spreads on Hungarian government debt have increased significantly over the past two years but, after hitting 300 basis points in November 2022, they declined to less than 170 basis points in May 2024, 15 basis points higher than their level in May 2022. Hungary's government debt is rated investment grade by all three main rating agencies (Moody's: Baa2; S&P: BBB; Fitch: BBB).

**Hungary's long-term interest rate differential vis-à-vis the euro area declined recently after a long period of stabilisation (Chart 5.3.6).** Hungary's long-term interest rate differential declined from around 3 percentage points in 2014 to around 2 percentage points in 2015, where it stayed for the following five years. From May 2020 the long-term interest rate differential increased steadily, initially owing to the relatively sharper decline in euro area interest rates and then, from 2021, to the positive and increasing inflation differential and the relatively larger increase in policy rates in Hungary. Over the period from May 2022 to May 2024 the long-term interest rate differential declined from 5.5 percentage points to 3.7 percentage points, having peaked at more than 7.0 percentage points in October 2022.

**Capital markets in Hungary are smaller and much less developed than those in the euro area (Table 5.3.4).** Stock market capitalisation, which stood at 17.6% of

GDP in 2023, was slightly higher than the annual average during the period 2014-23. In 2023 outstanding debt securities issued by non-financial corporations remained at low levels, standing at 4.7% of GDP, but were higher than the ten-year average of 2.8% over the period 2014-23. Debt securities issued by financial institutions in 2023 amounted to 12.7% of GDP, which is considerably above the average value recorded over the period 2014-23. Hungarian banks' borrowing from euro area banks – a measure of banking system integration – increased significantly in 2023, with claims by euro area banks on Hungarian banks standing at 7.3% of GDP, compared with 4.9% over the period 2014-23. The degree of financial intermediation is lower than the euro area average and is among the lowest in the region. MFI credit to non-government residents stood at 35.1% of GDP in 2023, slightly below the average level recorded over the period 2014-23.

### 5.3.5 Statistical tables and charts

[Hungary](#)



## 5.4 Poland

### 5.4.1 Price developments

**In May 2024 the 12-month average rate of HICP inflation in Poland was 6.1%, i.e. well above the reference value of 3.3% for the criterion on price stability (Chart 5.4.1).** This rate is expected to decrease gradually over the coming months, driven by the past monetary policy tightening and the ongoing easing of pipeline pressures and supply bottlenecks.

**Over the past ten years the 12-month average rate of HICP inflation has fluctuated within a very wide range, from -0.7% to 15.2%.** HICP inflation was notably subdued in 2014 and 2015, reflecting the weakening of domestic economic activity in the preceding years and the significant fall in global commodity prices. In response to the decline in inflation, Narodowy Bank Polski cut its main policy rate to 1.5% in March 2015. From mid-2016 HICP inflation rose gradually on the back of relatively robust economic activity. In line with forecasts of an economic slowdown and a faster than anticipated fall in inflation in 2020 as a result of the COVID-19 pandemic, from mid-March that year Narodowy Bank Polski lowered its main policy rate on several occasions, bringing it down to a historical low of 0.1% in May. In 2021 inflation rose sharply, to 5.2%, on account of surging energy prices, supply bottlenecks triggered by the pandemic, and strong increases in global demand for goods amid a robust rebound in economic activity. Russia's invasion of Ukraine in late February 2022 exacerbated the increase in global commodity prices and supply bottlenecks, which led to a strong acceleration of HICP inflation to 13.2% that year (Table 5.4.1). As with the other central and eastern European countries under review, Poland has been particularly vulnerable to recent global shocks, owing mainly to certain structural features of its economy and its exposure to Russia (see Chapter 3). To counteract the risk of inflation expectations becoming unanchored from the target, Narodowy Bank Polski implemented a number of decisive policy rate hikes in 2021 and 2022, up to 6.75%. The government also introduced discretionary fiscal support measures, predominantly in 2022 and 2023, to alleviate the high inflation burden on the economy. These measures were mainly in the form of caps on electricity and gas prices and reductions in indirect taxes. After peaking at 17.2% in February 2023, HICP inflation started to decrease notably, owing to the fall in food and energy prices, weaker domestic demand resulting, in part, from earlier monetary policy tightening, subdued economic activity abroad and an appreciation of the Polish zloty. In this context, Narodowy Bank Polski decided to cut its main policy rate in September and October, bringing it down to 5.75%.

**In May 2024 the annual rate of HICP inflation reached 2.8%.** The strong decline in headline inflation in 2023 moderated in early 2024. This can be attributed to the fading impact of the unwinding of the sharp increases in energy prices a year before and the return of the VAT rate on staple food products to 5% from April 2024. At the same time, inflation excluding food and energy has remained higher than headline HICP inflation amid robust wage growth, labour market bottlenecks and a gradual improvement in economic activity.

**Policy choices have played an important role in anchoring inflation expectations 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 has had an inflation-targeting monetary policy framework in place since 1998. The medium-term consumer price inflation target has been 2.5% ( $\pm 1$  percentage point) since 2004. Despite the high level of inflation recorded since 2021, inflation expectations have remained broadly consistent with the inflation target range over the medium term, supported by the past monetary policy tightening, greater labour market flexibility and increased product market competition, as well as the discretionary fiscal measures implemented in 2022 and 2023 to help to contain inflationary pressures.

**While remaining elevated, inflation is projected to decline in 2024-25, but over the longer term there are concerns about the sustainability of inflation convergence in Poland.** According to the European Commission's Spring 2024 Economic Forecast, HICP inflation is projected to fall from 10.9% in 2023 to 4.3% in 2024 and 4.2% in 2025. The removal of the measures to contain price pressures could have a significant temporary upward impact on inflation, particularly from mid-2024. However, these forecasts are subject to considerable uncertainty about the evolution of energy prices and the geopolitical situation. Risks to the inflation outlook are tilted to the upside, as renewed global supply bottlenecks could push up prices further in certain product segments, and tensions in energy markets may continue to exacerbate inflationary pressures. In addition, labour market conditions remain tight, with unit labour costs having grown by 22.0% over the period from 2020 to 2023 – well above the euro area rate of 9.5% – challenging the competitiveness of the Polish economy (Table 3.2). 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, unless this is counteracted by an appreciation of the nominal exchange rate. 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 energy price shock and the decline in global activity comparatively well, a number of structural issues still need to be addressed. It is important that fiscal and structural policies continue to support external sustainability, enhance competitiveness and ensure investor confidence. In order to foster potential growth and resource allocation, efforts are required to boost competition in product markets, and to speed up innovation and infrastructure modernisation. In the labour market, in view of the ageing population, it is essential to increase the labour force participation rate by removing disincentives to work and by pursuing policies to support a better integration of refugees. In the medium term, there is a pressing need for Poland to reduce both its reliance on fossil fuel energy production and its greenhouse gas emissions. Against this background, it will be important to ensure an efficient and effective absorption of the EU funds allocated to the country. With regard to macroeconomic imbalances, the European

Commission did not select Poland for an in-depth review in its Alert Mechanism Report 2024.

**Financial sector policies should be aimed at safeguarding financial stability and ensuring that the financial sector makes a sound contribution to economic growth.** The banking sector remains resilient and banks' capital positions have improved. Growth in lending to the non-financial sector began to recover in late 2023,

partly as a result of the government's new mortgage subsidy scheme, but could remain relatively subdued in the coming years, owing largely to factors affecting demand. However, long-term loans to non-financial corporations are expected to pick up, among other things, to co-finance investment projects under Poland's Recovery and Resilience Plan. Credit risk remains at a moderate level owing to the favourable labour market situation and to banks' still relatively solid capacity to service their liabilities, as well as to their prudential lending policies. Legal risks associated with banks' exposure to foreign exchange-denominated mortgage loans remain the main challenge facing the banking sector. Banks have actively managed this risk by offering settlements to their customers and by creating loan loss provisions, although the associated costs are squeezing their profitability. In this respect, regulatory changes and any related uncertainty may impair the stability of banking activity and adversely affect long-term business decisions. Untargeted mortgage credit holidays could undermine incentives to service debt and weaken the banking system's ability to provide credit. In order to further strengthen the financial system, the national competent authorities should continue to improve their supervisory practices, among other things, by following the applicable recommendations from the relevant international and European bodies, and by collaborating closely with other national supervisors of EU Member States within the supervisory colleges.

#### 5.4.2 Fiscal developments

**Poland's general government budget balance was well above the 3% deficit reference value in 2023, while its government debt remained below the 60% reference threshold.** In the reference year 2023, the general government budget balance recorded a deficit of 5.1% of GDP, well above the 3% reference value. The general government gross debt-to-GDP ratio stood at 49.6%, therefore remaining below the 60% reference value (Table 5.4.2). Compared with the previous year, the deficit saw an increase of 1.7 percentage points of GDP, with a slight rise of 0.4 percentage points in the debt ratio. The budget deficits in 2022 and 2023 were significantly influenced by the economic impact of Russia's war against Ukraine and the discretionary fiscal policy measures taken in response to the related high energy prices.

**The European Commission found, in June 2024, that Poland did not fulfil the deficit criterion of the Stability and Growth Pact.** On 19 June 2024, the European Commission published a report prepared in accordance with Article 126(3) of the Treaty for 12 Member States, including Poland, which found that Poland had exceeded the deficit reference value in 2023 and was planning for its deficit in 2024 to be above 3% of GDP. These deficits were above, and not close to, the reference value

and the excess was not assessed to be either temporary or exceptional. Overall, taking into account relevant factors, as appropriate, the report's analysis suggested that Poland did not fulfil the deficit criterion of the Stability and Growth Pact. Based on the conclusions of its report, the Commission announced its intention to propose to the Council, in July, that a decision be adopted under Article 126(6) establishing the existence of an excessive deficit situation in Poland. During the period in which the general escape clause under the Stability and Growth Pact applied (due to the pandemic and the invasion of Ukraine by Russia), the European Commission found, in June 2021 and May 2023, that the general government deficit-to-GDP ratio in 2020 and 2022, respectively, had been above and not close to the reference value of 3%. Moreover, in May 2022, the Commission found that the planned deficit in 2022 was also above and not close to 3% of GDP. In all three cases, the Commission's analysis suggested that the deficit criterion had not been fulfilled. However, given the high uncertainty surrounding the macroeconomic outlook, the Commission considered that at that juncture a decision on whether to place Member States under the excessive deficit procedure should not be taken. From 2009 Poland had been subject to an excessive deficit procedure, which was subsequently abrogated by the ECOFIN Council in June 2015, one year earlier than the extended deadline, on account of a systemic pension reform. In the subsequent period to 2019, there were some deviations from the requirements of the preventive arm of the Stability and Growth Pact, particularly in respect of the recommended adjustment path towards the country's medium-term objective.

**The budget balance deteriorated significantly over the period 2021-23, with the deficit standing at much higher levels than those prior to the pandemic.**

Poland's budget balance had shown a marked improvement prior to the pandemic, with a low deficit of 0.7% of GDP in 2019, which was 3 percentage points lower than in 2014. However, during the pandemic in 2020, the deficit ratio surged by 6.2 percentage points, driven by cyclical factors and fiscal measures to protect the economy. Once the pandemic-related support had been phased out and the economy had begun to recover, the deficit improved significantly, dropping to 1.8% of GDP by 2021. This improvement was short-lived, as the deficit rose again to 3.4% of GDP by 2022, mainly due to measures to address the energy crisis. In 2023 the deficit further deteriorated by 1.7 percentage points, which was attributable to cyclical factors, the impact of inflation indexation, a rise in interest payments and new spending initiatives, including for defence. The budget balance in 2023 was 4.4 percentage points of GDP lower than in 2019, i.e. the year before the outbreak of the pandemic.

**Aside from the peak during the pandemic in 2020, the debt-to-GDP ratio has remained relatively stable over the past decade, fluctuating around 50%.** Prior to the pandemic, the ratio had been on a downward trajectory, falling from 54.5% in 2016 to 45.7% in 2019, thanks to a very favourable interest-growth differential and modest primary surpluses. The pandemic subsequently led to an increasing primary deficit and negative growth, along with a significant deficit-debt adjustment (5.5% of GDP), resulting in an 11.5 percentage point increase in the debt ratio in 2020, which was above its historical average. Since then, it declined up to 2023 by 7.6 percentage points, reaching 49.6% in 2023, largely on the back of strong nominal GDP growth.

While the debt ratio in 2023 was only slightly above its average level, it remained 3.9 percentage points above the 2019 level.

**The composition of Poland's government debt makes it vulnerable to fluctuations in interest rate and exchange rate developments.** Since 2023, 23.7% of the government debt has been tied to variable interest rates, while short-term debt has constituted a mere 1.6% of the total debt (Table 5.4.2). Considering these factors, along with the debt-to-GDP ratio, the budget balance is sensitive to shifts in interest rates. Furthermore, a relatively high share of the debt, 24.4%, is denominated in foreign currencies, predominantly in euro, while 66.4% of the debt is held domestically. Given these factors, as well as the debt-to-GDP ratio, Poland's budget balance is also sensitive to changes in exchange rates.

**The European Commission's Spring 2024 Economic Forecast anticipates a continuation of the high deficits and a notable increase in the debt ratio.** The forecast predicts the general government deficit to reach 5.4% and 4.6% of GDP in 2024 and 2025, respectively, which significantly exceeds the 3% reference value. This development is largely structural, with the structural deficit also remaining excessively high and amounting to 4.3% of GDP in 2025. This sizeable deficit reflects persisting high spending pressures, most notably in areas of public wages, social transfers and defence investments. The government debt ratio is projected to increase during this period, yet to remain below the 60% reference value, reaching 53.7% and 57.7% in 2024 and 2025 respectively. One significant factor which contributes towards the divergence between the budget balance and the debt ratio developments has been attributed to substantial stock-flow adjustments, primarily on account of the timing of payments and deliveries of military-related investments.

**The Polish fiscal framework is strong overall, but its effectiveness could be enhanced.** The constitutional debt limit of 60% of GDP acts as a constraint against the accumulation of excessive debt and, therefore, helps ensure fiscal sustainability. Medium-term budgetary planning is based on the Multiannual State Financial Plan, as well as a permanent expenditure rule established in 2015. This rule limits spending growth in accordance with predefined debt thresholds. However, recent developments have seen several new expenditure categories being funded through extra-budgetary funds which do not fall under this spending rule. Thus far, Poland is the only EU country that does not have an independent fiscal council, a situation which is at odds with the provisions of the fiscal compact. This is expected to change based on intentions expressed by its government.

**Poland faces high risks to fiscal sustainability in the medium run and medium risks in the long run, as the adequacy of the pension system needs to be safeguarded.** The European Commission's 2024 Country Report found that Poland faces high fiscal sustainability risks over the medium term.<sup>157</sup> Long-term risks are classified as medium due to an unfavourable initial budgetary position and projected age-related expenditure. In this respect, the 2024 Ageing Report prepared by the

<sup>157</sup> The debt sustainability analysis published as part of the European Commission's Country Report for Poland on 19 June 2024 follows the multidimensional approach of the European Commission's 2023 Debt Sustainability Monitor, updated based on the Commission's Spring 2024 Economic Forecast.

Ageing Working Group of the EU's Economic Policy Committee<sup>198</sup> shows a 1.9 percentage point rise in age-related expenditure by 2070 under the baseline, from 19.1% of GDP in 2022. The expected increase is driven by healthcare and long-term care spending, while pension spending is projected to remain stable. However, amid a marked increase in population ageing and the old-age dependency ratio, only a substantial decline in the benefit ratio can stabilise the pension bill, unless reforms are undertaken to increase contributions or the retirement age.<sup>199</sup> This poses risks of old-age poverty and could trigger additional social payments to support the elderly, thereby weighing on long-term fiscal sustainability.

**Looking ahead, Poland's fiscal policy should focus on reducing the budgetary deficit and complying with the Stability and Growth Pact, pushing through structural reforms to ensure the long-term sustainability of public finances.** This will help to counter any adverse shocks. The Next Generation EU programme needs to be implemented efficiently and effectively in order to foster the necessary reforms to the Polish economy. Strengthening the role of national institutions that monitor EU fiscal rule compliance is vital. Additionally, efforts to simplify labour taxation, reduce the tax wedge and improve the progressivity of tax and social benefits schemes should continue. Preserving the long-term sustainability of public finances and providing adequate pension payments, as well as healthcare and long-term care services, continues to be of paramount importance.

### 5.4.3 Exchange rate developments

**In the two-year reference period from 20 June 2022 to 19 June 2024, the Polish zloty did not participate in ERM II, but traded under a flexible exchange rate regime.** Over the reference period the Polish zloty often traded close to its June 2022 average exchange rate against the euro of 4.6471 zlotys per euro, which is used as a benchmark for illustrative purposes in the absence of an ERM II central rate (Chart 5.4.3). The maximum upward deviation from this benchmark was 8.6%, while the maximum downward deviation amounted to 4.8%. On 19 June 2024 the exchange rate stood at 4.3300 zlotys per euro, i.e. the zloty was 6.8% stronger than its average level in June 2022. Between March 2022 and mid-January 2024 Narodowy Bank Polski had a swap line arrangement with the ECB, under which it could borrow up to €10 billion against zlotys in order to address potential euro liquidity needs in the Polish financial system. As this arrangement helped to reduce the potential risk of financial vulnerabilities, it may also have had an impact on exchange rate developments over the reference period. Over the past ten years the exchange rate of the Polish zloty against the euro has depreciated by 4.7%.

<sup>198</sup> European Commission and Economic Policy Committee, "The 2024 Ageing Report: Economic & Budgetary Projections for the EU Member States (2022-2070)", *European Economy Institutional Paper*, No 279, European Commission, 2021.

<sup>199</sup> The benefit ratio is defined as average pensions in relation to average wages. The old-age dependency ratio is defined as the ratio between the number of persons aged 65 and over (age when they are generally economically inactive) and the number of persons aged between 15 and 64.



**The exchange rate of the Polish zloty against the euro exhibited, on average, a relatively high degree of volatility over the reference period.** From June 2022 to March 2023 the Polish zloty fluctuated mostly within a narrow range of between 4.7 zlotys and 4.8 zlotys per euro. However, since the beginning of April 2023 the zloty has appreciated somewhat against the euro. Overall, exchange rate volatility tended to increase in autumn 2023, likely reflecting changes in Narodowy Bank Polski's monetary policy rates in September and October 2023. The exchange rate has stabilised since the beginning of 2024 at around 4.3 zlotys per euro. There was a notable decline in short-term interest rate differentials against the three-month EURIBOR, which gradually decreased from around 6.6 percentage points in mid-2022 to around 1.9 percentage points at the end of 2023. They have remained largely stable since then. Changes in these differentials largely reflected the increases in the key ECB interest rates between July 2022 and September 2023.

**The HICP-based real effective exchange rate of the Polish zloty has appreciated somewhat over the past ten years (Chart 5.4.4).** The real effective exchange rate weakened until 2016 and then remained broadly stable before recording a strong appreciation from early 2022. Relatively high inflation following the sharp rise in energy prices in 2021, which was exacerbated in the wake of Russia's invasion of Ukraine in February 2022, put upward pressure on the real effective exchange rate. Looking ahead, this indicator should be interpreted with caution, as Poland is subject to a process of economic convergence, which complicates any long-term assessment of real exchange rate developments.

**Poland's combined current and capital account balance has increased over the past ten years and the country's net foreign liabilities have tended to decline (Table 5.4.3).** After standing virtually in balance on average over the period 2014-18, the combined current and capital account subsequently recorded an increasing surplus which reached a peak in 2020 of slightly above 4% of GDP. It then declined to a deficit of close to 2% of GDP in 2022, largely owing to a reduction in the goods trade balance. However, in 2023 a higher goods balance led to an improvement in the combined current and capital account, which turned into a surplus of 1.8% of GDP. On the financing side, Poland has received net inflows in direct investment over the past ten years, which have tended to increase. Gross external debt increased until 2016, but has steadily declined since then and reached 49.3% of GDP in 2023. Over this ten-year period Poland's negative net international investment position has also declined gradually, from close to 70% of GDP in 2014 to 31.4% of GDP in 2023. Net foreign liabilities mostly consist of net direct investment. Fiscal and structural policies continue to be important for supporting external sustainability, maintaining Poland's attractiveness as a target for foreign direct investment and enhancing the competitiveness of the economy, especially in a more volatile environment characterised by geopolitical and commodity price shocks.

**The Polish economy is well integrated with the euro area through trade and investment linkages.** In 2023 exports of goods and services to the euro area constituted 57.2% of total exports, while the corresponding figure for imports was slightly lower at 55.8%. In the same year the share of the euro area in Poland's stock of inward direct investment stood at 76.7%, and its share in the country's stock of

portfolio investment liabilities was 46.4%. The share of Poland's stock of foreign assets invested in the euro area amounted to 56.1% in the case of direct investment and 48.4% for portfolio investment.

#### 5.4.4 Long-term interest rate developments

**Over the reference period from June 2023 to May 2024, long-term interest rates in Poland stood at 5.6% on average and were thus above the reference value of 4.8% for the interest rate convergence criterion (Chart 5.4.5).**

**Overall, long-term interest rates in Poland have increased since 2014, when they averaged around 3.5%.** Over the period 2014-20 long-term interest rates on sovereign bonds fluctuated between 2% and 4% amid a gradual tightening of the fiscal stance by the Polish Government and the diminishing impact of the global and euro area financial crises. From the end of 2014 long-term interest rates in Poland increased for two years as the positive economic cycle led to higher growth and inflation. After peaking at around 4% at the start of 2017, long-term interest rates initially declined only moderately, reflecting falling inflation amid still resilient real economic growth as well as fiscal tightening. The decline accelerated in 2019, with long-term rates being mostly influenced by global trends. They reached around 2% at the beginning of 2020, despite quite robust domestic growth and increasing inflation. In 2020 long-term interest rates declined further and stabilised at historical lows of slightly above 1% in the context of a swift easing of monetary policy. In response to the outbreak of the pandemic, Narodowy Bank Polski cut the monetary policy reference rate to 0.1% in May 2020 and launched quantitative easing measures. The measures were aimed at changing the long-term liquidity structure of the banking sector, ensuring the liquidity of the secondary markets for government securities and government-guaranteed debt securities and enhancing the impact of the Narodowy Bank Polski's interest rate cuts on the economy (i.e. strengthening the functioning of the monetary policy transmission mechanism). Between 2021 and late 2022, long-term interest rates increased, gradually at first and then more decisively from October 2021, owing mostly to the economic recovery, the rise in inflation, the significant upside risks to inflation and the downside risks to the fiscal position posed by Russia's invasion of Ukraine. Narodowy Bank Polski responded to rising inflationary pressures by decisively raising policy rates until September 2022. It subsequently cut policy rates in September and October 2023 as incoming data suggested that the inflation outlook had improved substantially amid weaker than expected growth. As a result, the reference interest rate stood at 5.75% at the end of the review period. Long-term interest rates also increased significantly during the review period, reaching 5.7% in May 2024 after peaking at about 8.0% in October 2022. After increasing significantly at the beginning of the review period, credit default swap spreads declined to around 100 basis points by May 2024, around the same level as in May 2022. The spreads thus remain low by historical standards and among the lowest in the group of peer countries in the region, suggesting a benign market perception of sovereign credit risk. Poland's government debt is currently rated investment grade by all three main rating agencies (Moody's: A2; S&P: A-; Fitch: A-).

**Poland's long-term interest rate differential vis-à-vis the euro area declined significantly during the review period, reaching 2.6 percentage points in May 2024 (Chart 5.4.6).** This figure is in line with the long-term average differential over the period 2014-21, which fluctuated between around 1 and 2 percentage points, driven by the dynamism of economic activity and inflationary pressures. Owing to the sharp acceleration in inflation in Poland since the summer of 2021, the interest rate differential widened and reached its historical peak of 4.8 percentage points in May 2022 (up from 1.1 percentage points in April 2020). In May 2024, the end of the review period, the interest rate differential vis-à-vis the euro area AAA yield stood at 3.0 percentage points.

**Capital markets in Poland are smaller and much less developed than those in the euro area (Table 5.4.4).** The markets for financial and non-financial corporate debt were still much smaller than the respective markets in the euro area at the end of 2023. Debt securities issued by financial and non-financial corporations stood at 10.0% and 2.0% of GDP respectively. In 2023 stock market capitalisation was 22% of GDP, lower than the annual average over the period 2014-23 but still one of the highest levels among peer countries. Euro area banks' provision of funds to the Polish banking system is quite limited. The claims of euro area MFIs on Polish banks accounted for 3.8% of Polish banks' liabilities at the end of 2022. The degree of financial intermediation in Poland, as measured by credit extended by MFIs to the private sector, is in line with that of peer countries in the region, amounting to 40.3% of GDP in 2023 (compared with 99.6% in the euro area). Foreign ownership of banks in Poland, while remaining elevated, has declined markedly in recent years on the back of government initiatives. At the end of 2023 the share of foreign banks in total Polish banking sector assets stood at around 40%.

## 5.4.5 Statistical tables and charts

### Poland

## 5.5 Romania

### 5.5.1 Price developments

**In May 2024 the 12-month average rate of HICP inflation in Romania was 7.6%, i.e. considerably above the reference value of 3.3% for the criterion on price stability (Chart 5.5.1).** This rate is expected to decrease gradually over the coming months, driven by past monetary policy tightening and the ongoing easing of pipeline pressures and supply bottlenecks.

**Over the past ten years the 12-month average rate of HICP inflation has fluctuated within a very wide range, from -1.7% to 13.2%.** Starting from a moderate level, HICP inflation slipped into negative territory in June 2015 owing to a series of tax cuts. It remained negative throughout 2016, before turning positive again at the beginning of 2017, partly on account of favourable base effects. In 2018 it continued on an upward trend on the back of strong fiscal stimulus and increases in minimum wages, averaging 4.1% over the year and remaining around that level also in 2019 (Table 5.5.1). HICP inflation then fell significantly in 2020, reflecting the downturn in economic activity as a result of the COVID-19 pandemic. Supply-side shocks, particularly in relation to prices for electricity, natural gas and fuel, and then food price increases, contributed to inflation rising considerably during the second half of 2021 and exceeding the upper bound of the variation band around the target. In response, Banca Națională a României started a monetary policy tightening cycle in October 2021. Inflation accelerated further following Russia's invasion of Ukraine in late February 2022, peaking at 14.6% in November that year. This increase was largely due to higher food and energy prices, together with severe bottlenecks in global supply chains. As with the other central and eastern European countries under review, Romania has been particularly vulnerable to recent global shocks, owing mainly to certain structural features of its economy (see Chapter 3). Since the end of 2022 HICP inflation has been falling, down from 12% on average that year to 9.7% in 2023. This decrease was driven by the ongoing easing of pipeline pressures and supply bottlenecks, the monetary policy tightening and government measures to mitigate the impact of the energy price rises (mainly in the form of transfers to households and firms). This notwithstanding, HICP inflation remained at elevated levels owing to domestic price pressures stemming from wage and pension increases. Between October 2021 and January 2023 Banca Națională a României raised its policy rate on 11 occasions, from 1.25% up to the current level of 7%.

**In May 2024 the annual rate of HICP inflation reached 5.8%.** After rising in January on the back of hikes in indirect taxes, HICP inflation decreased gradually over the following months, owing to declining food prices alongside falling electricity and natural gas prices in April after the government changed its energy price-related measures. At the same time, core inflation remained sticky, reflecting strong wage developments in the context of a tight labour market and minimum wage increases, as well as higher short-term inflation expectations. Banca Națională a României has kept its main policy rates unchanged since January 2023 in an attempt to durably reduce inflation.

**The orientation of monetary policy towards price stability has played an important role in shaping inflation dynamics in Romania over the past decade.**

In 2005 Banca Națională a României shifted to an inflation-targeting framework combined with a managed floating exchange rate regime. In 2005 the annual CPI inflation target was set at 7.5% and was reduced gradually until 2012. In 2013 the central bank adopted a flat target of 2.5%, with a variation band of  $\pm 1$  percentage point. Despite the significant increases in monetary policy rates from October 2021 in order to bring inflation back to the target, the prolonged period of loose fiscal policy (see Section 5.5.2) has continued to fuel inflationary pressures, especially since 2022.

**While remaining elevated, inflation is expected to continue on a downward trend over the forecast horizon, but over the longer term there are concerns about the sustainability of inflation convergence in Romania.** According to the European Commission's Spring 2024 Economic Forecast, HICP inflation is expected to decrease to 5.9% in 2024 and 4.0% in 2025. However, these forecasts are subject to considerable uncertainty about the evolution of energy prices and the geopolitical situation, as renewed global supply bottlenecks and tensions in energy markets could push up inflation further. Risks to the inflation outlook are tilted to the upside, owing mainly to fiscal policy, as well as labour market conditions and wage dynamics. Labour shortages and related wage pressures are expected to persist in the medium term. Looking further ahead, there are concerns about the sustainability of inflation convergence in Romania over the longer term, also taking into account the marked increase in unit labour costs. Unit labour costs grew by 26.7% over the period from 2020 to 2023 – well above the euro area rate of 9.5% – challenging the competitiveness of the Romanian economy, as this differential was not offset by nominal exchange rate developments (Table 3.2). The catching-up process is also 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 Romania than in the euro area, unless this is counteracted by an appreciation of the domestic currency against the euro. In order to prevent the build-up of excessive price pressures and reduce macroeconomic imbalances, the catching-up process must be supported by appropriate policies. In particular, wage growth needs to be consistent with productivity growth, among other things in order to safeguard price competitiveness and the attractiveness of Romania to foreign investors.

**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 2024, highlighting significant concerns related to cost competitiveness, external sustainability and the government deficit. The relative inefficiency of the country's institutions and governance, as well as its weak business environment, continue to hamper its growth potential in an environment of low productivity. As headwinds related to Romania's demographic profile and labour market (i.e. its ageing population coupled with high migration outflows) are likely to persist, Romania's current growth strategy, based on extensive labour utilisation, should be complemented by a growth model that is more focused on fostering innovation, as well as knowledge-based and high-value-added industries (e.g. ICT). Continued reform efforts aimed at fighting

corruption, improving competition and enhancing the predictability of the country's tax, judicial, regulatory and administrative systems are needed, as they would also boost the country's attractiveness to foreign creditors by increasing trust in domestic institutions. Measures should include upgrading skill levels by improving access to education for the minorities and the under-represented, strengthening the insolvency regime and combating regional disparities in living standards to spur a more inclusive growth. Finally, an efficient and effective absorption of EU funds remains key to fostering economic convergence in the medium term and to guiding the economy in the upcoming green and digital transition.

**Financial sector policies should be aimed at safeguarding financial stability and ensuring that the financial sector makes a sound contribution to economic growth.** After several profitable years, there appears to be limited vulnerabilities in the banking sector, with banks having built up relatively large capital and liquidity buffers, and non-performing loan ratios having come closer to EU levels. The rise in foreign currency lending to non-financial corporations since 2022 warrants close monitoring. To further strengthen the resilience of the financial system in the light of the high global uncertainty, the Romanian authorities decided to increase the countercyclical capital buffer from 0.5% to 1% from October 2023. In order to bolster confidence in the financial system, the national competent authorities should continue to improve their supervisory practices, among other things, by following the applicable recommendations from the relevant international and European bodies, and by collaborating closely with other national supervisors of EU Member States within the supervisory colleges.

## 5.5.2 Fiscal developments

**Romania's general government budget deficit was significantly above the 3% reference value in 2023, while its debt level was below the 60% reference value.** In the reference year 2023, the general government budget balance recorded a deficit of 6.6% of GDP, i.e. significantly above the 3% reference value. The general government debt ratio was 48.8% of GDP, i.e. below the 60% reference value (Table 5.5.2). Compared with the previous year, the general government deficit increased by 0.3 percentage points of GDP and the debt ratio increased moderately by 1.3 percentage points of GDP. With regard to other fiscal factors, the deficit ratio exceeded the ratio of public investment to GDP in 2023. The budget deficits in 2022 and 2023 were affected by the economic impact of Russia's war against Ukraine and the discretionary fiscal policy measures taken in response to the related high energy prices.

**Romania is currently subject to an excessive deficit procedure and the European Commission found, in June 2024, that it had not taken effective action to put an end to its excessive deficit situation.** Following a recommendation from the European Commission of 4 March 2020 on the basis of a projected excessive deficit in 2019, the Council decided on 3 April 2020, in accordance with Article 126(6) of the Treaty, that an excessive deficit existed in Romania and issued a recommendation to correct the excessive deficit by 2022 at the



latest. In 2021, a Council recommendation revised the date for correcting this excessive deficit to 2024, with the argument being that the economic recovery following the pandemic should not be compromised. On 19 June 2024, the European Commission assessed that Romania had not reached the headline deficit target of 4.4% in 2023 and was not forecast to put an end to its excessive deficit by 2024 either.<sup>160</sup> Moreover, it found that Romania's fiscal effort had fallen significantly short of what had been recommended and that net primary expenditure had grown much faster than recommended. On that basis, the Commission recommended to the Council that a decision be adopted establishing that Romania had not taken effective action in response to the Council recommendation to put an end to the excessive deficit situation by 2024, at the latest.

**Both cyclical and non-cyclical factors contributed to the deterioration in the budget balance over the period 2019-23, with the budget deficit in 2023 remaining above the pre-pandemic level in 2019.** Romania's fiscal position appeared highly vulnerable even before the outbreak of the pandemic and the energy crisis, with the deficit having reached 4.3% of GDP by 2019, following a steady deterioration which had begun in 2016. In 2020 the deficit ratio deteriorated by 5 percentage points and the structural balance by 2.9 percentage points. This was mainly the result of pre-existing expansionary policies (including significant increases in pension payments), as well as temporary measures taken in the face of the pandemic (albeit these were smaller in size than those implemented in other countries) and cyclical factors. The budget deficit recorded a net improvement of 2.7 percentage points between 2021 and 2023, driven by a rise in the structural balance by 1.5 percentage points. This was on account of strong energy-related taxes and current expenditure that had grown less than nominal GDP, as well as cyclical conditions. The 2023 budget deficit nonetheless stands 2.3 percentage points above the pre-pandemic deficit level seen in 2019, with the structural deficit being higher than in 2019 by 1.4 percentage points.

**The debt-to-GDP ratio, while remaining below the 60% reference value, has been predominantly increasing since 2019.** Prior to the pandemic, the debt ratio had decreased from 39.1% of GDP in 2014 to 34.4% of GDP in 2018 owing to a favourable interest-growth differential and, to a lesser extent, some favourable deficit-debt adjustments, but in 2019, it had increased slightly. The debt ratio subsequently increased strongly by 13.4 percentage points over the period 2020-21, when it reached 48.5% of GDP. Since then, it increased slightly, reaching 48.8% of GDP in 2023, thus remaining 13.7 percentage points above its pre-pandemic level. The increases over the period 2019-23 were largely the result of primary deficits, with the favourable interest-growth differential helping to contain the debt increase over the period of 2021-23 (Table 5.5.2).

**The level and structure of government debt indicate that Romania's fiscal balances are protected from sudden changes in interest rates, however, those balances are sensitive to exchange rate fluctuations.** The share of government

<sup>160</sup> Recommendation for a Council decision establishing that Romania has taken no effective action in response to the Council Recommendation of 18 June 2021, (COM(2024) 597), Brussels, 19 June 2024.

debt with a short-term maturity is low (6.5% of overall debt in 2023 – Table 5.5.2). Taking into account medium and 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 (51.8% in 2023). Taking the size of the debt in relation to GDP into consideration, it can therefore be concluded that the fiscal balances are sensitive to exchange rate movements, mainly the euro/leu exchange rate, as a large part of the debt is denominated in euro (83.0% of foreign-denominated debt in 2023).

**The European Commission's Spring 2024 Economic Forecast foresees a moderate deterioration in the budget balance by 2025 and a significant increase in the debt ratio, with significant further consolidation required for Romania to correct its excessive deficit situation.**

According to the European Commission's Spring 2024 Economic Forecast, the deficit is projected to increase to 6.9% of GDP in 2024 and to 7.0% of GDP in 2025. This forecast includes the short-term cost of the pension reform that was adopted in November 2023 and will come into force in September 2024. Romania is therefore not expected to correct its excessive deficit by 2024, as required by the Council of the European Union. Over the period 2024-25, the structural deficit is projected to increase to 6.4% of GDP in 2024 and 6.7% of GDP in 2025. With regard to the debt ratio, the European Commission forecasts an increase of 2.1 percentage points of GDP in 2024, followed by a further increase of 3.0 percentage points in 2025. The debt ratio is projected to remain below the 60% reference value, reaching 53.9% of GDP in 2025, but this would be its highest level since 1995. On the basis of the European Commission's Spring 2024 Economic Forecast, significant further consolidation will be required to correct its excessive deficit.

**Romania has strengthened its national fiscal governance framework significantly, but the framework has not been respected or applied effectively, particularly in the context of policy decisions taken from 2015 onwards.**

Romania's fiscal governance framework was strengthened following the adoption of the fiscal compact (through the implementation of a structural budget balance rule, a debt rule and a correction mechanism), the creation of an independent fiscal council in 2010 and a reform of the tax collection agency. However, Romania has systematically and repeatedly derogated from its national fiscal rules and the timeline for the adoption of the medium-term fiscal strategy, as enshrined in the national fiscal framework, thereby rendering these rules largely ineffective. In particular, the Romanian authorities should fully support the Fiscal Council by submitting the budget in a timely manner and by increasing the transparency of the macroeconomic and fiscal forecasts as well as the budget documentation. The government should also increase efforts to reform the public administration and make tax policy and administration more efficient. Some progress has been made with public finance management, including through the new law tasking the Fiscal Council with a regular impact assessment of spending reviews. Limited progress has been made in public investment project preparation and prioritisation. However, progress in improving the governance and performance of state-owned enterprises has been made, yet significant shortcomings in terms of implementation persist. Romania's budgetary adjustment would be well supported by the full application of the national fiscal framework.

**Romania faces high sustainability risks in the medium and in the long term, with only slight increases in age-related public expenditure projected over the period 2022-70.** Over the medium term, the European Commission's 2024 Country Report risk classification remains unchanged compared with the 2021 Fiscal Sustainability Report, with ageing costs weighing on the results.<sup>161</sup> Over the long term, the increase from the medium to high-risk classification, compared with the 2021 Fiscal Sustainability Report, is attributable to the unfavourable initial budgetary position. The European Commission's 2024 Ageing Report prepared by the Ageing Working Group (AWG) of the EU's Economic Policy Committee<sup>162</sup>, which incorporates the pension reforms adopted in November 2023, points to a slight increase of 0.2 percentage points of GDP in age-related public expenditure over the period 2022-70 under its baseline, from a level of 15.8% of GDP in 2022. The projected decrease in pension expenditure by 0.9 percentage points of GDP over the period 2022-70 largely compensates for the projected increase in health and long-term care expenditure. While over the full projection horizon of the Ageing Report, pension spending is projected to fall, a notable increase is expected during the first period of the projection horizon (2022-45). Under the AWG's risk scenario, the increase in the cost of ageing amounted to 4.3 percentage points of GDP.

**Looking ahead, additional reforms and significant consolidation in line with the requirements of the Stability and Growth Pact are needed to safeguard the sustainability of public finances over the medium term.** Romania must ensure compliance with the requirements of the excessive deficit procedure through significant further consolidation. This needs to be supported by efforts geared towards enhancing the quality of public finances and reinforcing the growth potential of the economy. Moreover, the Next Generation EU programme needs to be implemented efficiently and effectively. The Romanian government should make further efforts to improve the tax collection system, fight tax evasion, increase spending efficiency, advance structural fiscal reforms (including in the corporate governance of state-owned enterprises) and complete tax system reforms.

### 5.5.3 Exchange rate developments

**Over the reference period from 20 June 2022 to 19 June 2024, the Romanian leu did not participate in ERM II, but traded under a flexible exchange rate regime involving a managed float of the currency's exchange rate.** Over the two-year reference period the Romanian leu mostly traded close to its June 2022 average exchange rate against the euro of 4.9444 lei per euro, which is used as a benchmark for illustrative purposes in the absence of an ERM II central rate (Chart 5.5.3). The maximum upward deviation from this benchmark was 2.5%, while the maximum

<sup>161</sup> The debt sustainability analysis published as part of the European Commission's Country Report for Romania on 19 June 2024 follows the multidimensional approach of the European Commission's 2023 Debt Sustainability Monitor, updated based on the European Commission's Spring 2024 Economic Forecast.

<sup>162</sup> European Commission and Economic Policy Committee, "The 2024 Ageing Report: Economic & Budgetary Projections for the EU Member States (2022-2070)", *European Economy Institutional Paper*, No279, European Commission, 2024.

downward deviation amounted to 0.7%. On 19 June 2024 the exchange rate stood at 4.9768 lei per euro, i.e. the leu was 0.7% weaker than its average level in June 2022. Between June 2020 and mid-January 2024 Banca Națională a României had a repo line arrangement with the ECB, under which it could borrow up to €4.5 billion against high-quality euro-denominated collateral to provide euro liquidity to Romanian financial institutions in order to address possible liquidity needs. As this arrangement helped to reduce the potential risk of financial vulnerabilities, it may also have had an impact on exchange rate developments over the reference period. Over the past ten years the Romanian leu has depreciated against the euro by 13.3%.

**The exchange rate of the Romanian leu against the euro exhibited, on average, a low degree of volatility over the reference period.** From mid-2022 exchange rate volatility increased somewhat, with the leu seeing several episodes of slight appreciation against the euro followed by more pronounced depreciations. This was against the background of the greater relative attractiveness of investments in domestic currency and the downward correction of the current account deficit in 2023, as well as fluctuations in global risk appetite. Throughout the reference period the Romanian leu continued its steady trend depreciation, given the risks stemming from the fiscal position and external imbalance. Since September 2023 the exchange rate has fluctuated between 4.96 lei and 4.98 lei per euro. Over the reference period short-term interest rate differentials against the three-month EURIBOR were wide. After reaching a peak of 7.1 percentage points in the three-month period ending in September 2022, the interest rate differential came down again and stood at 2 percentage points in the three-month period ending in March 2024. The recent narrowing of short-term interest rate differentials largely reflects a moderation in the pace of monetary policy tightening by Banca Națională a României, as well as the increases in the key ECB interest rates which started in July 2022.

**The Romanian leu has appreciated over the past ten years in HICP-based real effective terms (Chart 5.5.4).** Overall, this appreciation mainly reflected developments in relative prices. The relatively high level of inflation following the sharp rise in energy prices in 2021, which was exacerbated in the wake of Russia's invasion of Ukraine in February 2022, put additional upward pressure on the real effective exchange rate. Looking ahead, this indicator should be interpreted with caution, as Romania is subject to a process of economic convergence, which complicates any long-term assessment of real exchange rate developments.

**Romania's current and capital account balance has weakened over the past ten years, while the country's net foreign liabilities have declined gradually but remain high (Table 5.5.3).** Following three consecutive EU and IMF financial assistance programmes ending in 2015, the combined current and capital account balance strengthened until 2016, before deteriorating notably in subsequent years. This deterioration reflected a growing trade deficit on the back of a worsening merchandise goods balance in conjunction with a flattening services surplus, as Romania's export performance weakened and strong domestic demand fuelled import growth. This trend continued after the pandemic, which further worsened the trade balance owing to the emergence of global supply chain disruptions. In 2023 the current account deficit declined as domestic demand growth slowed, import prices of

energy declined and services exports continued their upward trend. On the financing side, from 2014 to 2018 net inflows in direct and portfolio investment were more than offset by net outflows in other investment, and gross external debt declined simultaneously. Portfolio investment inflows in the form of debt securities subsequently gained in importance. Given the Romanian government's fiscal support measures (financed in part by the issuance of international bonds) and the contraction of the country's economy induced by the pandemic, the gross external debt ratio increased to 57.9% in 2020. After declining over the following two years on the back of high nominal GDP growth, it edged up again to 52.7% in 2023. While the country's net international investment position has improved steadily over the past ten years, net foreign liabilities remained relatively high at -39.8% in 2023. Hence, fiscal and structural policies continue to be important for supporting external sustainability, maintaining Romania's attractiveness to foreign direct investors and enhancing the competitiveness of the economy, especially in a more volatile environment characterised by geopolitical and commodity price shocks.

**The Romanian economy is well integrated with the euro area through trade and investment linkages.** In 2023 exports of goods and services to the euro area constituted 55.5% of total exports, while the corresponding figure for imports amounted to 54.4%. In the same year the share of the euro area in Romania's stock of inward direct investment stood at 79.6% and its share in the country's stock of portfolio investment liabilities was 53.4%. The share of Romania's stock of foreign assets invested in the euro area amounted to 66.1% in the case of direct investment and 70.6% for portfolio investment in 2023.

#### 5.5.4 Long-term interest rate developments

**Over the reference period from June 2023 to May 2024, long-term interest rates in Romania stood at 6.4% on average, above the 4.8% reference value for the interest rate convergence criterion (Chart 5.5.5).**

**Long-term interest rates in Romania stood at 6.3% in May 2024, having reached more than 9% in October 2022, the highest level during the review period.** In 2014 and early 2015 long-term interest rates in Romania declined steadily from more than 5% to a historical low of 2.8% in February 2015. This was driven by both domestic factors, such as a decrease in inflation outturns and expectations, and external factors, in particular developments in the euro area, where sovereign bonds gradually priced in the lower risk of euro area member government bonds. For the following five years, long-term interest rates were affected by imbalances in the Romanian economy, which materialised in positive inflation dynamics, sizeable current account deficits and uncertainty regarding the sustainability of the Government's fiscal policy. The long-term interest rate in Romania increased steadily and fluctuated between 3% and 4% over the period 2015-17 and between 4% and 5% from 2018 until the outbreak of the pandemic in spring 2020. To counter the negative impact of the pandemic on inflation and economic growth, Banca Națională a României acted quickly to ease monetary policy. In March 2020 it cut policy rates and decided to conduct government bond purchases in the secondary market. After cumulative rate cuts of 125 basis



points between March 2020 and January 2021, policy rates stood at 1.25% until October 2021. From then, in a context of rising inflation and supply-side shocks posing upside risks to medium-term inflation expectations – which were then further exacerbated by the impact on food and energy prices of Russia's invasion of Ukraine in February 2022 – Banca Națională a României reversed the course of monetary policy and, over time, brought the policy rate up to 7%, where it currently stands. Over the review period, long-term interest rates in Romania declined from a peak of more than 9% in October 2022 to 6.3% in May 2024. This came on the back of declining inflation from the end of 2022 and evidence of a slowdown in economic activity in 2023. During the review period, credit default swap spreads for Romanian government bonds increased to more than 400 basis points in October 2022 before falling to 200 basis points in May 2024. This is one of the highest levels among the group of peer countries in the region and is mainly related to market concerns about the structural sustainability of domestic government finances. Romania's government debt is rated the lowest investment-grade notch by all three main rating agencies (Moody's: Baa3; S&P: BBB-; Fitch: BBB-).

**After standing at close to 2.5 percentage points over the period 2014-16, the long-term interest rate differential of Romanian bonds vis-à-vis the euro area has since increased (Chart 5.5.6).** The increase was driven by persistent macroeconomic imbalances in the Romanian economy. It showed a spike in 2022 before completely reversing. The differential stood at 3.2 percentage points at the end of the review period, having reached 7.3 percentage points in July 2022.

**Capital markets in Romania are much smaller than those in the euro area and are still underdeveloped (Table 5.5.4).** At the end of 2023 the Romanian corporate debt market was almost non-existent, with outstanding debt securities issued by financial and non-financial corporations amounting to only 1.8% and 0.3% of GDP respectively. Romania's equity market also remains quite small, with a stock market capitalisation of 13.5% of GDP in 2023, which ranks among the lowest in the region. Foreign-owned banks play a major role in Romania and accounted for around 66% of total banking assets in 2023. The degree of financial intermediation is quite small and the lowest in the region, with MFIs extending the equivalent of 24.1% of GDP in credit to the private sector in 2023. Over the past decade Romanian banks have gradually relied less on euro area banks for their funding needs. The claims of euro area banks on Romanian banks have declined from an annual average of 6.7% of total liabilities of domestic MFIs over the period 2014-23 to 2.9% in 2023. Since 2014 MFI loans denominated in domestic currency as a share of total loans extended to the private sector have increased consistently, from about 44% at the end of 2014 to 69% in April 2024.

## 5.5.5 Statistical tables and charts

Romania



## 5.6 Sweden

### 5.6.1 Price developments

**In May 2024 the 12-month average rate of HICP inflation in Sweden was 3.6%, i.e. above the reference value of 3.3% for the criterion on price stability (Chart 5.6.1).** This rate is expected to decrease gradually over the coming months, driven by a restrictive monetary policy stance, a fall in energy prices and the ongoing easing of pipeline pressures.

**Over the past ten years the 12-month average rate of HICP inflation has fluctuated within a wide range, from 0.2% to 9.2%.** Owing to the lagged effects of the krona's depreciation and strong economic growth, HICP inflation picked up in 2015 from the very low levels the year before. This upward trend was also driven by an accommodative monetary policy stance, as that year Sveriges Riksbank had lowered its main policy rate into negative territory and launched a programme of government bond purchases. Between early 2017 and early 2019, HICP inflation hovered between 1.4% and 2.5%, as volatile energy prices contributed to fitful inflation growth. In 2018 and 2019 Sveriges Riksbank raised its repo rate in two steps from -0.50% to 0%, in the light of robust economic growth and accelerating core inflation. With the COVID-19 pandemic-related contraction of the Swedish economy in the first half of 2020, HICP inflation fell significantly, averaging 0.7% over the whole year. In 2021 it rose to 2.7% owing to rising energy prices and a strong rebound in economic activity. Russia's invasion of Ukraine in late February 2022 exacerbated supply shortages and the scarcity of raw materials, pushing up energy and commodity prices significantly. As a result, HICP inflation peaked at 10.8% in December 2022 and remained well above the 2.0% target until November 2023. In April 2022 Sveriges Riksbank launched a series of interest rate hikes, bringing its key policy rate up to 4.0% in September 2023. In addition, the government introduced energy support measures, including fuel tax cuts (combined with a reduction in the biofuel blending requirements) and electricity price subsidies in 2022. Economic activity started to contract in the second half of 2023, as real disposable incomes were hit by tighter financial conditions and high energy prices, leading to falls in spending, particularly in the household and construction sectors (Table 5.6.1). By December inflation had fallen to 1.9% on the back of a decline in non-energy inflation and energy prices.

**In May 2024 the annual rate of HICP inflation reached 2.5%.** In the first five months of 2024 both headline and core inflation moderated further, in a context of high interest rates and weak economic activity. In addition, energy prices fell sharply, reflecting lower global energy prices, changes in energy taxation and a reduction in the requirements for mixing biofuel into petrol and diesel. With inflation approaching the target and economic activity remaining weak, Sveriges Riksbank reduced its key policy rate by 25 basis points to 3.75% in May 2024.

**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 2.0% in the consumer price index (CPI). Sweden's institutional framework, which fosters prudent fiscal policy and wage formation, has lent support to the achievement of price stability. In September 2017, while keeping the inflation target at 2.0%, Sveriges Riksbank decided to switch to an inflation target defined in terms of the CPIF (the CPI with a fixed interest rate) as a formal target variable for monetary policy. It also decided to introduce a variation band of  $\pm 1$  percentage point to illustrate uncertainty surrounding the development of inflation.

**Inflation in Sweden is likely to fall to close to the target over the forecast horizon.** According to the European Commission's Spring 2024 Economic Forecast, HICP inflation is projected to stand at 2.0% in 2024 and to fall to 1.8% in 2025. The near-term outlook for economic activity is subdued. Although base effects for energy prices led to a rise in headline inflation at the beginning of 2024, disinflation is set to continue over the forecast horizon, as domestic wage and price pressures are likely to remain contained. However, these forecasts are subject to considerable uncertainty about the evolution of energy prices and the geopolitical situation. Risks to the inflation outlook are balanced, as there are a number of uncertain factors relating to the international environment and the exchange rate that could drive inflation either up or down. Looking further ahead, monetary policy and the stability-oriented institutional framework should continue to support the achievement of price stability in Sweden.

**Maintaining an environment that is conducive to sustainable convergence in Sweden requires the continuation of stability-oriented economic policies and targeted structural reforms.** High levels of private debt coupled with large numbers of flexible interest rate mortgages mean that Swedish households are particularly vulnerable to interest rate fluctuations and economic downturns, which, in turn, poses risks for the housing market and the stability of the Swedish economy. The European Commission selected Sweden for an in-depth review in its Alert Mechanism Report 2024, in particular because of the macroeconomic imbalances stemming from the housing market.

**Financial sector policies should be aimed at continuing to safeguard financial stability and ensuring that the financial sector makes a sound contribution to economic growth.** Macro-financial volatility has increased in recent years, owing primarily to instability in property prices, elevated levels of household indebtedness and the banking sector's large exposure to the real estate market. Although the resilience of the banking sector has improved in recent years, as banks have built up liquidity buffers and increased their capital ratios, the Swedish authorities need to address the structural factors behind the volatility in property prices once the business cycle allows, for instance by reforming property taxation and improving the functioning of the rental market. In order to bolster confidence in the financial system, the national competent authorities should continue to improve their supervisory practices, among other things, by following the applicable recommendations from the relevant international and European bodies, and by collaborating closely with other national supervisors of EU Member States within the supervisory colleges.

## 5.6.2 Fiscal developments

**Sweden's general government budget deficit was well below the 3% reference value in 2023 and its debt ratio was well below the 60% reference value.** In the reference year 2023, the general government budget recorded a deficit of 0.6% of GDP, i.e. well below the 3% deficit reference value. The general government debt ratio was 31.2% of GDP, i.e. well below the 60% reference value (Table 5.6.2). Compared with the previous year, the budget balance decreased by 1.8 percentage points of GDP, while the debt ratio declined notably by 2.0 percentage points. With regard to other fiscal factors, the deficit ratio did not exceed the ratio of public investment to GDP in 2023. The budget deficits in 2022 and 2023 were affected by the economic impact of Russia's war against Ukraine and the discretionary fiscal policy measures taken in response to the related high energy prices.

**Sweden has never been subject to an ECOFIN Council decision on the existence of an excessive deficit.** Sweden is currently subject to the preventive arm of the Stability and Growth Pact. The European Commission's Spring 2024 Economic Forecast assessed that the structural balance remained within the medium-term objective in 2023.

**The budget balance improved strongly in 2021 and 2022, following the trough during the pandemic, but deteriorated again in 2023.** Prior to the pandemic, Sweden had consistently recorded structural surpluses and most of the time also surpluses in the overall fiscal balance, amounting to 0.5% of GDP in 2019. In 2020, at the peak of the pandemic, the budget balance deteriorated by 3.3 percentage points of GDP due to a deterioration in the cyclical conditions, as well as a deterioration in the structural balance by 1.1 percentage points. As the effects of the pandemic dissipated, the exceptional expenditure measures were gradually withdrawn and the structural balance returned to surplus territory, reaching 0.9% of GDP in 2022 and 0.1% in 2023. Over this period, the budget balance was also helped by a strong cyclical recovery, which partly reversed in 2023 when economic activity began to weaken. The budget balance in 2023 was 1.1% of GDP lower than in 2019, i.e. the year before the outbreak of the pandemic.

**Despite the pandemic, the government debt-to-GDP ratio has continued its declining trend and remained well below the 60% reference value over the past ten years.** Prior to the pandemic, the debt ratio had declined between 2014 and 2019 by 9.4 percentage points to 35.6% of GDP thanks to a combination of primary surpluses and favourable interest-growth differentials. The fallout of the pandemic was an increase in the debt ratio by 4.6 percentage points in 2020, but by 2022, the ratio had fallen back below the pre-pandemic level, driven by an improved interest-growth differential and primary surpluses. In 2023 the ratio fell further, in spite of a deteriorating economic cycle, to reach the historically low rate of 31.2% of GDP, which was 4.4 percentage points below its level in 2019.

**Sweden's government debt structure shows that fiscal balances are relatively sensitive to interest rate variations but relatively insensitive to exchange rate fluctuations.** The share of government debt with a short-term maturity is high (31.5% in 2023). A further noticeable part of its debt with medium and long-term maturities is

exposed to variable interest rates (12.0% in 2022 – Table 5.6.2). After taking into account the level of the debt ratio, the fiscal balances remain relatively sensitive to interest rate movements. Furthermore, the share of government debt denominated in foreign currency is low (9.9% in 2023), which leaves fiscal balances relatively insensitive to exchange rate movements.

**The European Commission's Spring 2024 Economic Forecast predicts a moderate deterioration in the budget balance, with a moderate deficit projected for both 2024 and 2025.** According to the Commission's latest forecast, the budget balance is expected to deteriorate, with a deficit of 1.4% of GDP in 2024 and 0.9% in 2025, but remaining well below the reference value of 3% in both cases. The expected moderate deterioration in the general government balance in 2024 stems primarily from weak economic activity, increasing unemployment and the lagged impact of price increases on government expenditure, while the contribution from discretionary spending measures is relatively limited. The government debt ratio is projected to increase moderately to 32.0% of GDP in 2024 and then to moderately decrease to 31.3% of GDP in 2025, thus remaining well below the 60% reference value in both years.

**Sweden has a strong fiscal governance framework.** Following the last revision of the fiscal framework, which entered into force in 2019, the general government surplus target is now ½% of GDP over the business cycle. In addition, a debt anchor was introduced into the fiscal framework in 2019, targeting a debt ratio of 35% (Maastricht definition). A deviation from the debt anchor by 5 percentage points or more in either direction requires the government to submit a report to Parliament explaining the causes of the deviation and presenting an action plan to address it. The debt level of 35% leaves a significant safety margin to the Maastricht reference value of 60% of GDP. The Swedish fiscal framework also includes a three-year rolling nominal expenditure ceiling for central government and the pension system, as well as a balanced budget requirement for local governments. Overall, the national fiscal framework is strong and supports the medium-term sustainability of public finances in line with the requirements of the Stability and Growth Pact.

**Sweden faces low risks to the sustainability of public finances over the medium and long term.** The analysis laid out in the European Commission's 2023 Debt Sustainability Monitor points to low risks over the medium and long term, which is an assessment that has remained unchanged as compared with the 2021 Fiscal Sustainability Report.<sup>163</sup> The positive assessment in the 2023 report stemmed from a favourable initial budgetary position that more than fully mitigates the projected increase in ageing-related costs, as well as from low government debt. According to the baseline from the 2024 Ageing Report prepared by the Ageing Working Group (AWG) of the EU's Economic Policy Committee<sup>164</sup>, a moderate increase in age-related public expenditure by 0.9 percentage points of GDP is expected over the period

<sup>163</sup> This assessment was confirmed by the updated debt sustainability analysis that was published as part of the European Commission's Country Report for Sweden on 19 June 2024.

<sup>164</sup> European Commission and Economic Policy Committee, "The 2024 Ageing Report: Economic and Budgetary Projections for the EU Member States (2022-2070)", *European Economy Institutional Paper*, No 279, European Commission, 2024.

2022-70, from a level of 23.6% of GDP in 2022. This rise is mainly driven by long-term care costs. Under the AWG's risk scenario, the increase in the cost of ageing amounted to 2.7 percentage points of GDP, which is in line with the EU average.

**Looking ahead, Sweden should build on its strong track record and continue complying with the requirements of the preventive arm of the Stability and Growth Pact.** Sweden should continue to anchor sound public finances in its rule-based fiscal framework, which would help to maintain the resilience of public finances to adverse economic shocks, while ensuring fiscal space where needed for both the green and digital transitions in the years to come.

### 5.6.3 Exchange rate developments

**In the two-year reference period from 20 June 2022 to 19 June 2024, the Swedish krona did not participate in ERM II, but traded under a flexible exchange rate regime.** Over the reference period the Swedish currency was mostly significantly weaker than its June 2022 average exchange rate against the euro of 10.6005 kronor per euro, which is used as a benchmark for illustrative purposes in the absence of an ERM II central rate (Chart 5.6.3). The maximum upward deviation from this benchmark was 2.3%, while the maximum downward deviation amounted to 13.1%. On 19 June 2024 the exchange rate stood at 11.2140 kronor per euro, i.e. the krona was 5.8% weaker than its average level in June 2022. Over the reference period Sveriges Riksbank maintained a swap agreement with the ECB for borrowing up to €10 billion in exchange for Swedish kronor, which has been in place since 20 December 2007, with the aim of facilitating the functioning of financial markets and providing euro liquidity to them if needed. As this agreement helped to reduce the potential risk of financial vulnerabilities, it might also have had an impact on the exchange rate of the Swedish krona against the euro over the reference period. Over the past ten years the exchange rate of the Swedish krona against the euro has depreciated by 23.4%.

**The exchange rate of the Swedish krona against the euro exhibited, on average, a high degree of volatility over the two-year reference period.** Overall, the krona weakened steadily against the euro for most of 2022 and 2023, with the exchange rate peaking in September 2023 when the krona traded at historically high levels of just under 12 kronor per euro. Several factors contributed to this weakening, such as global risk sentiment and risk perceptions related specifically to the Swedish economy in connection with the real estate market and the high level of household debt. From late September 2023 the krona began to strengthen against the euro, before depreciating at the turn of the year as the Swedish economy weakened and fluctuating between 11 kronor and 11.7 kronor per euro. During the reference period short-term interest rate differentials against the three-month EURIBOR were overall low and stood at 0.1 percentage points in the three-month period ending in March 2024.

**The HICP-based real effective exchange rate of the Swedish krona has depreciated over the past ten years (Chart 5.6.4).** This depreciation in real terms mainly reflected developments in the nominal effective exchange rate.

**Over the past ten years Sweden has recorded relatively large current account surpluses and has had a large positive net international investment position (Table 5.6.3).** In 2023 the surplus in the combined current and capital account of the balance of payments stood at 6.8% of GDP, reflecting surpluses in the goods and primary income balances. The corresponding net capital outflows in the financial account were mainly in direct investment. Gross external debt, which is concentrated in monetary and financial institutions, stood at 166.4% of GDP in 2023. Over the past ten years Sweden has recorded a positive net international investment position on average. In 2018 its net international investment position turned positive and it reached 33.2% of GDP in 2023.

**The Swedish economy is well integrated with the euro area through trade and investment linkages.** In 2023 exports of goods and services to the euro area constituted 40.7% of total exports, while the corresponding figure for imports was higher, at 50.4%. In the same year the share of the euro area in Sweden's stock of inward direct investment stood at 56.6% and its share in the country's stock of portfolio investment liabilities was 40.8%. The share of Sweden's stock of foreign assets invested in the euro area amounted to 44.1% in the case of direct investment and 33% for portfolio investment.

#### 5.6.4 Long-term interest rate developments

**Over the reference period from June 2023 to May 2024, long-term interest rates in Sweden stood at 2.5% on average and thus remained well below the 4.8% reference value for the interest rate convergence criterion (Chart 5.6.5).**

**Long-term interest rates in Sweden stood at very low levels over most of the review period but rose towards the end to levels last seen in 2014.** After falling to almost 0% between 2014 and mid-2015, partly owing to high levels of risk appetite and a gradual shift from safe to riskier assets, long-term interest rates in Sweden continued to be driven by both the domestic economic cycle and global developments. Long-term interest rates increased moderately between 2016 and 2018, owing to a recovery in economic growth and inflation, before falling again in 2019. Following the global downward trend in 2019 and 2020, long-term interest rates in Sweden declined and fluctuated closely around 0% until the end of 2020, with short spells in slightly negative territory. In 2020 Sveriges Riksbank responded to the pandemic by increasing the envelope of its quantitative easing programme until the end of 2021, including purchases of government and corporate bonds and commercial paper. It also cut the repo rate to 0% in August 2020 – close to its historically low level of -50 basis points set in February 2016. Sveriges Riksbank's monetary policy stance remained accommodative from August 2020 to April 2022, at which point, against a backdrop of rising and persistent inflation, the central bank began a tightening cycle with a view to stopping high inflation from becoming entrenched in price and wage-setting. Sveriges Riksbank's last rate increase, at the end of November 2023, brought the repo rate to 4.0%. It remained there until May 2024, when the central bank lowered it to 3.75%. The long-term interest rate has also been increasing since January 2022, standing at 2.4% in May 2024, the end of the review period. Sweden's



government debt is rated the top investment-grade notch by all three main rating agencies (Moody's: Aaa; S&P: AAA; Fitch: AAA).

**Historically, Sweden's long-term interest rate differential vis-à-vis the highest-rated euro area countries has been negative, or temporarily positive but very small (Chart 5.6.6).** Thanks to its sound fiscal policy and its balanced and healthy economy, Sweden enjoys the same credibility as the highest-rated euro area countries. Vis-à-vis the euro area average, the interest rate differential has been historically negative and declined to almost -1 percentage point by the end of 2022. It has since recovered slightly, reaching -0.7 percentage points at the end of the review period (-0.3 percentage points vis-à-vis the euro area AAA yield).

**Capital markets in Sweden are highly developed, with corporate bond issuance and stock market capitalisation accounting for a higher percentage of GDP than in the euro area (Table 5.6.4).** Relative to GDP, outstanding amounts of debt securities issued by non-financial corporations in Sweden are more than twice as large as those in the euro area. The size of the Swedish stock market, as a percentage of GDP, is also more than twice that of the euro area. Sweden's banks tend to fund their activities by borrowing from euro area banks only to a limited extent. Claims of euro area MFIs accounted for 8.7% of Swedish banks' total liabilities in 2023. The degree of financial intermediation in Sweden is high. At the end of 2023 bank credit to the private sector amounted to 131.3% of GDP, much higher than the figure for the euro area, which was 99.6%.

## 5.6.5 Statistical tables and charts

[Sweden](#)

## 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 any political or other external interference.** 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 high 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, the Regulation on European statistics<sup>165</sup> and the European Statistics Code of Practice<sup>166</sup>. 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 elaborated further in the European Statistics 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 European**

<sup>165</sup> Regulation (EC) No 223/2009 of the European Parliament and of the Council of 11 March 2009 on European statistics and repealing Regulation (EC, Euratom) No 1101/2008 of the European Parliament and of the Council on the transmission of data subject to statistical confidentiality to the Statistical Office of the European Communities, Council Regulation (EC) No 322/97 on Community Statistics, and Council Decision 89/382/EEC, Euratom establishing a Committee on the Statistical Programmes of the European Communities (OJ L 87, 31.3.2009, p. 164).

<sup>166</sup> The European Statistics Code of Practice was endorsed by the European 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), and revised by the European Statistical System Committee in September 2011 and November 2017.

**Statistics 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<sup>167</sup> granted Eurostat new competences for the regular monitoring and verification of public finance data, 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 in 2011 to strengthen the economic governance structure of the euro area and the EU as a whole requires the compilation of high-quality statistical information, which needs to be produced under robust quality management.**<sup>168</sup> In this context, the European Statistics 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. In 2017 it was revised again in order to emphasise that the NSIs and Eurostat coordinate all activities involved in the development, production and dissemination of European statistics (produced in accordance with the Regulation on European statistics) at the level of their national statistical systems and the ESS respectively.<sup>169</sup>

**In 2015 the Regulation on European statistics<sup>170</sup> was 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.

**Lastly, it is necessary to assure the independence of other statistical authorities responsible for the compilation of European statistics (e.g. ministries of finance).** Other statistical authorities' responsibility for the publication of statistics needs to be clearly identified in order to distinguish statistical releases from political statements. In Poland and Romania, the Ministries of Finance compile EDP debt data. In Bulgaria, the Ministry of Finance compiles quarterly government debt data, while the NSI compiles annual government debt. The institutional responsibilities

<sup>167</sup> 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, 30.7.2010, p. 1).

<sup>168</sup> On 13 December 2011 the reinforced Stability and Growth Pact (SGP) 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 in October 2010 by all 27 Member States at the time and the European Parliament.

<sup>169</sup> European statistics are developed, produced and disseminated by both the ESS and the European System of Central Banks (ESCB) but under separate legal frameworks reflecting their respective governance structures. The members of the ESCB are not involved in the production of European statistics pursuant to the Regulation on European statistics. However, with a view to minimising the reporting burden and guaranteeing the coherence necessary to produce European statistics, the ESS and the ESCB cooperate closely, while complying with the statistical principles set out in Article 2(1) of the Regulation on European statistics. Given that some European statistics may be compiled by NCBs in their capacity as members of the ESCB, the NSIs and the NCBs also cooperate closely under national arrangements with a view to ensuring the necessary cooperation between the ESS and the ESCB and to guaranteeing the production of complete and coherent European statistics.

<sup>170</sup> Regulation (EU) 2015/759 of the European Parliament and of the Council of 29 April 2015 amending Regulation (EC) No 223/2009 on European statistics (OJ L 123, 19.5.2015, p. 90).

for the compilation of EDP data and GFS in the countries are shown in Table 6.1. In Romania, the Law on the organisation and functioning of official statistics includes the principle of professional independence and applies to all statistical processes and products. In Bulgaria and Poland, although the independence of the compilers at the Ministries of Finance is not guaranteed by law, the monitoring and quality assurance of the EDP data and GFS compiled by the Ministries of Finance form part of the coordination role of the NSI.

**Table 6.1**  
Quality and integrity of convergence statistics

| Bulgaria   |  |
|--|--|
| Institutional features relating to the quality and integrity of the statistics used in assessing the convergence process |  |
| Legal independence of the national statistical institute   | Under the Law on Statistics, statistics are based on the principles of professional independence, impartiality, objectivity, reliability, statistical confidentiality and cost effectiveness. Under 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).  |
| 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.   |
| Legal mandate for data collection  | The Law on Statistics determines the main principles of data collection.   |
| Legal provisions regarding statistical confidentiality   | Under Articles 25 to 27 a of the Law on Statistics, the confidentiality of the statistical data is assured.  |
| HICP inflation <sup>1)</sup>   |  |
| 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. A follow-up report outlining the issues that had been addressed by Bulgaria was published in 2018. There were no apparent instances of non-compliance with the HICP methodology.  |
| Other issues   | Eurostat considered the representativeness of the HICP to be generally appropriate.  |
| Government finance statistics  |  |
| Data coverage  | Revenue, expenditure, deficit and debt data are provided for the period 2014-23.   |
| Outstanding statistical issues   | No major outstanding statistical issues identified. Eurostat made an <a href="#">EDP visit to Bulgaria in 2023</a> and published the final findings on its website.  |
| Institution responsible for the compilation of statistics  | The NSI compiles the non-financial and annual financial accounts of government, as well as annual government debt. The Ministry of Finance compiles quarterly government debt and the NCB compiles the quarterly financial accounts of government.   |
| 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   | Under Article 5 of the State Statistical Service Act, statistics are based on objectivity, impartiality and independence. Under Article 3, the Head of the NSI is appointed by the President of the Republic.  |
| Administrative supervision and budget autonomy   | 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 State Statistical Service Act determines the main principles of data collection.   |
| Legal provisions regarding statistical confidentiality   | Under Articles 16, 17 and 18 of the State Statistical Service Act, the confidentiality of the statistical data is assured.   |
| HICP inflation <sup>1)</sup>   |  |
| Compliance with legal minimum standards  | Eurostat made a compliance monitoring visit in 2019 and published a report in January 2020 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. In February 2023 Eurostat reviewed the recommendations implemented by the NSI of the Czech Republic and identified two areas in which the quality of the HICP could be improved further. |
| Other issues   | Eurostat considered the representativeness 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 2014-23.   |



|   |   |
|---|---|
| Outstanding statistical issues                            | No major outstanding statistical issues identified. Eurostat made an <a href="#">EDP visit to the Czech Republic in 2021</a> and published the final findings on its website. |
| Institution responsible for the compilation of statistics | The NSI compiles the non-financial and financial accounts of government, as well as government debt.  |

## 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   | Under Act CLV of 2016 on Official Statistics, statistics are compiled following the principles of 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 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  | Act XLVI on Statistics determines the main principles of data collection.  |
| Legal provisions regarding statistical confidentiality   | Under Article 17 of Act XLVI on Statistics, the confidentiality of the statistical data is assured.  |
| HICP inflation <sup>1)</sup>   |  |
| Compliance with legal minimum standards  | Eurostat made a compliance monitoring visit in 2019 and published a report in March 2020 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 those 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 representativeness 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 2014-23.   |
| Outstanding statistical issues   | No major outstanding statistical issues identified. Eurostat made an <a href="#">EDP visit to Hungary in 2023</a> and will publish the final findings on its website.  |
| Institution responsible for the compilation of statistics  | The NSI compiles the non-financial accounts of government. The NCB compiles government debt and the financial accounts of government.  |

## Poland

| Institutional features relating to the quality and integrity of the statistics used in assessing the convergence process |  |
|--|--|
| Legal independence of the national statistical institute   | Under Article 1 of the Law on Public Statistics, statistics are based on reliability, objectivity and transparency.<br><br>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). |
| 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.   |
| Legal mandate for data collection  | The Law on Official Statistics determines the main principles of data collection.  |
| Legal provisions regarding statistical confidentiality   | Under Articles 10, 11, 12, 38, 39 and 54 of the Law on Official Statistics, the confidentiality of the statistical data is assured.  |
| HICP inflation <sup>1)</sup>   |  |
| Compliance with legal minimum standards  | Eurostat made a compliance monitoring visit in 2015 and published a report in 2016 confirming that the methods used for producing the HICP are of a good standard and in line with legal requirements.   |
| Other issues   | In the 2016 report, Eurostat made further recommendations for increasing the accuracy and reliability of the HICP. A follow-up report issued in 2018 showed that most recommendations had been implemented or were in the process of being implemented.                              |
| Government finance statistics  |  |
| Data coverage  | Revenue, expenditure, deficit and debt data are provided for the period 2014-23.   |
| Outstanding statistical issues   | No major outstanding statistical issues identified. Eurostat made an <a href="#">EDP visit to Poland in 2022</a> and published the final findings on its website.  |
| 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.   |

## 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   | 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   | Under 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  | Under the Statistical Law, "the official statistics in Romania are implemented and coordinated by the NSI".  |
| Legal provisions regarding statistical confidentiality   | 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 <sup>1)</sup>   |  |
| Compliance with legal minimum standards  | Eurostat made a compliance monitoring visit in 2016 and published a report in February 2020 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. In January 2023 Eurostat reviewed the recommendations implemented by the NSI of Romania and took good note of the progress achieved.  |
| Other issues   | Eurostat considered the representativeness 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 2014-23.   |
| Outstanding statistical issues   | No major outstanding statistical issues identified. Eurostat made an <a href="#">EDP visit to Romania in 2023</a> and will publish the final findings on its website.  |
| Institution responsible for the compilation of statistics  | The NSI compiles the non-financial accounts of government. The Ministry of Finance compiles government debt. The NCB compiles the financial accounts of government.  |

## 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   | Under 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 (six years, three-year reappointment possible, only once).   |
| Administrative supervision and budget autonomy   | The NSI is a central statistical 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 stems from 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   | Under Sections 5 and 6 of the Official Statistics Act, the confidentiality of the statistical data is assured.   |
| HICP inflation <sup>1)</sup>   |  |
| 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 identified, but those were considered by Eurostat to be limited and unlikely to have a major impact in practice on the annual average rate of change in the HICP. In March 2022 Eurostat reiterated that Statistics Sweden should take measures to bring the coverage of the HICP into line with the legal requirements in some areas, albeit stating that those measures were not expected to affect annual HICP inflation significantly. |
| Other issues   | Eurostat considered the representativeness 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 2014-23.   |
| Outstanding statistical issues   | There is a public unit currently classified as a monetary financial institution, which may be subject to a reclassification into the general government sector. Eurostat made an <a href="#">EDP visit to Sweden in 2022</a> and published the final findings on its website.  |
| Institution responsible for the compilation of statistics  | The NSI compiles the non-financial and financial accounts of government, as well as government debt.   |

Note: NCB stands for national central bank.

1) See Eurostat's website for the [full reports on the findings and recommendations of the HICP compliance monitoring visits](#) for each country.



## 6.2 HICP inflation

**This section considers the methodology and quality of the statistics underlying the measurement of price developments, specifically the Harmonised Index of Consumer Prices (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.<sup>171</sup> The HICP covering the euro area as a whole has been the main measure of price developments for the 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.** The framework regulation introduced to establish HICPs, Council Regulation (EC) No 2494/95<sup>172</sup>, was adopted in October 1995 and subsequently replaced by Regulation (EU) 2016/792<sup>173</sup>, which entered into force in June 2016. The HICPs have also been harmonised on the basis of EU Council and European Parliament 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. 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. The "HICP – administered prices" includes only prices which are directly set or significantly influenced by the government, including national regulators. It is based on a common definition and compilation, and is 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.

<sup>171</sup> See Eurostat's website for details on the [HICP legislative framework](#). Eurostat has also published [recommendations and a methodological manual](#).

<sup>172</sup> Council Regulation (EC) No 2494/95 of 23 October 1995 concerning harmonized indices of consumer prices (OJ L 257, 27.10.1995, p. 1).

<sup>173</sup> Regulation (EU) 2016/792 of the European Parliament and of the Council of 11 May 2016 on harmonised indices of consumer prices and the house price index, and repealing Council Regulation (EC) No 2494/95 (OJ L 135, 24.5.2016, p. 11).

## 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<sup>174</sup> and Commission Regulation (EU) No 220/2014<sup>175</sup>. 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.

**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<sup>176</sup>, as well as trade credits<sup>177</sup> 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.

**Government deficit and debt ratios are expressed as a percentage of GDP at current market prices.**

### 6.3.1 Data source

**The national central banks (NCBs) provide the ECB with detailed GFS data under the ECB's GFS Guideline<sup>178</sup>.** 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

<sup>174</sup> 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, 26.6.2013, p. 1).

<sup>175</sup> 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, 8.3.2014, p. 101).

<sup>176</sup> 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.

<sup>177</sup> 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.

<sup>178</sup> Guideline (EU) 2020/1552 of the European Central Bank of 14 October 2020 amending Guideline ECB/2013/23 on government finance statistics (ECB/2020/50) (OJ L 354, 26.10.2020, p. 22).

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

### 6.3.2 Methodological issues

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

**In the Czech Republic and Hungary, there are monetary financial institutions (MFIs) that are reclassified into the general government sector for EDP purposes.**

These units are classified as part of the financial sector in other statistical data compiled by the NCB (e.g. monetary statistics and securities statistics). The resultant discrepancy in sector classification between those statistics and GFS is well documented and has been made known to users. However, one MFI in Hungary will be reclassified into the general government sector also in financial accounts statistics and balance of payments statistics, with effect from the 2024 benchmark revision.

**In Sweden, a public unit is currently classified as part of the financial sector and is on the ECB's list of MFIs, but may be reclassified into the general government sector subject to the outcome of methodological discussions at the European level.**

## 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 exchange rate mechanism 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 subsequently published on the ECB's website.<sup>179</sup> 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 41 trading partners. Both nominal and real EER statistics are published by the ECB.

## 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**

<sup>179</sup> Since 1 July 2016 the reference rates have been published at around 16:00 CET. For details, see "[ECB introduces changes to euro foreign exchange reference rates](#)", press release, ECB, 7 December 2015.

**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 cooperation 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  |
|------------------------|---|
| <b>Bond issuer</b>     | The bond should be issued by the central government.  |
| <b>Maturity</b>        | 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.        |
| <b>Coupon effects</b>  | No direct adjustment.   |
| <b>Taxation</b>        | Gross of tax.   |
| <b>Choice of bonds</b> | The selected bonds should be sufficiently liquid. This requirement should determine the choice between benchmark or sample approaches, depending on national market conditions. |
| <b>Yield formula</b>   | The "redemption yield" formula should be applied.   |
| <b>Aggregation</b>     | 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".

**With regard to 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,<sup>180</sup> and ii) statistics on financial and non-financial integration with the euro area.<sup>181</sup>

<sup>180</sup> Debt securities issued by resident corporations, stock market capitalisation, MFI credit to non-government residents and claims of euro area MFIs on resident MFIs.

<sup>181</sup> External trade and investment position with the euro area.

**The data covering the structure of the financial system are provided by the NCBs.** The indicators concerning the debt securities issued by resident financial corporations (MFIs excluding the national central bank and non-monetary financial corporations) and non-financial corporations are compiled in accordance with the methodology set out in Guideline (EU) 2022/971<sup>182</sup>. 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 are obtained from the countries under review and, for the latter indicator, also from the euro area countries covered by Regulation (EU) No 2021/379<sup>183</sup>. Historical data are compiled by the relevant NCBs, where appropriate. For the indicators mentioned in this paragraph, 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) and with guidance provided by the ECB in its Guideline on external statistics<sup>184,185</sup> and by 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 forecasts.<sup>186</sup>

**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 a harmonised basis under the EU Regulation on European business statistics<sup>187</sup>.

<sup>182</sup> Guideline (EU) 2022/971 of the European Central Bank of 19 May 2022 on the Centralised Securities Database and the production of securities issues statistics and repealing Guideline ECB/2012/21 and Guideline (EU) 2021/834 (ECB/2022/25) (OJ L 166, 22.6.2022, p. 147).

<sup>183</sup> Regulation (EU) 2021/379 of the European Central Bank of 22 January 2021 on the balance sheet items of credit institutions and of the monetary financial institutions sector (recast) (ECB/2021/2) (OJ L 73, 3.3.2021, p. 16).

<sup>184</sup> Guideline of the European Central Bank of 9 December 2011 on the statistical reporting requirements of the European Central Bank in the field of external statistics (ECB/2011/23), recast of Guideline ECB/2004/15 of 16 July 2004, as amended by Guidelines ECB/2013/25 of 30 July 2013, ECB/2015/392 of 26 November 2015, ECB/2018/19 of 2 August 2018, ECB/2020/52 of 14 October 2020 and ECB/2022/23 of 5 May 2022.

<sup>185</sup> See also "EU Balance of Payments and International Investment Position statistical sources and methods – B.o.p. and i.i.p. e-book", ECB, Frankfurt am Main, October 2023.

<sup>186</sup> These economic forecasts are made by the Directorate-General for Economic and Financial Affairs (DG ECFIN) on behalf of the European Commission.

<sup>187</sup> Regulation (EU) No 2019/2152 of the European Parliament and of the Council of 27 November 2019 on European business statistics (OJ L 327, 17.12.2019, p. 1).

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.



## 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 relevant from the perspective of their compatibility with provisions on the independence of NCBs, members of NCBs' decision-making bodies and Governors 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. While, in particular, the independence requirements and the monetary financing prohibition are applicable to all Member States, including those with a derogation since the date of their accession to the European Union, the following country assessments additionally 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).<sup>188</sup>

### 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,<sup>189</sup>
- the Law on Българска народна банка (Bulgarian National Bank) published on 13 February 2024 (hereinafter the "Law on BNB").<sup>190</sup> The Law on BNB enters into force and repeals and replaces the previous Law on Българска народна банка (Bulgarian National Bank)<sup>191</sup> as of the date stipulated in the Council Decision on the adoption by the Republic of Bulgaria of the euro, adopted in accordance with Article 140(2) of the Treaty, and in the Council Regulation, adopted in accordance with Article 140(3) of the Treaty. There are no additional conditions for the entry into force of the Law on BNB.

The Law on counter-corruption<sup>192</sup> applies to public office holders.

<sup>188</sup> According to Section 2.2.2 of this Convergence Report.

<sup>189</sup> Constitution of the Republic of Bulgaria, Darjaven vestnik issue 56, 13.7.1991.

<sup>190</sup> Law on Българска народна банка (Bulgarian National Bank), Darjaven vestnik issue 13, 13.2.2024.

<sup>191</sup> Law on Българска народна банка (Bulgarian National Bank), Darjaven vestnik issue 46, 10.6.1997.

<sup>192</sup> Darjaven vestnik issue 84, 6.10.2023.

There have been several changes in relation to the points identified in the ECB's Convergence Report of June 2022, also addressing the recommendations made in previous Convergence Reports.

### 7.1.2 Independence of the NCB

With regard to the independence of Българска народна банка (Bulgarian National Bank), the Law on BNB, the Law on counter-corruption and the Bulgarian Constitution have been examined.

#### Institutional independence

Article 6 of the Law on BNB prohibits European Union institutions, bodies, offices or agencies, the Council of Ministers or the governments of other EU Member States, as well as any other bodies and institutions from giving instructions to Българска народна банка (Bulgarian National Bank), the Governor or the members of the Governing Council. This provision is in line with Article 130 of the Treaty and Article 7 of the Statute.<sup>193</sup>

Article 99 of the Bulgarian Constitution governs the formation of the government. Article 99(5) provides that if no agreement is reached on the formation of a government, the President of the Republic of Bulgaria, following consultations with the parliamentary groups and acting on a motion by the caretaker prime minister-designate, shall appoint a caretaker cabinet, and shall schedule new elections within two months. A caretaker prime minister shall be appointed from among the Chairperson of the National Assembly, the Governor or a Deputy Governor of Българска народна банка (Bulgarian National Bank), the President or a Vice-President of the Bulgarian National Audit Office, and the Ombudsman or a deputy thereof. In principle, such a possible appointment of a Governor or a Deputy Governor, entailing the interruption of their term of office, risks compromising the independent exercise of the powers and carrying out the tasks and duties conferred upon the NCB. In particular, in case of an interruption of the term of office, the risk may arise that the Governor or Deputy Governor may take position as caretaker prime minister, which is incompatible with the position of the NCB, before going back to their position as Governor or Deputy Governor and then being conflicted with stances that they may have taken as caretaker prime minister. In any event, pursuant to Article 130 TFEU, when exercising the powers and carrying out the tasks and duties conferred upon them by the Treaties and the Statute, members of the decision-making bodies of the NCBs must not seek or take instructions from Union institutions, bodies, offices or agencies, from any government of a Member State or from any other body. Furthermore, the governments of the Member States undertake to respect this principle and not to seek to influence the members of the decision-making bodies of the NCBs in the performance of their tasks. It follows from Article 130 TFEU that a

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<sup>193</sup> See paragraph 3.2 of Opinion CON/2018/53.

member of an NCB's decision-making body cannot at the same time assume the function as a member of a national government, in particular not as prime minister. Otherwise, independent exercise of the powers and carrying out of the tasks and duties, in which the Governor or a Deputy Governor of Българска народна банка (Bulgarian National Bank) can take an independent position, which may be different to that of the government, is logically not conceivable. It is moreover imperative that, once appointed, the Governor or Deputy Governor of Българска народна банка (Bulgarian National Bank), as caretaker prime minister and member of the government, should be required to fully respect the institutional independence of Българска народна банка (Bulgarian National Bank) and its decision-making bodies in compliance with Article 130 TFEU. Moreover, the risk that the Governor or Deputy Governor may take position as caretaker prime minister, which is incompatible with the position of the Българска народна банка (Bulgarian National Bank), before going back to their position as Governor or Deputy Governor and then being conflicted with stances that they may have taken as caretaker prime minister, would only be sufficiently mitigated by requiring the Governor or Deputy Governor to resign when appointed as caretaker prime minister, in order to exclude the materialisation of this risk. Any future amendment to the Law on BNB, which implements Article 99(5) of the Bulgarian Constitution, must be made in line with these principles.

### Personal independence

Article 15(1) and (2) of the Law on BNB lists the grounds on which members of the Governing Council may be relieved from office. Article 15(1) provides that the National Assembly may relieve the Governor from office in accordance with Article 14.2 of the Statute. Article 15(2) provides that other members of the Governing Council may be relieved from office if they no longer fulfil the conditions required for the performance of their duties or if they have been found guilty of serious misconduct in accordance with Article 14.2 of the Statute. Article 15(1) and (2) of the Law on BNB complies with Article 14.2 of the Statute.<sup>194</sup>

In 2023, Article 98(1) of the Law on counter-corruption replaced Article 80(1) of the Law on counter corruption and unlawfully acquired assets forfeiture, which had replaced Article 33(1) of the Law on the prevention of conflicts of interests, providing that the ascertainment of a conflict of interests by an enforceable legal act is a ground for relieving the Governor, Deputy Governors and the other members of the Governing Council of Българска народна банка (Bulgarian National Bank) from office, unless otherwise provided for in the Constitution or the Statute or special legislation. Article 98(2) of the Law on counter-corruption provides that the relieve from office must follow the procedure established in the relevant laws. It is understood that in the case of the Governor, Deputy Governors and the other members of the Governing Council of Българска народна банка (Bulgarian National Bank) this refers to Article 15(1) and (2) of the Law on BNB and that this reference entails that Article 98(1) of the Law on counter-corruption cannot apply in relation to the Governor or other members of the

<sup>194</sup> See paragraph 3.1 of Opinion CON/2018/53.

Governing Council of Българска народна банка (Bulgarian National Bank) because the wording of Article 98(1) of the Law on counter-corruption ensures that the ascertainment of a conflict of interest in accordance with that Law will not be a ground for removal from office of a senior public office holder where it is otherwise provided for in special legislation, such as the Law on BNB.<sup>195</sup>

Article 15(3) of the Law on BNB establishes that the grounds for relieving a Deputy Governor or another member of the Governing Council of Българска народна банка (Bulgarian National Bank) other than the Governor from office must be established by decision of the Governing Council of Българска народна банка (Bulgarian National Bank). Such decisions are adopted according to a procedure determined by the Governing Council of Българска народна банка (Bulgarian National Bank) and have the immediate effect of suspending the members concerned from the exercise of their duties. The decisions are subject to appeal before Върховния административен съд (the Supreme Administrative Court) within 7 days and the Supreme Administrative Court has 14 days to issue a final ruling on an appeal. The final ruling of the Supreme Administrative Court on an appeal is sent to the national authority, which has the competence to relieve from office the members of the Governing Council of Българска народна банка (Bulgarian National Bank). The final ruling is binding on the appointing authority under Article 13 of the Law on BNB. The ECB understands that Article 15(3) of the Law on BNB aims to ensure that within the administrative procedure for dismissal of any member of the decision-making bodies of Българска народна банка (Bulgarian National Bank) other than the Governor, it is possible to request a review by national courts of the decision of the Governing Council of Българска народна банка (Bulgarian National Bank) establishing the grounds for relieving a Deputy Governor or another member of the Governing Council of Българска народна банка (Bulgarian National Bank) other than the Governor from office. The judicial review of such a decision may lead to its annulment. The annulment of a decision of the Governing Council of Българска народна банка (Bulgarian National Bank) establishing the grounds for relieving a Deputy Governor or another member of the Governing Council of Българска народна банка (Bulgarian National Bank) other than the Governor from office precludes the adoption of a decision by the appointing authority to dismiss the relevant member of the Governing Council of Българска народна банка (Bulgarian National Bank). In addition, the ECB understands that when deciding on the dismissal, the appointing authority cannot consider and adopt additional grounds for dismissal that were not established in the decision of the Governing Council of Българска народна банка (Bulgarian National Bank). The ECB further understands that, in accordance with general administrative law, an appeal before the Supreme Administrative Court could suspend the application of the decision of the Governing Council of Българска народна банка (Bulgarian National Bank). Based on the above understanding, Article 15(3) of the Law on BNB is consistent with Article 130 of the Treaty and with the Statute.<sup>196</sup>

Article 13(1) and (2) of the Law on BNB, which replaced Article 12(1) and (2) of the previous Law on BNB, provides for the National Assembly's powers to elect the

<sup>195</sup> See paragraph 3.1 of Opinion CON/2021/2 and paragraph 3.1.4 of Opinion CON/2022/45.

<sup>196</sup> See paragraph 3.2 of Opinion CON/2022/45.

Governor and the Deputy Governors of Българска народна банка (Bulgarian National Bank). The ECB notes that any proper election or appointment of members of an NCB's decision-making body must 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 relieved from office under conditions other than those mentioned in Article 14.2 of the Statute, even if they have not yet taken up their duties.

As noted above, Article 99(5) of the Bulgarian Constitution provides that the Governor or a Deputy Governor of Българска народна банка (Bulgarian National Bank) may be appointed by the President of the Republic of Bulgaria as a caretaker prime minister for a period of two months. Pursuant to Article 14.2. of the Statute, a Governor may be relieved from office only if he or she no longer fulfils the conditions required for the performance of his or her duties or if he or she has been guilty of serious misconduct. Consequently, the appointment of the Governor of Българска народна банка (Bulgarian National Bank) as a caretaker prime minister may not amount to a relieving from office without the existence of such a ground. It is understood that the appointment of the Governor of Българска народна банка (Bulgarian National Bank) as caretaker prime minister is subject to the acceptance of the appointment by the Governor of Българска народна банка (Bulgarian National Bank)<sup>197</sup>. Based on this understanding that the appointment of the Governor of Българска народна банка (Bulgarian National Bank) as a caretaker prime minister presupposes his or her acceptance, the appointment would not amount to a relieving from office. In such a situation, there is no need for the protection of the personal independence of the Governor of Българска народна банка (Bulgarian National Bank) by the mechanism of Article 14.2. of the Statute<sup>198</sup>.

### 7.1.3 Confidentiality

Article 4 of the Law on BNB provides that, without prejudice to Article 37 of the Statute, Българска народна банка (Bulgarian National Bank) may not disclose or transmit to other persons any information related to the ESCB, nor any information obtained that constitutes a banking, professional, commercial or other legally protected secret of the banks and the other participants in monetary and credit transactions. Article 24(1) of the Law on BNB provides that, without prejudice to Article 37 of the Statute, the employees of Българска народна банка (Bulgarian National Bank) shall respect confidentiality concerning negotiations, deals contracted, the amount of assets on

<sup>197</sup> In the light of the requirements flowing from Article 130 TFEU as to the independence of members of decision-making bodies of NCBs other than the Governor, it is understood that the appointment of a Deputy Governor of Българска народна банка (Bulgarian National Bank) as caretaker prime minister is also subject to the acceptance of the appointment by the Deputy Governor of Българска народна банка (Bulgarian National Bank).

<sup>198</sup> In this context, it is noted that any provision in Bulgarian law governing the replacement of the Governor of Българска народна банка (Bulgarian National Bank), in particular any future amendment to the Law on BNB seeking to implement Article 99(5) of the Bulgarian Constitution, cannot mandate the appointment of another person as Governor for only two months. In accordance with Article 14.2. of the Statute, first subparagraph, the term of office of a Governor of an NCB shall be no less than five years. See Chapter 2.2.3. on "Independence on NCBs", Section on "Minimum term of office for Governors", and Opinion CON/2018/23.

customers' deposits and their transactions, and information received by Българска народна банка (Bulgarian National Bank) , as well as any circumstances concerning the activities of Българска народна банка (Bulgarian National Bank) and its customers, which constitute business, banking, professional, commercial or other legally protected secrets, even after termination of their employment relationship. Under Article 37 of the Statute, professional secrecy is an ESCB-wide matter, which is duly acknowledged in Article 4 and Article 24(1) of the Law on BNB.

#### 7.1.4 Monetary financing and privileged access

In past Convergence Reports the ECB considered that certain provisions of the Law on BNB arising from the particularities of the currency-board regime were incompliant with the monetary financing prohibition. The Law on BNB adopted in 2024 which enters into force on the date stipulated in the Council Decision on the adoption by the Republic of Bulgaria of the euro, has repealed those provisions.

Pursuant to the Law on credit institutions,<sup>199</sup> Българска народна банка (Bulgarian National Bank) operates a central credit register (Article 56) and a bank account register (Article 56a). The costs of obtaining information from these registers by government and judicial authorities are to be borne by the State budget. In past Convergence Reports the ECB considered that in order to further ensure compatibility with the prohibition of monetary financing, the Law on credit institutions would benefit from a limitation of the liability of Българска народна банка (Bulgarian National Bank) in relation to the operation of the two registers.<sup>200</sup> The provisions of both Articles 56 and 56a have been amended to waive the liability of Българска народна банка (Bulgarian National Bank) in relation to the operation of the two registers. Instead of Българска народна банка (Bulgarian National Bank) , the State will be liable for damages resulting from the operation of the two registers in accordance with the general regime for State liability.<sup>201</sup> This makes the rules compliant with the prohibition of monetary financing.

#### 7.1.5 Legal integration of the NCB into the Eurosystem

In past Convergence Reports the ECB considered, with regard to legal integration of Българска народна банка (Bulgarian National Bank) into the Eurosystem, that the Law on BNB needed to be adapted in several respects. The Law on BNB, which was adopted in 2024, addresses these elements, as set out below.

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<sup>199</sup> Darjaven vestnik issue 59, 21.07.2006.

<sup>200</sup> See paragraph 3.1.6 of Opinion CON/2015/46, paragraph 3.2.1 of Opinion CON/2016/19 and paragraph 2.2 of Opinion CON/2016/57.

<sup>201</sup> See paragraph 3.2 of Opinion CON/2021/2.



## Tasks

### Monetary policy

Article 2(1) and Article 17, items 3 and 4, and Articles 37, 38, 39 and 43, which provide for the powers of Българска народна банка (Bulgarian National Bank) in the field of monetary policy and instruments for the implementation thereof, recognise the ECB's powers in this field.

### Collection of statistics

Article 3(8) and Article 52 of the Law on BNB, which provide for the powers of Българска народна банка (Bulgarian National Bank) relating to the collection of statistics, recognise the ECB's powers in this field.

### Official foreign reserve management

Articles 39 to 42 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, recognise the ECB's powers in this field.

### Payment systems

Articles 3(5) of the Law on BNB, which provides for the powers of Българска народна банка (Bulgarian National Bank) with regard to the promotion of the smooth operation of payment systems, recognises the ECB's powers in this field.

### Issue of banknotes

Article 3(2) and Articles 26 to 36 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, recognise the Council's and the ECB's powers in this field.<sup>202</sup>

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<sup>202</sup> See paragraph 3.2 of Opinion CON/2023/27.

## Financial provisions

### Appointment of independent auditors

Article 7(7) of the Law on BNB, which provides that the external auditor is appointed by the Governing Council on the basis of a procedure complying with the Law on public procurement, recognises the Council's and the ECB's powers under Article 27.1 of the Statute.

### Financial reporting

Articles 53 to 57 of the Law on BNB reflect the obligation to comply with the Eurosystem's regime for financial reporting of NCB operations, pursuant to Article 26 of the Statute.

## International cooperation

Article 5(2) and Article 17, items 11 and 12, of the Law on BNB, which provide for the powers of Българска народна банка (Bulgarian National Bank) with regard to international cooperation, recognise the ECB's powers in this field.

### 7.1.6 Conclusions

The Law on BNB has been amended to reflect and implement the recommendations made in the ECB's Convergence Report of June 2022. As a result, and subject to the conditions and interpretations set out in this chapter, the national legislation is consistent with the Treaty and the Statute.

## 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,<sup>203</sup>
- the Law on Česká národní banka (hereinafter the "Law on CNB").<sup>204</sup>

<sup>203</sup> Constitutional Law No 1/1993 Coll.

<sup>204</sup> Law No 6/1993 Coll.

- the Law No 166/1993 Coll. on the Supreme Audit Office (hereinafter the "Law on NKU").

In relation to the points identified in the ECB's Convergence Report of June 2022, the comments made in that report are largely repeated.

## 7.2.2 Independence of the NCB

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

### 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.

### 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.<sup>205</sup>

Pursuant to the Law on NKU, 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.

### Personal independence

The Law on CNB is silent on the right of national courts to review a decision to dismiss any member, other than the Governor, from 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 would 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 exceptionally 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, in order to address an urgent situation, where the FMGS does not have sufficient funds to perform its tasks and this situation might jeopardise the stability of the financial market. Even if such funding is discretionary, temporary and in the interests of financial stability,<sup>206</sup> it remains the case that Article 123(1) of the Treaty prohibits any type of credit facility in favour of "bodies governed by public law". Given the features of the FMGS, the provisions laid down in the Law on CNB are not compatible with the monetary financing prohibition and should be amended accordingly.<sup>207</sup> The FMGS qualifies as a "body governed by public law" within the meaning of Article 123(1) of the Treaty, as has been recently clarified. In particular, the FMGS has all of the following characteristics: (a) it is established for the specific purpose of meeting needs in the general interest, not having an industrial or commercial character; (b) it has legal

<sup>205</sup> See Section 2.2.2 of this Convergence Report.

<sup>206</sup> See paragraphs 3.1.2 and 3.1.3 of Opinion CON/2015/22, and paragraph 3.2. of Opinion CON/2016/60.

<sup>207</sup> See *supra*, page 34 and Opinions CON/2020/24 and CON/2021/17.

personality; and (c) it is closely dependent on the public sector entities referred to in Article 123(1) of the Treaty, given that, although only a minority of the members of FMGS's governing body are representatives of the Ministry of Finance, the Ministry of Finance has in fact the right to appoint and dismiss all the members of the FMGS's governing body.

#### 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.

##### 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 7.2.2. but also to the secondary objective of the ESCB.

##### 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.

## **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.

## **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.



## 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, international financial institutions and other foreign and international organisations performing similar tasks to those performed by Česká národní banka, does not recognise the ECB's powers in this field.

## 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 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 Hungary

### 7.3.1 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,<sup>208</sup>
- Law CXXXIX of 2013 on the Magyar Nemzeti Bank (hereinafter the "Law on the MNB").<sup>209</sup>

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<sup>208</sup> Magyarország Alaptörvénye, Magyar Közlöny 2013/163. (X.3.).

The Law on the MNB has been amended several times since the ECB's Convergence Report of June 2022. As a result, some additional points are included in this year's assessment. Nevertheless, there have been no major changes in relation to the points identified in that Convergence Report, and those comments are therefore largely repeated in this year's assessment.

### 7.3.2 Independence of the NCB

With regard to the Magyar Nemzeti Bank's independence, the Law on the MNB, Law XXVII of 2008,<sup>210</sup> Government Decree 89/2023 (III. 22.) on economic and financial measures<sup>211</sup> and Government Decree 471/2022 (XI. 21.) on certain economic measures<sup>212</sup> need to be adapted as set out below.

#### Institutional independence

After introducing significant changes in 2013-2015,<sup>213</sup> minor amendments were made to the Law on the MNB. In the past two years, the Magyar Nemzeti Bank has been entrusted with additional tasks arising from the implementation of EU legislation.<sup>214</sup> Given the nature of these changes, it is unlikely that they will have a material impact on the institutional framework and organisational and governance stability of the Magyar Nemzeti Bank.

<sup>209</sup> A Magyar Nemzeti Bankról szóló 2013. évi CXXXIX. törvény, 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.

<sup>210</sup> Law XXVII of 2008 on the oath of certain public officials (egyes közjogi tisztségviselők esküjéről és fogadalmaról szóló 2008. évi XXVII. törvény).

<sup>211</sup> Gazdasági, finanszírozási tárgyú intézkedésekről szóló 89/2023. (III. 22.) Korm. rendelet.

<sup>212</sup> Egyes gazdasági tárgyú intézkedésekről szóló 471/2022. (XI. 21.) Korm. rendelet.

<sup>213</sup> The most notable amendment was 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 (see Articles 176 to 183 of the Law on the MNB as well as Opinions CON/2013/56 and CON/2013/71). Further amendments concerned the allocation of new tasks to the Magyar Nemzeti Bank, such as: resolution tasks (Law XXXVII of 2014); supervisory tasks involving the verification of compliance with the new legal measures applicable to consumer loan contracts (Law XL of 2014); mediation of complaints and the initiation of legal proceedings in the public interest (Law XL of 2014 and Law LXXXV of 2015). 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 of the need to amend the Magyar Nemzeti Bank's institutional framework, were mentioned in previous Convergence Reports as adversely affecting the organisational and governance stability of the Magyar Nemzeti Bank and having an impact on its institutional independence. The principle of central bank independence requires that a central bank has a stable legal framework to enable it to function.

<sup>214</sup> Article 40 of the Law on the MNB now covers the following EU secondary legislation as well: Regulation (EU) No 260/2012 of the European Parliament and of the Council of 14 March 2012 establishing technical and business requirements for credit transfers and direct debits in euro and amending Regulation (EC) No 924/2009 (OJ L 94, 30.3.2012, p. 22); Regulation (EU) 2019/1238 of the European Parliament and of the Council of 20 June 2019 on a pan-European Personal Pension Product (PEPP) (OJ L 198, 25.7.2019, p. 1); Regulation (EU) 2021/1230 of the European Parliament and of the Council of 14 July 2021 on cross-border payments in the Union (OJ L 274, 30.7.2021, p. 20); Regulation (EU) 2022/858 of the European Parliament and of the Council of 30 May 2022 on a pilot regime for market infrastructures based on distributed ledger technology, and amending Regulations (EU) No 600/2014 and (EU) No 909/2014 and Directive 2014/65/EU (OJ L 151, 2.6.2022, p. 1).

Article 1(2) of the Government Decree 89/2023 (III. 22.) on economic and financial measures provides that, until 1 April 2024,<sup>215</sup> voluntary mutual insurance funds, home savings and loan associations, private pensions and private pension funds, insurance institutions, entities regulated by the acts on investment firms, commodity dealers, collective investment firms and their managers<sup>216</sup> may not purchase any Hungarian forint-denominated debt instrument issued by the central bank of a Member State of the Union. The same prohibition applies to natural persons whose investments exceed HUF 20,000,000.<sup>217</sup> In addition, Article 1(1) of Government Decree 471/2022 (XI. 21.) on certain economic measures stipulates that, until 1 April 2024,<sup>218</sup> in the case of the same persons and entities covered by Government Decree 89/2023, the interest paid on demand deposits with a maximum maturity of one year under deposit agreements concluded with credit institutions may not exceed, the average yield of the last auction of the discount Treasury bill issued by the Hungarian State with a remaining maturity of three months, as published on the official website of the Államadósság Kezelő Központ (Hungarian Government Debt Management Agency). These provisions of Government Decree 89/2023 and Government Decree 471/2022 interfere with the independence of the Magyar Nemzeti Bank, since they prevent the Magyar Nemzeti Bank from independently choosing the necessary means and instruments to conduct an efficient monetary policy and to independently achieve price stability.<sup>219</sup> Therefore, Government Decree 89/2023 and Government Decree 471/2022 need to be adapted in this regard.

## Personal independence

Law XXVII of 2008 specifies the wording of the oath that the members of the Monetary Council – including the Governor – are required to take.<sup>220</sup> Pursuant to Article 9(7), in conjunction with Articles 10(3) and 11(2) of the Law on the MNB, 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.<sup>221</sup> Therefore, it is not clear whether the Governor and Deputy Governors take the same oath as the other members of the Monetary Council.

<sup>215</sup> The restriction as it was first introduced was to apply until 30 June 2023. Its period of application has been extended several times.

<sup>216</sup> As set out in Article 39(1)(a), (d), (f), (j), (l) and (m) of the Law on the MNB.

<sup>217</sup> See Article 1(2) of the Government Decree 89/2023 (III. 22.) on economic and financial measures.

<sup>218</sup> The restriction as it was first introduced was to apply until 30 June 2023. Its period of application has been extended several times.

<sup>219</sup> See paragraphs 3.4 and 3.5 of Opinion CON/2023/10.

<sup>220</sup> This has been noted in all ECB's Convergence Reports since 2010.

<sup>221</sup> Law XXVII of 2008 on the oath of certain public officials (egyes közjogi tisztségviselők esküjéről és fogadalmáról szóló 2008. évi XXVII. törvény). 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!"

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.<sup>222</sup>

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<sup>223</sup> 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;<sup>224</sup> (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 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 in which the Magyar Nemzeti Bank holds shares. Furthermore, pursuant to Article 153(6) of the Law on the MNB,<sup>225</sup> 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

<sup>222</sup> Law XXVII of 2008 was amended by Law XIV of 2014, but these changes did not affect the assessment of the Hungarian law laid down in this section.

<sup>223</sup> These entities are voluntary mutual insurance funds, private pension funds, cooperative credit institutions and insurance associations.

<sup>224</sup> 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.

<sup>225</sup> As introduced by Law LXXXV of 2015 on amendments to specific acts in order to enhance the development of the system of financial intermediation (egyes törvényeknek a pénzügyi közvetítőrendszer fejlesztésének előmozdítása érdekében történő módosításáról szóló 2015. évi LXXXV. törvény).

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 153(4) of the Law on the MNB stipulates that all employees of the Magyar Nemzeti Bank, including the members of the Monetary Council, must notify the Magyar Nemzeti Bank when acquiring financial instruments subject to the Law CXXXVIII of 2007 on Investment Service Providers and Commodity Traders and the Rules of their Services except for state bonds and securities issued by open-ended public investment funds. The notification must be made within three working days of acquiring the instruments. In order to avoid any potential conflict of interest, however, this notification obligation should cover all instruments including state bonds and securities issued by open-ended public investment funds.

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.<sup>26</sup> 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.

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(1) and Article 183A of the Law on the MNB, in the case

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<sup>26</sup> Introduced to Article 156(7) of the Law on the MNB by Article 174 of Law LXXXV of 2015.

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<sup>227</sup> so 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.<sup>228</sup>

## Financial independence

In the past two years, the Magyar Nemzeti Bank's recapitalisation and reimbursement regime was replaced twice. First, Article 166(3) of the Law on the MNB was amended to provide that if the amount of equity fell below the subscribed capital at the end of the year under review, the difference would be reimbursed from the central budget directly to the retained earnings over a period of five years, with equal instalments being paid every year, within 30 days of the shareholder's receipt of the notification of the report for the year under review.<sup>229</sup> Additionally, if the amount of the equity exceeded the subscribed capital, all outstanding repayment obligations would cease. If, within the five-year period, the central budget incurred a new reimbursement obligation, Article 166(3) of the Law on the MNB would apply to the fulfilment of this obligation if the central budget ensured that the Magyar Nemzeti Bank's equity did not remain below the level of subscribed capital for a longer period.<sup>230</sup>

As a result of the second amendment, Article 166(3) of the Law on the MNB currently provides that if the equity of the Magyar Nemzeti Bank is below the subscribed capital for a prolonged period of time, it must be ensured, by direct reimbursement to the retained earnings provided from the central budget, that the amount of the Magyar Nemzeti Bank's equity should be at least at the level of the subscribed capital within a reasonable period of time, in order to comply with the principle of financial independence. In addition, the Executive Board of the Magyar Nemzeti Bank must approve a year-by-year forecast of the preliminary level of the equity at the end of the previous year and its expected development and send the report to the shareholder and the Fiscal Council by 30 April.<sup>231</sup> The State authorities seem to have a wide margin of discretion to determine when the Magyar Nemzeti Bank's equity would be

<sup>227</sup> See Section 2.2.2 of this Convergence Report.

<sup>228</sup> See paragraphs 2.3 to 2.5 of Opinion CON/2014/8.

<sup>229</sup> In accordance with Article 6(2) of the Law on the MNB.

<sup>230</sup> Law LXXVII of 2022 on the amendment to Law CXXXIX of 2013 on the Magyar Nemzeti Bank (a Magyar Nemzeti Bankról szóló 2013. évi CXXXIX. törvény módosításáról szóló 2022. évi LXXVII. törvény).

<sup>231</sup> See Article 6(2) and Article 12(4)(b) as amended by Law CXII of 2023 and 12(8) of the Law on the MNB. This reimbursement mechanism closely resembles the recapitalisation mechanism of the Hrvatska Narodna Banka (HNB), as discussed in paragraph 3.5 of Opinion CON/2023/24.



restored up to the level of the Magyar Nemzeti Bank's subscribed capital, which, as such, is not inconsistent with the Treaty and the Statute of the ESCB.<sup>232</sup>

The Magyar Nemzeti Bank's dividend payment regime was also modified in the past two years.<sup>233</sup> Article 166(1) of the Law on the MNB currently provides that if the amount of the Magyar Nemzeti Bank's equity exceeds its subscribed capital at the end of the year under review, the Magyar Nemzeti Bank will pay 50% of its profit for the year under review as a dividend (automatic dividend payment). Article 166(1a) of the Law on the MNB stipulates that the Magyar Nemzeti Bank will pay dividends, based on a decision of its Executive Board, from the positive amount of its retained earnings supplemented by the loss or 50% of its profit from the year under review, up to the amount of the equity exceeding the subscribed capital (discretionary dividend payment). According to Article 166(1b) of the Law on the MNB, the dividend payment is due within 30 days of the Magyar Nemzeti Bank sending the notification of the report for the year under review to the shareholders. The ECB is of the view that the Law on the MNB may prescribe how its profits are to be allocated. Profits may be distributed to the State budget only after any accumulated losses from previous years have been covered and financial provisions deemed necessary to safeguard the real value of the Magyar Nemzeti Bank's capital and assets have been created. The Magyar Nemzeti Bank is best placed to assess independently what level of reserves is necessary to enable it to perform its tasks, and such a decision should not be the subject of a third party's decision.<sup>234</sup>

Article 183 of the Law on the MNB, read in conjunction with Article 176, provided that on 1 October 2013 all employees of the HFSA would be employees of the Magyar Nemzeti Bank and that the Magyar Nemzeti Bank was to bear the financial obligations arising from any employment relations which HFSA 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 impeded the Magyar Nemzeti Bank's ability to decide on employing and retaining

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<sup>232</sup> See paragraph 3.7 of Opinion CON/2023/24.

<sup>233</sup> Law LXXVII of 2022 on the amendment to Law CXXXIX of 2013 on the Magyar Nemzeti Bank (a Magyar Nemzeti Bankról szóló 2013. évi CXXXIX. törvény módosításáról szóló 2022. évi LXXVII. törvény) and Law CXII of 2023 on the Magyar Nemzeti Bank (a Magyarország gazdasági stabilitásáról szóló 2011. évi CXCV. törvény, valamint a Magyar Nemzeti Bankról szóló 2013. évi CXXXIX. törvény módosításáról szóló 2023. évi CXII. törvény).

<sup>234</sup> See paragraph 3.4 of Opinion CON/2022/37 and paragraph 3.8 of Opinion CON/2023/24.

necessary and qualified staff for the Magyar Nemzeti Bank. See, also, the following Section regarding compatibility with the prohibition on monetary financing.<sup>235</sup>

### 7.3.3 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

<sup>235</sup> As noted in the section on institutional independence, over the past years the Magyar Nemzeti Bank has been entrusted with several new tasks. The legal provisions entrusting the Magyar Nemzeti Bank with these new tasks that required additional human and financial resources within a relatively short period of time were seen, in previous Convergence Reports, as an instrument to influence the Magyar Nemzeti Bank's ability to fulfil its mandate, both operationally and financially. Therefore, this raised concerns as regards the provisions' compliance with the principle of financial independence. Any allocation of new tasks should be supplemented by the necessary resources to carry them out. See paragraph 2.2 of Opinion CON/2014/62 and paragraph 3.4 of Opinion CON/2014/72. It is also important to note that, as introduced by Law LXX of 2017, the Magyar Nemzeti Bank also acts, within its existing tasks, as a competent authority to implement several delegated acts related to Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (OJ L 173, 12.6.2014, p. 349) and Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 (OJ L 173, 12.6.2014, p. 84). The Magyar Nemzeti Bank also implements Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014 (OJ L 171, 29.6.2016, p. 1), and shall function as a competent authority as referred to in Article 16 of Regulation (EU) 2015/2365 of the European Parliament and of the Council of 25 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012 (OJ L 337, 23.12.2015, p. 1). In addition, the Magyar Nemzeti Bank implements the following Regulations: Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012 (OJ L 347, 28.12.2017, p. 35); Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC (OJ L 168, 30.6.2017, p. 12); and Regulation (EU) 2019/1156 of the European Parliament and of the Council of 20 June 2019 on facilitating cross-border distribution of collective investment undertakings and amending Regulations (EU) No 345/2013, (EU) No 346/2013 and (EU) No 1286/2014 (OJ L 188, 12.7.2019, p. 55). The Magyar Nemzeti Bank also acts in compliance with Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on money market funds (OJ L 169, 30.6.2017, p. 8) and with Regulation (EU) 2017/1991 of the European Parliament and of the Council of 25 October 2017 amending Regulation (EU) No 345/2013 on European venture capital funds and Regulation (EU) No 346/2013 on European social entrepreneurship funds (OJ L 293, 10.11.2017, p. 1).

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,<sup>236</sup> 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)<sup>237</sup>. 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 is 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 that would 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 were not 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 provisions of the Law on the MNB introduced 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. As mentioned in previous Convergence Reports, 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

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<sup>236</sup> See, for example, paragraph 9.3 of Opinion CON/2011/104.

<sup>237</sup> See paragraph 3.7 of Opinion CON/2008/83.

member and the HFSA, in the light of the mass redundancy scheme provided for under Article 183(10) of the Law on the MNB<sup>238</sup>.

#### 7.3.4 Single spelling of the euro

In several Hungarian legal acts<sup>239</sup> 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.<sup>240</sup>

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.

#### 7.3.5 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.

#### 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 and environmental sustainability policy. 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.

<sup>238</sup> Although this concern and the one explained in the previous paragraph remain, they are obviously less strong than they were in the immediate years that followed the integration of the HFSA into the Magyar Nemzeti Bank as, due to the passage of time, it is less likely that Magyar Nemzeti Bank has to assume new financial obligations resulting from the legal succession of HFSA.

<sup>239</sup> For example, Law LV of 2023 on the 2024 central budget of Hungary (Magyarország 2024. évi központi költségvetéséről szóló 2023. évi LV. törvény) and Law CIX of 2023 on the amendment of certain Laws related to strengthening the competitiveness of domestic economic operators and increasing the efficiency of public administration (a hazai gazdasági szereplők versenyképességének erősítésével és a közigazgatás hatékonyságának növelésével összefüggő egyes törvények módosításáról szóló 2023. évi CIX. törvény).

<sup>240</sup> See paragraph 3.3.1 of Opinion CON/2006/55.

## Tasks

### Monetary policy

Article 41 of the Fundamental Law of Hungary and Article 1(2) and Articles 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(6) 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, Articles 1(2) and 171(1) and Articles 9, 12, 30 and 160 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 9, 13, 27 and 28, and Article 171 (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, 12, 23 to 26 and Articles 171(1) and 172(2) of the Law on the MNB 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.

## 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 their 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) and Article 147 of the Law on the MNB and Law C of 2000,<sup>241</sup> in conjunction with Government Decree 221/2000,<sup>242</sup> 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.

## Exchange rate policy

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

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

## Miscellaneous

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

<sup>241</sup> Law C of 2000 on Accounting (a számvitelről szóló 2000. évi C. törvény).

<sup>242</sup> Government Decree 221/2000 (XII.19.) on the special reporting and accounting requirements of the Magyar Nemzeti Bank (a Magyar Nemzeti Bank éves beszámoló készítési és könyvvezetési kötelezettségének sajátosságairól szóló 221/2000 (XII.19) Kormányrendelet).



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 7.4.2, 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.<sup>243</sup>

### 7.3.6 Conclusions

The Fundamental Law of Hungary, the Law on the MNB, Law XXVII of 2008, Government Decree 89/2023 and Government Decree 471/2022 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.

## 7.4 Poland

### 7.4.1 Compatibility of national legislation

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

- the Polish Constitution,<sup>244</sup>
- the Law on Narodowy Bank Polski (hereinafter the "Law on NBP"),<sup>245</sup>
- the Law on the Bank Guarantee Fund, deposit guarantee system and compulsory restructuring (hereinafter the "Law on the Fund"),<sup>246</sup>
- the Law on banking (hereinafter the "Law on banking"),<sup>247</sup>

<sup>243</sup> See paragraph 3.7 of Opinion CON/2008/83.

<sup>244</sup> Konstytucja Rzeczypospolitej Polskiej of 2 April 1997, Dziennik Ustaw of 1997, No 78, item 483, with further amendments.

<sup>245</sup> Ustawa o Narodowym Banku Polskim of 29 August 1997. Consolidated version published in Dziennik Ustaw of 2022, item 2025.

<sup>246</sup> Ustawa o Bankowym Funduszu Gwarancyjnym, systemie gwarantowania depozytów oraz przymusowej restrukturyzacji of 10 June 2016. Consolidated version published in Dziennik Ustaw of 2024, item 487.

<sup>247</sup> Ustawa Prawo bankowe of 29 August 1997. Consolidated version published in Dziennik Ustaw of 2023, item 2488, with further amendments.

- the Law on settlement finality in the payment and settlement systems and on the supervision of such systems.<sup>248</sup>

No major new legislation has been enacted in relation to the points identified in the ECB's Convergence Report of June 2022, and those comments are therefore largely repeated in this year's assessment.

## 7.4.2 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<sup>249</sup> need to be adapted in the respects set out below. Currently, the Polish Constitution specifies that Narodowy Bank Polski "shall have the exclusive right to issue money and to formulate and implement monetary policy".<sup>250</sup> The Law on NBP states that "the primary objective of the activity of Narodowy Bank Polski shall be to maintain price stability, while supporting the economic policies of the Government insofar as this does not constrain the pursuit of the primary objective of Narodowy Bank Polski".<sup>251</sup> The ECB understands that these provisions necessarily imply that Narodowy Bank Polski carries out its tasks and pursues its objectives independently of any other authority. Accordingly, the well-established case-law of the Constitutional Tribunal derives the principle of the independence of Narodowy Bank Polski from a functional interpretation of the content of Article 227 of the Polish Constitution<sup>252</sup>.

### Institutional independence

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

Article 23(1)(2) of the Law on NBP, which obliges Narodowy Bank Polski's Governor 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, among others, all public

<sup>248</sup> 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 2024, item 685.

<sup>249</sup> Ustawa o Trybunale Stanu of 26 March 1982. Consolidated version published in Dziennik Ustaw of 2022, item 762, with further amendments.

<sup>250</sup> See Article 227(1), second sentence, of the Polish Constitution.

<sup>251</sup> See Article 3(1) of the Law on NBP.

<sup>252</sup> See the judgements of the Constitutional Tribunal in cases K 25/99 of 28 June 2000, K 26/03 of 24 November 2003, U 4/06 of 22 September 2006, Kp 4/08 of 16 July 2009 and K 23/23 of 11 January 2024.

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,<sup>253</sup> 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 "efficiency criterion" does not extend to an evaluation of Narodowy Bank Polski's activities related to its primary objective of price stability.<sup>254</sup> Article 203(1) of the Polish Constitution needs to be adapted to comply with Article 130 of the Treaty and Article 7 of the Statute.

## Personal independence

Article 9(5) of the Law on NBP regulates the dismissal of Narodowy Bank Polski's Governor by the Sejm (lower house of Parliament) upon request of the President of the Republic of Poland, 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,<sup>255</sup>
- been prohibited by the State Tribunal from occupying executive positions or holding posts of particular responsibility in state bodies.<sup>256</sup>

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 Governor may also be relieved from office<sup>257</sup> if he or she violates the Constitution or a law.<sup>258</sup>

The ECB understands that the grounds listed above in principle do not constitute new grounds for dismissal of Narodowy Bank Polski's Governor in addition to those

<sup>253</sup> For the activities of the NCB's independent external auditors see, as an example, Article 27.1 of the Statute.

<sup>254</sup> See paragraph 3.6 of Opinion CON/2011/9.

<sup>255</sup> The provision was added with effect from 15 March 2007 by Article 37 a of the Law on disclosure of information relating to documents of state security's 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 2024, item 273).

<sup>256</sup> Such prohibition by the State Tribunal is one of the sanctions enumerated in Article 25(1)(2) of the Law on the State Tribunal.

<sup>257</sup> As the relevant legislation currently stands, it is not entirely clear whether the relieving in accordance with Article 25(3) of the Law on the State Tribunal also requires the involvement of the Sejm and the President of the Republic of Poland.

<sup>258</sup> The indictment by the Sejm of the Governor of Narodowy Bank Polski before the State Tribunal results, by operation of law, in suspension of the Governor from office. According to the judgment of the Polish Constitutional Court of 11 January 2024 (Case K 23/23), the provision of Article 11(1), second sentence, of the Law on the State Tribunal, in conjunction with Article 13(1a) of that Law, is unconstitutional and needs to be amended by the Sejm, insofar as it allows for the suspension of the Governor as a result of a resolution of the Sejm adopted by only an absolute majority of votes in the presence of at least half of the statutory number of deputies.

contained in Article 14.2 of the Statute. However, Article 25(3) in conjunction with Article 3 and Article 1(1)(3) of the Law on the State Tribunal could be understood as extending the scope of serious misconduct beyond Article 14.2 of the Statute to mere violations of the law. For the sake of legal clarity, the potential inconsistency resulting from these provisions with the grounds of dismissal contained in Article 14.2 of the Statute should be removed.<sup>259</sup> Until then, these provisions should be interpreted in line 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 Governor, 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 lustration declaration, and this has been confirmed by a final court judgment,<sup>260</sup>
- non-suspension of membership of a political party or trade union.

The grounds listed above and Article 14(3) of the Law on NBP, which reaffirms the possibility of dismissal of a member of the Monetary Policy Council of Narodowy Bank Polski for a conviction for a criminal offence, therefore need to be interpreted in line with Article 130 of the Treaty.<sup>261</sup>

The Governor 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 Governor, needs to be adapted to reflect the status and the obligations and duties of the Governor 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 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 for any member of the NCB's decision-making bodies other than the Governor

<sup>259</sup> See Section 2.2.2. of this Convergence Report, sub-section on "Compatibility' versus 'Harmonisation'".

<sup>260</sup> This provision was added with effect from 15 March 2007 by Article 37 a 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 2024, item 273).

<sup>261</sup> See Section 2.2.3 of this Convergence Report, sub-section on "Personal Independence", in particular the paragraph on "Security of tenure and grounds for relieving from office of members of NCBs' decision-making bodies, other than Governors, who are involved in the performance of ESCB-related tasks".

(whose dismissal falls within the jurisdiction of the Court of Justice of the European Union), providing specifically for such a right of review would increase legal certainty.

### Financial independence

In March 2019 the Law amending the Law on prohibitions regarding conducting of business activities by public officials and the Law on NBP<sup>262</sup> entered into force. According to Article 66(3) of the amended Law on NBP, the upper salary limit (salary cap) for all employees (excluding members of the Management Board of Narodowy Bank Polski) is set at 60% of the salary of the Governor of Narodowy Bank Polski (the salary of the Governor is determined on the basis of other provisions which have not been amended). However, amendments included in any legislative proposal that lead to reductions in remuneration are not compatible with the principle of financial independence if the ability of the relevant national central bank to employ and retain staff to perform independently the tasks conferred on it by the Treaty and the Statute is affected. Any adopted legislative solution should provide for a cooperation mechanism with Narodowy Bank Polski, to ascertain if it considers that an exception to a cap on remuneration is required. Such an exception should be decided upon in close and effective cooperation with Narodowy Bank Polski, taking due account of its views, to ensure its ongoing ability to independently carry out its tasks.<sup>263</sup> As such close and effective cooperation with Narodowy Bank Polski is not provided for in the present legal framework regarding the salary cap, the legislation does not satisfy the requirements of Article 130 of the Treaty and Article 7 of the Statute.

#### 7.4.3 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".<sup>264</sup> 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.<sup>265</sup>

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 Section 7.4.2, 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

<sup>262</sup> Ustawa z dnia 22 lutego 2019 r. o zmianie ustawy o ograniczeniu prowadzenia działalności gospodarczej przez osoby pełniące funkcje publiczne oraz ustawy o Narodowym Banku Polskim, Dz. U. 2019 item 371.

<sup>263</sup> See paragraph 2.2.3 of Opinion CON/2019/3.

<sup>264</sup> Article 23(7)(3) of the Law on NBP.

<sup>265</sup> See Opinion CON/2008/53.

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.

#### 7.4.4 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.<sup>266</sup> In addition, Article 42(3) of the Law on NBP allows Narodowy Bank Polski to grant refinancing credit for the purpose of implementing a bank recovery plan, which is initiated in the event of a bank infringing, or being likely to infringe, certain requirements relating to, among other things, own funds and liquidity ratio.<sup>267</sup> 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.<sup>268</sup> 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 undergoing recovery proceedings which then becomes insolvent.<sup>269</sup> 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.<sup>270</sup> 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 43 of the Law on NBP in conjunction with Articles 270 and 306 of the Law on the Fund provides for Narodowy Bank Polski's powers to grant, at its discretion, short-term credit to the Bank Guarantee Fund (hereinafter the "Fund") related to the financing of its deposit guarantee function, if a threat to financial stability arises and in view of its urgent needs. Given the current features of the Fund, the provisions laid down in the Law on NBP and the Law on the Fund regarding the possibility of NBP granting loans to the Fund are not compatible with the monetary financing prohibition and should be amended accordingly. The Fund qualifies as a "body governed by public law" within the meaning of Article 123(1) of the Treaty. In particular, the Fund has all of the following characteristics: (a) it has been established for the purpose of

<sup>266</sup> 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).

<sup>267</sup> Article 142(1) and (2) of the Law on banking.

<sup>268</sup> Article 42(7) of the Law on NBP.

<sup>269</sup> 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).

<sup>270</sup> See Opinion CON/2013/5.



meeting needs in the general interest – especially tasks related to financial stability, administering the deposit guarantee scheme and resolution; (b) it has legal personality; and (c) it is closely dependent on public sector entities referred to in Article 123(1) of the Treaty, as the majority of the members of the Fund's Council, which acts as the Fund's administrative board, are appointed by the Minister competent for financial institutions and the Chairman of the Financial Supervisory Authority.<sup>271</sup> Additionally, the Fund is included in the catalogue of entities that are part of the public sector for the purposes of the Law of 27 August 2009 on public finance.<sup>272</sup>

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 Council Regulation (EC) No 3603/93, is directly applicable, so it may not be reproduced or transposed into national legislation.

#### 7.4.5 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.

#### 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 ESCB's secondary objective of supporting the general economic policies in the Union.

#### Tasks

##### Monetary policy

Article 227(1) and (6) 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.

<sup>271</sup> See Opinion CON/2021/17.

<sup>272</sup> Ustawa o finansach publicznych. Consolidated version published in Dziennik Ustaw of 2023, item 1270, with further amendments.

### **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.

## **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.

## **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.

## 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.

## Miscellaneous

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

### 7.4.6 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.<sup>273</sup>

## 7.5 Romania

### 7.5.1 Compatibility of national legislation

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

- Law No 312/2004 on the Statute of Banca Națională a României (hereinafter the "Law on BNR").<sup>274</sup>

There have been no changes in relation to the points identified in the ECB's Convergence Report of June 2022 concerning the Law on BNR, and therefore those comments are largely repeated in this year's assessment.

<sup>273</sup> For a detailed review of necessary adaptations of the Constitution, the Law on NBP and other laws, see Opinion CON/2011/9.

<sup>274</sup> Published in Monitorul Oficial al României, Part One, No 582, 30.6.2004.

## 7.5.2 Independence of the NCB

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

### Institutional independence

Article 3 of the Law on BNR does not expressly prohibit the Government from seeking to influence the members of Banca Națională a României's decision-making bodies in situations where this may have an impact on Banca Națională 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.<sup>275</sup>

### Personal independence

Article 33(7) of the Law on BNR provides that no member of the Board of Banca Națională 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,<sup>276</sup> and Law 176/2010 on the integrity in the exercise of public functions and dignities,<sup>277</sup> define the conflicts of interest and incompatibilities applicable to the Governor and the other members of the Board of Banca Națională 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<sup>278</sup> do not constitute new grounds for dismissal of the Governor or other members of the Board of Banca Națională a României in addition to those contained in Article 33 of the Law on BNR.

### Financial independence

Article 43 of the Law on BNR provides that each month, Banca Națională 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. This arrangement

<sup>275</sup> See Section 2.2.2 of this Convergence Report

<sup>276</sup> Published in Monitorul Oficial al României, Part One, No 279, 21.4.2003.

<sup>277</sup> Published in Monitorul Oficial al României, Part One, No 621, 2.9.2010.

<sup>278</sup> According to the relevant provisions of Article 99 of Law 161/2003, if a member of the Board of Banca Națională a României or an employee occupying a leading position with Banca Națională 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.

may in certain circumstances amount to an intra-year credit, which in turn may undermine the financial independence of Banca Națională a României. Article 43(3) of the Law on BNR also provides that Banca Națională 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.

Article 43 of the Law on BNR should therefore be adapted to ensure that such arrangement does not undermine the ability of Banca Națională a României to carry out its ESCB 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,<sup>279</sup> the Court of Auditors is empowered to control the establishment, management and use of the public sector's financial resources, including Banca Națională a României's financial resources, and to audit the management of the funds of Banca Națională 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 Națională 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 Națională 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 Națională a României.<sup>280</sup>

### 7.5.3 Confidentiality

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

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

<sup>279</sup> Published in Monitorul Oficial al României, Part One, No 238, 3.4.2014.

<sup>280</sup> For the activities of the NCB's independent external auditors see, for example, Article 27.1 of the Statute.

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 needs to be extended to be fully consistent with Article 123 of the Treaty and aligned with the definitions contained in Regulation (EC) No 3603/93<sup>281</sup>.

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 Națională a României in the same way as any other credit institution eligible under Banca Națională a României's regulations. Article 7(3) of the Law on BNR should be adapted to be fully consistent 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".<sup>282</sup>

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 Națională 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 Națională 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 Națională 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 losses 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 Națională 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 Națională 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.

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<sup>281</sup> See Section 2.2.2 of this Convergence Report.

<sup>282</sup> See Section 2.2.2 of this Convergence Report.



### 7.5.5 Legal integration of the NCB into the Eurosystem

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

#### Economic policy objectives

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

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

### **Financial provisions**

#### **Appointment of independent auditors**

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

### **Exchange rate policy**

Article 2(2)(a) and (d), Article 9 and Article 33(1)(a) of the Law on BNR, which empower Banca Națională 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 Națională 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.

### 7.5.6 Miscellaneous

With regard to Article 3(2) of the Law on BNR, which entitles Banca Națională a României to be consulted on draft national legislation, consulting Banca Națională 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 Națională 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.

### 7.5.7 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.

## 7.6 Sweden

### 7.6.1 Compatibility of national legislation

The following legislation forms the main legal basis for Sveriges Riksbank and its operations:

- the Instrument of Government,<sup>283</sup> which forms part of the Swedish Constitution,
- the Law on Sveriges Riksbank,<sup>284</sup>
- the Law on exchange rate policy.<sup>285</sup>

The Law on Sveriges Riksbank, which entered into force on 1 January 2023, was substantially reviewed<sup>286</sup>. Hence, substantial changes were made in relation to the points identified in the ECB's Convergence Report of June 2022.

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<sup>283</sup> SFS 1974:152.

<sup>284</sup> SFS 2022:1568.

<sup>285</sup> SFS 1998:1404.

## 7.6.2 Independence of the NCB

With regard to Sveriges Riksbank's independence, the Instrument of Government and the Law on Sveriges Riksbank need to be adapted in the respects set out below.

### Institutional independence

Article 13 of Chapter 9 of the Instrument of Government states that Sveriges Riksbank is an authority under the Swedish Parliament and that Sveriges Riksbank is responsible for formulating and implementing monetary policy, implementing currency interventions, holding and managing a foreign currency reserve, promoting a well-functioning payment system and carrying out other basic tasks pursuant to special legislation. Article 15 of Chapter 9 of the Instrument of Government states that no public authority may determine how Sveriges Riksbank is to decide in matters for which it is responsible under Article 13 and that Sveriges Riksbank may not request or receive instructions from anyone within these areas of responsibility. The Law on Sveriges Riksbank contains a distinction between Sveriges Riksbank's monetary policy objectives, tasks and powers in Chapter 2, and its financial stability objectives, tasks and powers in Chapter 3. A narrow conceptualisation of monetary policy and a broad conceptualisation of financial stability, combined with the prohibition on Sveriges Riksbank seeking and taking instructions pursuant to the Instrument of Government applying only in the area of monetary policy, would not provide the legally required compatibility with the Treaties and the Statute of the ESCB.<sup>287</sup>

Article 3 of Chapter 2 of the Law on Sveriges Riksbank states that Sveriges Riksbank shall, with the approval of the Swedish Parliament, decide on the specification of the price stability objective. The rights of third parties to approve, suspend, annul and defer an NCB's decisions are contrary to NCBs' institutional independence and incompatible with the Treaty and the Statute of the ESCB as far as ESCB-related tasks are concerned. The Swedish Parliament's right to approve or reject Sveriges Riksbank's decisions on the design of the price stability objective is therefore inconsistent with Article 130 of the Treaty.<sup>288</sup>

Article 1(3) of Chapter 6 of the Law on Sveriges Riksbank states that Sveriges Riksbank in its international activities shall be guided by the overall positions of the Swedish Government and the Swedish Parliament in various policy areas. This entails a risk of the Swedish Parliament influencing Sveriges Riksbank in a way that is not compatible with Article 130 of the Treaty. Therefore, this obligation should be set out in the Law on Sveriges Riksbank without prejudice to Sveriges Riksbank's independence under the Treaty.<sup>289</sup>

<sup>287</sup> On 20 April 2020, the ECB delivered an opinion (Opinion CON/2020/13) on the Law on Sveriges Riksbank in its initially proposed form, together with proposed amendments to the Instrument of Government, the Law on exchange rate policy and other legislation included in the Swedish Government's Official Report published on 29 November 2019 (SOU 2019:46 – En ny riksbankslag).

<sup>288</sup> See paragraphs 1.5, 2.7, 3.1, 3.2 and 7.2.1 Opinion CON/2020/13.

<sup>289</sup> See Convergence Report, June 2022, p. 22 and paragraphs 2.5 and 4.2.2 of Opinion CON/2020/13.

<sup>290</sup> See paragraph 11.2.3 of Opinion CON/2020/13.

## Financial independence

Article 3 of Chapter 10 of the Law on Sveriges Riksbank provides that Sveriges Riksbank may only restore its foreign reserves for financial stability purposes. These constraints on Sveriges Riksbank's ability to increase its foreign reserves whenever necessary in pursuance of its independently formulated monetary, foreign exchange and liquidity policies clearly encroach on Sveriges Riksbank's independence under the Treaty and Statute of the ESCB in the performance of its basic monetary, foreign exchange and liquidity policies, jeopardising its capacity to achieve its Treaty-based primary objective of maintaining price stability.<sup>290</sup>

### 7.6.3 Monetary financing prohibition

Article 6(2) of Chapter 1 of the Law on Sveriges Riksbank partially reproduces Article 123 of the Treaty, which is supplemented by Regulation (EC) No 3603/93. Article 123 of the Treaty and Regulation (EC) No 3603/93 are directly applicable in the legal order of the Member State. There is a discrepancy between the wording of Article 123(2) of the Treaty and the relevant provisions of the Law on Sveriges Riksbank. The exemption from the monetary financing prohibition for publicly owned credit institutions set out in Article 123(2) of the Treaty is stated to apply only "in the context of the supply of reserves by central banks". This wording is absent from the Law on Sveriges Riksbank, thus expanding this exemption beyond the particular context envisaged under the Treaty. Nevertheless, in the event of a conflict between these provisions, the directly applicable Union provisions would prevail.<sup>291</sup> The ECB notes, however, that the reproduction of relevant provisions of Union law directly applicable in the legal order of the Member State is to be avoided<sup>292</sup>.

Article 6(1) of Chapter 1 of the Law on Sveriges Riksbank provides that Sveriges Riksbank may not provide credits to or acquire debt instruments directly from the State, municipalities, regions or associations of municipalities, or legal persons over which the State, regions, municipalities or associations of municipalities, individually or jointly, exercise direct or indirect legal control, or institutions, bodies or offices within the European Union that are not central banks. However, this provision does not cover the public sector, including public undertakings of other Member States, and, therefore, needs to be adapted to be consistent with Article 123 of the Treaty.<sup>293</sup>

<sup>290</sup> See paragraphs 2.12 and 8.2.3 of Opinion CON/2020/13 and paragraphs 3.4.3 and 3.4.5 Opinion CON/2017/17.

<sup>291</sup> See paragraph 5.2.2 of Opinion CON/2020/13.

<sup>292</sup> See Section 2.2.2 of this Convergence Report.

<sup>293</sup> See Section 2.2.2 of this Convergence Report.

#### 7.6.4 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.

#### Economic policy objectives

Article 1 of Chapter 2 of the Law on Sveriges Riksbank provides that Sveriges Riksbank's overriding objective is to maintain permanently low and stable inflation (the price stability objective) and that without neglecting the price stability objective, the Riksbank shall contribute to the balanced development of production and employment, considering the real economy. However, the ECB notes that Article 1 is more limited than the objective of supporting the general economic policies in the Union as set out in Article 127(1) of the Treaty.

#### Tasks

#### Monetary policy

Article 13 of Chapter 9 of the Instrument of Government, which establish Sveriges Riksbank's powers in the field of monetary policy, do not recognise the ECB's powers in this field.

Articles 4, 5 and 6 of Chapter 2 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 5 of Chapter 2 of the Law on Sveriges Riksbank states that Sveriges Riksbank may only purchase and sell financial instruments other than Swedish sovereign debt instruments when there are exceptional grounds. This restriction on Sveriges Riksbank's ability to purchase and sell financial instruments other than Swedish sovereign debt instruments constitutes a constraint in the context of Article 18 of the Statute of the ESCB, which allows the NCBs to buy and sell outright or under repurchase agreements and by lending or borrowing all manner of claims and marketable instruments, including instruments issued by sovereign and private issuers alike.<sup>294</sup>

Article 6 of Chapter 2 of the Law on Sveriges Riksbank, concerning Sveriges Riksbank's ability to require that a certain proportion of a financial company's investments or obligations should be equivalent to the company's deposits at Sveriges Riksbank (reserve requirement) and the payment of a financial penalty to the Swedish

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<sup>294</sup> See paragraph 6.2.3 of Opinion CON/2020/13.



Government in the event of a breach of this requirement, do not recognise the ECB's powers in this field.

#### **Collection of statistics**

Article 11 of Chapter 1 of the Law on Sveriges Riksbank, which establishes Sveriges Riksbank's powers relating to the collection of statistics, does not recognise the ECB's powers in this field.

#### **Official foreign reserve management**

Chapter 10 of the Law on Sveriges Riksbank, and Article 13 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 13 of Chapter 9 of the Instrument of Government and Articles 1 to 5 and 8 of Chapter 3 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 4 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.

### **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.

### **Exchange rate policy**

Article 12 of Chapter 9 of the Instrument of Government and Chapter 10 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

rate policy. These provisions do not recognise the Council's and the ECB's powers in this field.

### International cooperation

Pursuant to Article 1 of Chapter 6 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.

### Miscellaneous

With regard to Article 5(2) of Chapter 7 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<sup>295</sup> 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.

## 7.6.5 Conclusions

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. Despite the recent reform of Sveriges Riksbank, which should have aimed to achieve the required legal convergence, the Law on Sveriges Riksbank, the Instrument of Government, 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 has the legal duty to adapt its legislation to ensure compatibility with the Treaty and the Statute. Any legislative reform in Sweden should aim to gradually achieve consistency with ESCB standards<sup>296</sup>.

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<sup>295</sup> SFS 2009:400.

<sup>296</sup> See paragraph 2.1 of Opinion CON/2020/13.

### Acknowledgements

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#### Conventions used in the tables

"-" data do not exist/data are not applicable  
" " data are not yet available