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**REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND
THE COUNCIL**

CONVERGENCE REPORT 2014

**(prepared in accordance with Article 140(1) of the Treaty on the Functioning of the
European Union)**

{SWD(2014) 177 final}

1. PURPOSE OF THE REPORT

Article 140(1) of the Treaty on the Functioning of the European Union (hereafter TFEU) requires the Commission and the European Central Bank (ECB) to report to the Council, at least once every two years, or at the request of a Member State with a derogation¹, on the progress made by the Member States in fulfilling their obligations regarding the achievement of economic and monetary union. The latest Commission and ECB Convergence Reports relating to all Member States with a derogation were adopted in May 2012².

The 2014 Convergence Report covers the following eight Member States with a derogation: Bulgaria, the Czech Republic, Croatia, Lithuania, Hungary, Poland, Romania and Sweden³. A more detailed assessment of the state of convergence in these Member States is provided in a Technical Annex to this Report (SWD(2014) 177). At the time of the Convergence Report in 2012, Member States had shown uneven progress with convergence, as many of them were undergoing significant adjustments of previously accumulated macroeconomic imbalances, against the background of the economic and financial crisis. The present examination takes place in a still difficult external environment, though with a generally stronger recovery in Member States with a derogation and lower risk perception by financial markets.

The content of the reports prepared by the Commission and the ECB is governed by Article 140(1) of the TFEU. This Article requires the reports to include an examination of the compatibility of national legislation, including the statutes of the national central bank, with Articles 130 and 131 of the TFEU and the Statute of the European System of Central Banks and of the European Central Bank (hereafter ESCB/ECB Statute). The reports must also examine whether a high degree of sustainable convergence has been achieved in the Member State concerned by reference to the fulfilment of the convergence criteria (price stability, public finances, exchange rate stability, long-term interest rates), and by taking account of other factors mentioned in the final sub-paragraph of Article 140(1) of the TFEU. The four convergence criteria are developed in a Protocol annexed to the Treaties (Protocol No 13 on the convergence criteria).

The economic and financial crisis along with the recent euro-area sovereign debt crisis, has exposed gaps in the economic governance system of the Economic and Monetary Union (EMU) and showed that its existing instruments need to be used more comprehensively. With the aim of ensuring a sustainable functioning of EMU, an overall strengthening of economic governance in the Union has been undertaken since then. The assessment of convergence is thus aligned with the broader "European Semester" approach which takes an integrated and upstream look at the economic policy challenges facing the EMU in ensuring fiscal sustainability, competitiveness, financial market stability and economic growth. The key

¹ The Member States that have not yet fulfilled the necessary conditions for the adoption of the euro are referred to as "Member States with a derogation". Denmark and the United Kingdom negotiated opt-out arrangements before the adoption of the Maastricht Treaty and do not participate in the third stage of EMU.

² In 2013, the Commission and ECB prepared Convergence Reports on Latvia, following the request of the national authorities. Latvia adopted the euro on 1 January 2014.

³ Denmark and the United Kingdom have not expressed an intention to adopt the euro and are therefore not covered in the assessment.

innovations in the area of governance reform, reinforcing the assessment of each Member States' convergence process and its sustainability, include *inter alia* the strengthening of the excessive deficit procedure by the 2011 reform of the Stability and Growth Pact and new instruments in the area of surveillance of macroeconomic imbalances. In particular, this report takes into account the assessment of the 2014 Convergence Programmes and the findings under the Alert Mechanism Report of the Macroeconomic Imbalances Procedure⁴.

Convergence criteria

The examination of the compatibility of national legislation, including the statutes of the national central bank, with Article 130 and with the compliance duty under Article 131 of the TFEU encompasses an assessment of observance of the prohibition of monetary financing (Article 123) and the prohibition of privileged access (Article 124); consistency with the ESCB's objectives (Article 127(1)) and tasks (Article 127(2)) and other aspects relating to the integration of the national central bank into the ESCB at the moment of the euro adoption.

The **price stability criterion** is defined in the first indent of Article 140(1) of the TFEU: “*the achievement of a high degree of price stability [...] will be apparent from a rate of inflation which is close to that of, at most, the three best performing Member States in terms of price stability*”.

Article 1 of the Protocol on the convergence criteria further stipulates that “*the criterion on price stability [...] shall mean that a Member State has a price performance that is sustainable and an average rate of inflation, observed over a period of one year before the examination, that does not exceed by more than 1.5 percentage points that of, at most, the three best-performing Member States in terms of price stability. Inflation shall be measured by means of the consumer price index on a comparable basis, taking into account differences in national definitions*”⁵. The requirement of sustainability implies that the satisfactory inflation performance must essentially be attributable to the behaviour of input costs and other factors influencing price developments in a structural manner, rather than the influence of temporary factors. Therefore, the convergence examination includes an assessment of the factors that have an impact on the inflation outlook and is complemented by a reference to the most recent Commission services' forecast of inflation⁶. Related to this, the report also assesses whether the country is likely to meet the reference value in the months ahead.

The inflation reference value was calculated to be 1.7% in April 2014, with Latvia, Portugal and Ireland as the three 'best-performing Member States'⁷.

It is warranted to exclude from the 'best performers' countries whose inflation rates could not be seen as a meaningful benchmark for other Member States⁸. Such

⁴ The Commission published its third Alert Mechanism Report (AMR) in November 2013 and the conclusions of the corresponding in-depth reviews in March 2014.

⁵ For the purpose of the criterion on price stability, inflation is measured by the Harmonised Index of Consumer Prices (HICP) defined in Council Regulation (EC) No 2494/95.

⁶ All forecasts for inflation and other variables in the current report are from the Commission services' 2014 Spring Forecast. The Commission services' forecasts are based on a set of common assumptions for external variables and on a no-policy change assumption while taking into consideration measures that are known in sufficient detail.

⁷ The cut-off date for the data used in this report is 15 May 2014.

outliers were in the past identified in the 2004, 2010 and 2013 Convergence Reports⁹. At the current juncture, it is warranted to identify Greece, Bulgaria and Cyprus as outliers, as their inflation rates deviated by a wide margin from the euro area average and including them would unduly affect the reference value and thus the fairness of the criterion¹⁰. In case of Greece and Cyprus, negative inflation mainly reflected the severe adjustment needs and exceptional situation of the economy. In case of Bulgaria, it was due to an unusually strong combination of disinflationary factors, inter alia, a good harvest, administrative energy price reductions and declining import prices. Against this background, Latvia, Portugal and Ireland, the Member States with the next-lowest average inflation rates, are used for the calculation of the reference value.

The convergence **criterion dealing with public finances** is defined in the second indent of Article 140(1) of the TFEU as “*the sustainability of the government financial position: this will be apparent from having achieved a government budgetary position without a deficit that is excessive as determined in accordance with Article 126(6)*”. Furthermore, Article 2 of the Protocol on the convergence criteria states that this criterion means that “*at the time of the examination the Member State is not the subject of a Council decision under Article 126(6) of the said Treaty that an excessive deficit exists*”. As part of an overall strengthening of economic governance in EMU, the secondary legislation related to public finances was enhanced in 2011, including the new regulations amending the Stability and Growth Pact¹¹.

The TFEU refers to the **exchange rate criterion** in the third indent of Article 140(1) as “*the observance of the normal fluctuation margins provided for by the exchange-rate mechanism of the European Monetary System, for at least two years, without devaluing against the euro*”.

Article 3 of the Protocol on the convergence criteria stipulates: “*The criterion on participation in the exchange rate mechanism of the European Monetary System (...) shall mean that a Member State has respected the normal fluctuation margins provided for by the exchange-rate mechanism of the European Monetary System without severe tensions for at least the last two years before the examination. In particular, the Member State shall not have devalued its currency’s bilateral central rate against the euro on its own initiative for the same period*”¹².

⁸ The use of the term 'best performer in terms of price stability' should be understood in the meaning of Article 140(1) of the TFEU and is not intended to represent a general qualitative judgement about the economic performance of a Member State.

⁹ Lithuania, Ireland and Greece, respectively.

¹⁰ In April 2014, the 12-month average inflation rate of Greece, Bulgaria and Cyprus were respectively -1.2%, -0.8% and -0.4% and that of the euro area 1.0%.

¹¹ A directive on minimum requirements for national budgetary frameworks, two new regulations on macroeconomic surveillance and three regulations amending the Stability and Growth Pact (SGP) entered into force on 13 December 2011 (one out of two new regulations on macroeconomic surveillance and one out of three regulations amending the SGP include new enforcement mechanisms for euro-area Member States). Besides the operationalisation of the debt criterion in the Excessive Deficit Procedure, the amendments introduced a number of important novelties in the Stability and Growth Pact, in particular an expenditure benchmark to complement the assessment of progress towards the country-specific medium-term budgetary objective.

¹² In assessing compliance with the exchange rate criterion, the Commission examines whether the exchange rate has remained close to the ERM II central rate, while reasons for an appreciation may be taken into

The relevant two-year period for assessing exchange rate stability in this report is 16 May 2012 to 15 May 2014. In its assessment of the exchange rate stability criterion, the Commission takes into account developments in auxiliary indicators such as foreign reserve developments and short-term interest rates, as well as the role of policy measures, including foreign exchange interventions, and international financial assistance wherever relevant, in maintaining exchange rate stability.

The fourth indent of Article 140(1) of the TFEU requires “*the durability of convergence achieved by the Member State with a derogation and of its participation in the exchange rate mechanism being reflected in the **long-term interest rate levels***”. Article 4 of the Protocol on the convergence criteria further stipulates that “*the criterion on the convergence of interest rates (...) shall mean that, observed over a period of one year before the examination, a Member State has had an average nominal long-term interest rate that does not exceed by more than 2 percentage points that of, at most, the three best-performing Member States in terms of price stability. Interest rates shall be measured on the basis of long-term government bonds or comparable securities, taking into account differences in national definitions*”.

The interest rate reference value was calculated to be 6.2% in April 2014¹³.

Article 140(1) of the TFEU also requires an examination of other factors relevant to economic integration and convergence. These additional factors include financial and product market integration, the development of the balance of payments on current account and the development of unit labour costs and other price indices. The latter are covered within the assessment of price stability. The additional factors are important indicators that the integration of a Member State into the euro area would proceed without difficulties and broadens the view on sustainability of convergence.

2. BULGARIA

In the light of its assessment on legal compatibility and on the fulfilment of the convergence criteria, and taking into account additional relevant factors, the Commission considers that Bulgaria does not fulfil the conditions for the adoption of the euro.

Legislation in Bulgaria – in particular the Law on the Bulgarian National Bank – **is not fully compatible** with the compliance duty under Article 131 of the TFEU. Incompatibilities and imperfections exist in the fields of central bank independence, the prohibition of monetary financing and central bank integration into the ESCB at the time of euro adoption with regard to the tasks laid down in Article 127(2) of the TFEU and Article 3 of the ESCB/ECB Statute.

Bulgaria fulfils the criterion on price stability. In Bulgaria, 12-month average inflation was above the reference value at the last convergence assessment in 2012. The average inflation rate in Bulgaria during the 12 months to April 2014 was -0.8%, well below the reference value of 1.7%. It is projected to remain well below the reference value in the months ahead.

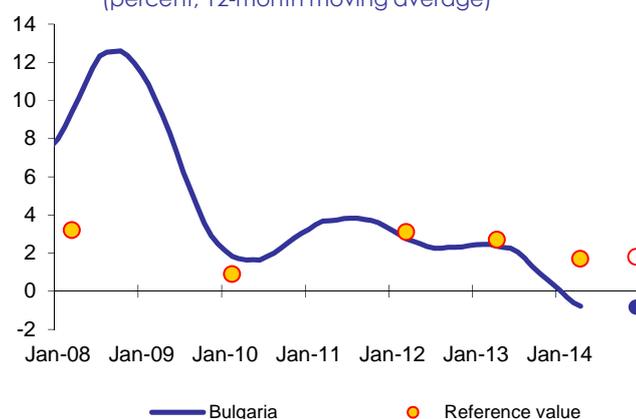
account, in accordance with the Common Statement on Acceding Countries and ERM2 by the Informal ECOFIN Council, Athens, 5 April 2003.

¹³ The reference value for April 2014 is calculated as the simple average of the average long-term interest rates of Latvia (3.3%), Portugal (5.8%) and Ireland (3.5%), plus two percentage points.

Annual HICP inflation declined from its peak in September 2012, turning negative in the second half of 2013 and the first months of 2014. The fall in inflation has been broad-based, but largely driven by declining import prices, decreases in administratively set energy prices and a good agricultural harvest. In April 2014, annual HICP inflation stood at -1.3%.

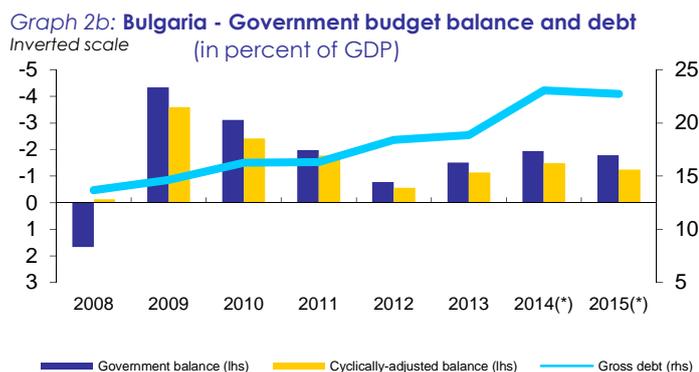
Inflation is expected to pick up slowly in the second half of 2014, with the fading of base effects from favourable energy and food price developments. Accordingly, the Commission services' 2014 Spring Forecast projects annual average inflation at -0.8% in 2014 and 1.2% in 2015. The relatively low price level in Bulgaria (47% of the euro-area average in 2012) suggests significant potential for further price level convergence in the long term.

Graph 2a: Bulgaria - Inflation criterion since 2008
(percent, 12-month moving average)



Note: The dots in December 2014 show the projected reference value and 12-month average inflation in the country.
Sources: Eurostat, Commission services' Spring 2014 Forecast.

Bulgaria fulfils the criterion on public finances. Bulgaria is not the subject of a Council Decision on the existence of an excessive deficit. The general government deficit fell from 2.0% of GDP in 2011 to 0.8% in 2012, supported by higher revenues-to-GDP. The deficit-to-GDP ratio was 1.5% in 2013 and according to the Commission services' 2014 Spring Forecast, it is projected to increase to 1.9% of GDP in 2014 and to decrease slightly to 1.8% in 2015, under a no-policy-change assumption, supported by the economic recovery. The gross public debt ratio remained low at 18.9% of GDP in 2013 and it is projected to increase to 23.1% of GDP in 2014 and to abate to 22.7% of GDP in 2015.



(*) Commission services' Spring 2014 Forecast.

Source: Eurostat, Commission services.

Bulgaria does not fulfil the exchange rate criterion. The Bulgarian lev is not participating in ERM II. The BNB pursues its primary objective of price stability through an exchange rate anchor in the context of a Currency Board Arrangement (CBA). Bulgaria introduced its CBA on 1 July 1997, pegging the Bulgarian lev to the German mark and later the euro. Additional indicators, such as developments in foreign exchange reserves and short-term interest rates, suggest that investors' risk perception towards Bulgaria has remained favourable. A sizeable official reserves buffer continues to underpin the resilience of the CBA. During the two-year assessment period, the Bulgarian lev remained fully stable vis-à-vis the euro, in line with the operation of the CBA.

Bulgaria fulfils the criterion on the convergence of long-term interest rates. The average long-term interest rate in Bulgaria in the year to April 2014 was 3.5%, well below the reference value of 6.2%. It was also below the reference value at the time of the last convergence assessment in 2012. It declined from above 5% in early 2012 to around 3.5% by mid-2013. Yield spreads vis-à-vis the euro-area long-term benchmark bonds¹⁴ declined significantly in the second half of 2012, as Bulgarian bond yields fell with the calming of financial market tensions in the region. The spread against the German benchmark bond widened slightly to some 200 basis points in early 2014.

Additional factors have also been examined, including balance of payments developments and integration of labour, product and financial markets. Bulgaria's external balance recorded a significant surplus in 2013. The trade balance deteriorated slightly from 2011 to 2013, but this was more than offset by improvements in the income account and current transfers. The Bulgarian economy is well integrated to the euro area through trade and investment linkages. On the basis of selected indicators relating to the business environment, Bulgaria performs worse than most euro-area Member States. Bulgaria's financial sector is well integrated with the EU financial sector, in particular through a high level of foreign ownership in its banking system. In the context of the Macroeconomic Imbalance Procedure, Bulgaria was subject to an in-depth review, which found that Bulgaria

¹⁴ Countries' long-term interest spreads vis-à-vis the euro-area long-term benchmark bonds (n.b. the German benchmark bond is used as a proxy for the euro area) are computed using the monthly series "EMU convergence criterion bond yields" published by Eurostat. The series is also published by the ECB under the name "Harmonised long-term interest rate for convergence assessment purposes".

continues to experience macroeconomic imbalances, which require monitoring and policy action.

3. THE CZECH REPUBLIC

In the light of its assessment on legal compatibility and on the fulfilment of the convergence criteria, and taking into account the additional relevant factors, the Commission considers that the Czech Republic does not fulfil the conditions for the adoption of the euro.

Legislation in the Czech Republic – in particular the Czech National Council Act No. 6/1993 Coll. on the Czech National Bank (the ČNB Law) – **is not fully compatible** with the compliance duty under Article 131 of the TFEU. Incompatibilities concern the independence of the central bank and central bank integration in the ESCB at the time of euro adoption with regard to the ČNB's objectives and the ESCB tasks laid down in Article 127(2) of the TFEU and Article 3 of the ESCB/ECB Statute. In addition, the ČNB Law also contains imperfections relating to the prohibition of monetary financing and the ESCB tasks.

The Czech Republic fulfils the criterion on price stability. In the Czech Republic, 12-month average inflation was below the reference value at the time of the last convergence assessment in 2012. The average inflation rate in the Czech Republic during the 12 months to April 2014 was 0.9%, below the reference value of 1.7%. It is projected to fall well below the reference value in the months ahead.

Annual HICP inflation in the Czech Republic increased above the euro-area inflation in 2012, largely due to an increase in the lower VAT rate while higher energy and food prices in global commodity markets were also passed through into consumer prices. Inflation moderated significantly throughout 2013 as pressures stemming from energy prices gradually eased off and growth in prices of services became subdued. Lack of demand pressures, reflecting the economic downturn, also contributed to the moderate price growth. Annual HICP inflation hovered close to 0.3% in early 2014.

Inflation is projected to pick up in the second half of 2014 on account of the significant weakening of the koruna in late 2013. Stronger domestic demand is then expected to stoke up inflation in 2015. On this basis, the Commission services' Spring 2014 Forecast projects annual HICP inflation to average 0.8% in 2014 and 1.8% in 2015. The price level in the Czech Republic (about 71% of the euro-area average in 2012) suggests potential for price level convergence in the long term.

Graph 3a: Czech Republic - Inflation criterion since 2008
(percent, 12-month moving average)

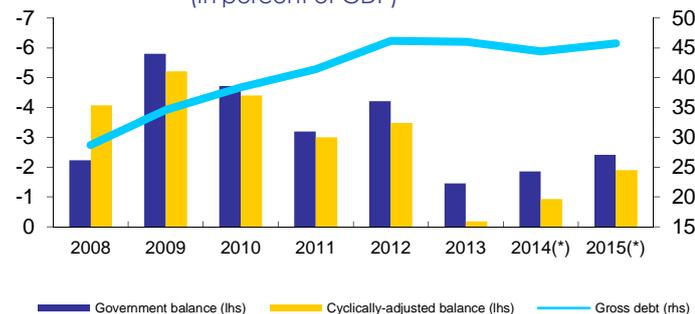


Note: The dots in December 2014 show the projected reference value and 12-month average inflation in the country.
Sources: Eurostat, Commission services' Spring 2014 Forecast.

If the Council decides to abrogate its excessive deficit procedure, the Czech Republic will fulfil the criterion on public finances. The Czech Republic is at present the subject of a Council Decision on the existence of an excessive deficit (Council Decision of 2 December 2009)¹⁵. The Council recommended the Czech Republic to correct the excessive deficit by 2013. The general government deficit in the Czech Republic declined to 1.5% of GDP in 2013. According to the Commission services' 2014 Spring Forecast, which is based on a no-policy-change assumption, the deficit-to-GDP ratio will amount to 1.9% in 2014 and 2.4% in 2015, while general government debt is expected to remain broadly stable at 45.8% of GDP in 2015.

In view of these developments and the Commission services' 2014 Spring Forecast, the Commission considers that the excessive deficit has been corrected with a credible and sustainable reduction of the budget deficit below 3% of GDP. The Commission is therefore recommending that the Council abrogate the decision on the existence of an excessive deficit for the Czech Republic.

Graph 3b: Czech Rep. - Government budget balance and debt
(in percent of GDP)



(*) Commission services' Spring 2014 Forecast.

Source: Eurostat, Commission services.

The Czech Republic does not fulfil the exchange rate criterion. The Czech koruna is not participating in ERM II. The Czech Republic operates a floating exchange rate

¹⁵ Decision 2010/284/EU (OJ L 125, 21.5.2010, p. 36-37).

regime, allowing for foreign exchange market interventions by the central bank. From early 2010 until late 2013, the exchange rate of the Czech koruna against the euro remained broadly stable, predominantly trading between 24 and 26 CZK/EUR. On 7 November 2013, the ČNB announced that it would intervene on the foreign exchange market to weaken the koruna, so that its exchange rate against the euro was above 27 CZK/EUR. As a result, the koruna swiftly weakened from below 26 CZK/EUR to above 27 CZK/EUR and then continued to trade close to 27.4 CZK/EUR in early 2014. During the two years before this assessment, the koruna depreciated against the euro by almost 11%.

The Czech Republic fulfils the criterion on the convergence of long-term interest rates. The Czech 12-month average interest rate was below the reference value at the time of the last convergence assessment in 2012. The average long-term interest rate in the Czech Republic in the year to April 2014 was 2.2%, well below the reference value of 6.2%. Following a protracted downward trend, long-term interest rates in the Czech Republic declined from above 5% in mid-2009 to below 2% in late 2012. At the same time, the spread against the German long-term benchmark bond narrowed to below 100 basis points. Long-term spreads remained broadly stable in 2013, oscillating around 50 basis points, as yields increased somewhat in both the Czech Republic and Germany. The spread against the German benchmark bond widened to about 70 basis points in early 2014.

Additional factors have also been examined, including balance of payments developments and integration of labour, product and financial markets. The external balance of the Czech Republic gradually improved from a deficit of above 3% of GDP in 2010 to a surplus of 0.5% of GDP in 2013, mainly as a result of the increased trade surplus. The Czech economy is highly integrated into the euro area through trade and investment linkages. On the basis of selected indicators relating to the business environment, the Czech Republic performs worse than most euro-area Member States. The Czech financial sector is highly integrated into the EU financial sector, in particular through a high degree of foreign ownership of financial intermediaries. In the context of the Macroeconomic Imbalance Procedure, the Czech Republic has not been subject to an in-depth review.

4. CROATIA

In the light of its assessment on legal compatibility and on the fulfilment of the convergence criteria, and taking into account the additional relevant factors, the Commission considers that Croatia does not fulfil the conditions for the adoption of the euro.

Legislation in Croatia is fully compatible with the compliance duty under Article 131 of the TFEU.

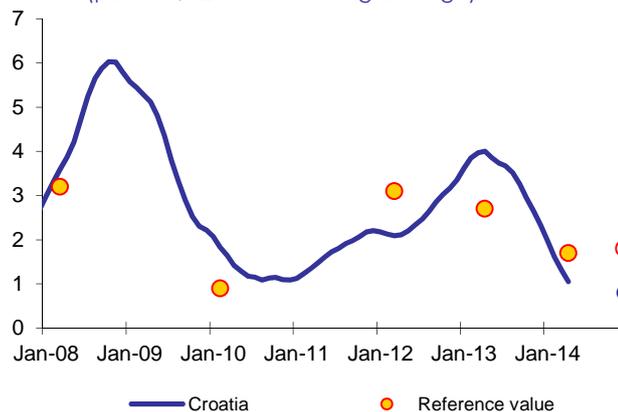
Croatia fulfils the criterion on price stability. In Croatia, the average inflation rate during the 12 months to April 2014 was 1.1%, below the reference value of 1.7%. It is expected to remain below the reference value in the months ahead.

Annual HICP inflation has slowed down significantly during the past 1½ years from above 4% in the second half of 2012 to around zero in spring 2014. The decline in inflation has reflected lower energy and food prices on global commodity markets, the fading of the impact of earlier increases in administered prices, and

disinflationary effects from the protracted recession. In April 2014, annual inflation stood at -0.1%.

Inflation is projected to remain subdued throughout 2014, in the context of weak domestic demand, unfavourable labour market developments and high deleveraging needs of the private and the public sector. The Commission services' 2014 Spring Forecast projects annual HICP inflation to average 0.8% in 2014 and 1.2% in 2015. The price level in Croatia (about 69% of the euro-area average in 2012) suggests potential for further price level convergence in the long-run.

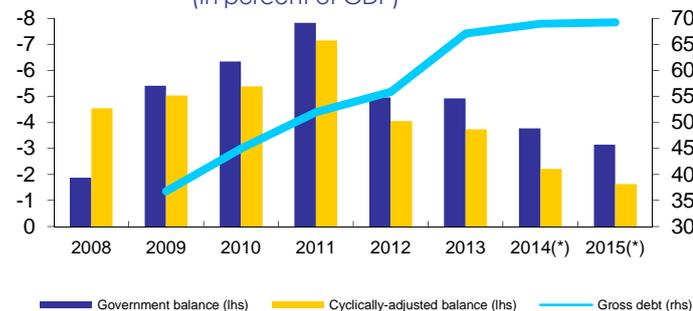
Graph 4a: Croatia - Inflation criterion since 2008
(percent, 12-month moving average)



Note: The dots in December 2014 show the projected reference value and 12-month average inflation in the country.
Sources: Eurostat, Commission services' Spring 2014 Forecast.

Croatia does not fulfil the criterion on public finances. Croatia is at present the subject of a Council Decision on the existence of an excessive deficit (Council Decision of 28 January 2014), which the Council recommended to correct by 2016. The general government deficit-to-GDP ratio reached 4.9% in 2013, slightly down from 5% in 2012. The Commission services' 2014 Spring Forecast projects the deficit to decline to 3.8% of GDP in 2014 and 3.1% of GDP in 2015. The general government debt-to-GDP ratio is projected to increase throughout the forecast horizon, from 67.1% in 2013 to 69.2% in 2015.

Graph 4b: Croatia - Government budget balance and debt
Inverted scale (in percent of GDP)



(*) Commission services' Spring 2014 Forecast.
Source: Eurostat, Commission services.

Croatia does not fulfil the exchange rate criterion. The Croatian kuna is not participating in ERM II. Croatia operates a tightly-managed floating exchange rate

regime, allowing for foreign exchange market intervention by the central bank. During the past two years, the kuna has remained broadly stable against the euro, its anchor currency, fluctuating between 7.4 and 7.7 HRK/EUR. The marginal depreciation of the kuna against the euro in recent years has reflected poor domestic economic developments and unfavourable external conditions, while intra-year volatility has been related to the seasonality of tourism revenues.

Croatia fulfils the criterion on the convergence of long-term interest rates. The average long-term interest rate in Croatia, as reflected by the secondary market yield on a single benchmark bond with a residual maturity of about 6 years, was 4.8% in the year to April 2014, below the reference value of 6.2%. It declined from close to 7% in mid-2012 to around 4.6% in autumn 2013, before increasing slightly in early 2014. In the absence of a kuna-denominated sovereign bond with longer maturity, yield developments should be interpreted with great caution. The yield spread against the German benchmark bond with 6-year maturity stood at around 370 basis points in April 2014.

Additional factors have also been examined, including balance of payments developments and integration of labour, product and financial markets. Croatia's external balance improved considerably in recent years, turning into a surplus of 1.2% of GDP in 2013, mainly on account of import compression. The Croatian economy is integrated into the euro area through trade and investment linkages, although links to global supply chains have remained weak. On the basis of selected indicators relating to the business environment, Croatia performs worse than most euro-area Member States. The financial sector is highly integrated into the euro area through foreign ownership of domestic banks. Croatia was subject to an in-depth review in the context of the Macroeconomic Imbalance Procedure, which concluded that the country is experiencing excessive macroeconomic imbalances, which require specific monitoring and strong policy action. In particular, policy action is required in view of the vulnerabilities arising from sizeable external liabilities, declining export performance, highly leveraged firms and fast-increasing general government debt.

5. LITHUANIA

In the light of its assessment on legal compatibility and on the fulfilment of the convergence criteria, and taking into account the additional relevant factors, the Commission considers that Lithuania fulfils the conditions for the adoption of the euro.

Legislation in Lithuania is fully compatible with the compliance duty under Article 131 of the TFEU.

Lithuania fulfils the criterion on price stability. In Lithuania, 12-month average inflation was above the reference value at the last convergence assessment in 2012. The average inflation rate in Lithuania during the 12 months to April 2014 was 0.6%, well below the reference value of 1.7%. It is projected to remain below the reference value in the months ahead.

After a peak of annual HICP inflation at 10% in 2008, the economic recession and significant nominal wage adjustment led to moderating inflation in 2009 and 2010. Inflation accelerated again to 4.1% on average in 2011 on the back of higher

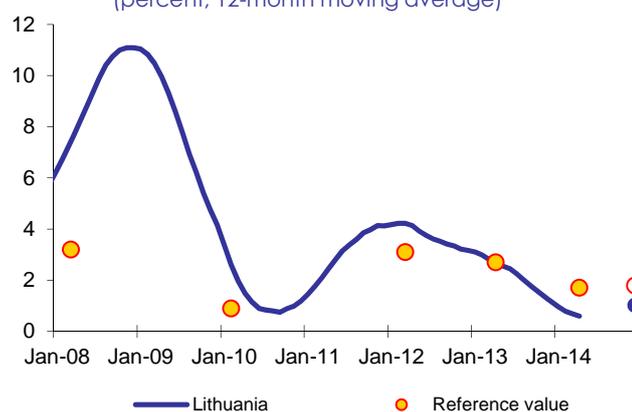
commodity prices and economic recovery. It has thereafter broadly followed a declining trend, induced by lower inflation of energy and processed food prices, which was also supported by continuing wage restraint in the economy. Inflation moderated to 3.2% in 2012 and 1.2% in 2013.

Annual HICP inflation is expected to be 1.0% on average in 2014 according to the Commission services' 2014 Spring Forecast, reflecting mainly favourable food and energy price developments. It is projected to pick up in 2015 to 1.8%, in the context of improving domestic demand. The relatively low price level in Lithuania (around 63% of the euro-area average in 2012) suggests potential for further price level convergence in the long term.

Sustainable convergence implies that the respect of the reference value is the result of underlying fundamentals rather than temporary factors. An analysis of underlying fundamentals and the fact that the reference value has been met by a comfortable margin support a positive assessment on the fulfilment of the price stability criterion.

Longer-term inflation prospects will hinge in particular on wages growing in line with productivity. As Lithuania is still a catching-up economy, wages are expected to grow faster than in most advanced euro-area members. However, risks to price stability from catching-up related price adjustment are limited by the recently demonstrated flexibility of the labour market and wage-setting mechanisms which should ensure that labour costs are aligned with productivity. They are also contained by the country's significant progress in implementing the EU services directive and low market entry costs, which keep competitive pressures high, as witnessed by recent new entries in the retail market. A shortage of well-qualified labour in the medium term could drive up wages relative to productivity. Addressing the remaining bottlenecks will be important in limiting any tightening of the labour market. Diversification of supplies and more competitive markets would also support favourable price developments in the energy sector.

Graph 5a: Lithuania - Inflation criterion since 2008
(percent, 12-month moving average)



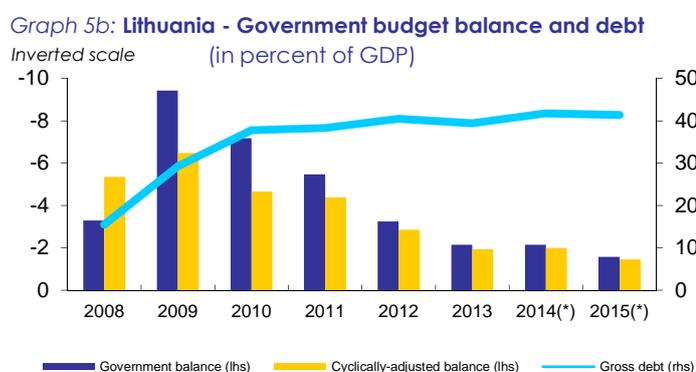
Note: The dots in December 2014 show the projected reference value and 12-month average inflation in the country.
Sources: Eurostat, Commission services' Spring 2014 Forecast.

Lithuania fulfils the criterion on public finances. Lithuania is not the subject of a Council Decision on the existence of an excessive deficit. The general government deficit declined from 5.5% of GDP in 2011 to 3.2% in 2012, mainly due to expenditure restraint. The deficit-to-GDP ratio was 2.1% in 2013 and according to

the Commission services' 2014 Spring Forecast it is projected to remain at 2.1% of GDP in 2014 and decline to 1.6% in 2015, under a no-policy-change assumption. The general government debt is expected to increase from 39.4% of GDP in 2013 to 41.4% of GDP in 2015.

Lithuania has put in place a number of fiscal governance measures, which should support the longer-term commitment to sound public finances. In March 2012, Lithuania signed the Treaty on Stability, Coordination and Governance in EMU (TSCG), and the respective ratification law was approved by Parliament in September 2012. This implies an additional commitment to conduct stability-oriented and sustainable fiscal policies. A draft legislative package including a constitutional law on the sustainability of general government sector finances in accordance with the Fiscal Compact has been approved by the government mid-April and will be voted by Parliament. The National Audit Office would be charged with the functions of an independent Fiscal Council. The transposition of the TSCG into national law would furthermore support existing legislation, in particular the Law on Fiscal Discipline, adopted in 2007 and applied since 2013. It is based on provisions of the Stability and Growth Pact, links an expenditure ceiling to revenues and sets as an objective a balanced budget in the medium term as well as long-term sustainability. However, it lacks a binding medium-term expenditure framework.

In addition, amendments of the National Budget Law to implement Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States targeting a balanced or surplus position over the cycle came into full force for the 2014 budget planning and execution process. These amendments increase the government's accountability for the implementation of the multiannual fiscal targets; however, the effect of the new law remains to be assessed.



(*) Commission services' Spring 2014 Forecast.
 Source: Eurostat, Commission services.

Lithuania fulfils the exchange rate criterion. Lithuania entered ERM II on 28 June 2004 and has been participating in the mechanism for almost ten years at the time of the adoption of this report. Upon ERM II entry, the authorities unilaterally committed to maintain the prevailing currency board within the mechanism. The currency board remains well supported by foreign exchange reserves. Short-term interest differentials vis-à-vis the euro area have narrowed to very low levels. During the two-year assessment period, the litas did not deviate from the central rate, and it did not experience tensions.

Lithuania fulfils the criterion on the convergence of long-term interest rates.

The average long-term interest rate in the year to April 2014 was 3.6%, well below the reference value of 6.2%. The average long-term interest rate in Lithuania had been below the reference value at the time of the last convergence assessment in 2012 (5.2%). It gradually declined further to below 4% in 2013, reflecting improved investor sentiment towards the country supported by increased sovereign credit ratings as well as a relatively low domestic inflation. Although the long-term litas-denominated government bond market is relatively shallow, the government issued debt securities with original maturity of up to 10 years in 2012 and 2013.

Additional factors have also been examined, including balance of payments developments and the integration of labour, product and financial markets. After recording a substantial surplus in 2009, Lithuania's external balance (i.e. the combined current and capital account) deteriorated somewhat in 2010, reaching a deficit of 1.2% of GDP in 2011, but it posted surpluses again in 2012 and 2013. The income account moved to surplus in 2009, reflecting mainly loan-loss provisions made by foreign-owned banks, and returned to a deficit from 2010 onwards, when foreign-owned banks regained profitability. Current transfers and the capital account have consistently recorded significant surpluses, reflecting positive net inflows from EU funds and migrant remittances. Net FDI inflows recovered after a collapse in 2009 and peaked at 3.2% of GDP in 2011, however, they subsided to 0.7% in 2012 and recovered only somewhat in 2013. A significant decline in the real-effective exchange rate in 2009-2011, in particular when deflated by ULC, gave a strong boost to Lithuania's cost competitiveness, and Lithuania substantially improved its export performance. Following a moderate upward trend, the ULC-deflated REER appreciated by about 6% and HICP-deflated by about 3% between mid-2012 and April 2014.

The Lithuanian economy is well integrated into the euro area through both trade and investment linkages. The labour market has demonstrated substantial flexibility, although structural unemployment is high. On the basis of selected indicators relating to the business environment, Lithuania performs broadly in line with the average of euro-area Member States. Lithuania's financial sector is well integrated into the EU financial system as confirmed by the high share of foreign-owned banks. Financial supervision has been strengthened substantially in the recent years. Cooperation with home supervisors has been further enhanced.

6. HUNGARY

In the light of its assessment on legal compatibility and on the fulfilment of the convergence criteria, and taking into account the additional relevant factors, the Commission considers that Hungary does not fulfil the conditions for the adoption of the euro.

Legislation in Hungary - in particular the Act on the Magyar Nemzeti Bank (MNB) - **is not fully compatible** with the compliance duty under Article 131 of the TFEU. Incompatibilities notably concern the independence of the MNB, the prohibition of monetary financing and central bank integration into the ESCB at the time of euro adoption with regard to the ESCB tasks laid down in Article 127(2) of the TFEU and Article 3 of the ESCB/ECB Statute. In addition, the Law on the MNB also contains

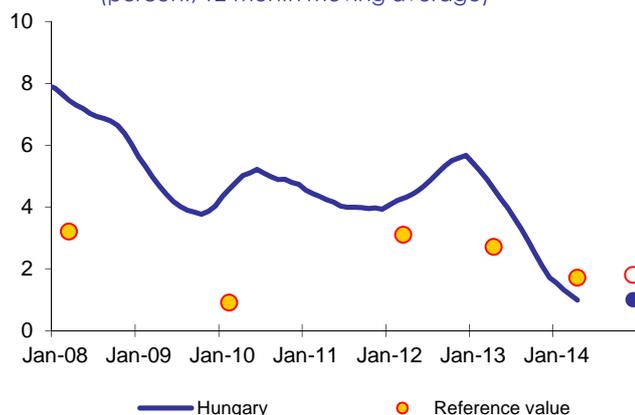
an incompatibility and further imperfections relating to MNB integration into the ESCB.

Hungary fulfils the criterion on price stability. In Hungary, 12-month average inflation was above the reference value at the last convergence assessment in 2012. The average inflation rate in Hungary during the 12 months to April 2014 was 1.0%, below the reference value of 1.7%. It is projected to remain below the reference value in the months ahead.

Annual inflation peaked in September 2012 before falling sharply in January 2013, with the fading of the effect of earlier indirect tax hikes and the start of a series of utility price reductions. A decline in market energy and food prices also supported disinflation, as did weak domestic demand and historically low inflation expectations. On the other hand, excise duty increases and some other government measures had a substantial upward effect on prices. In April 2014, annual HICP inflation stood at -0.2%.

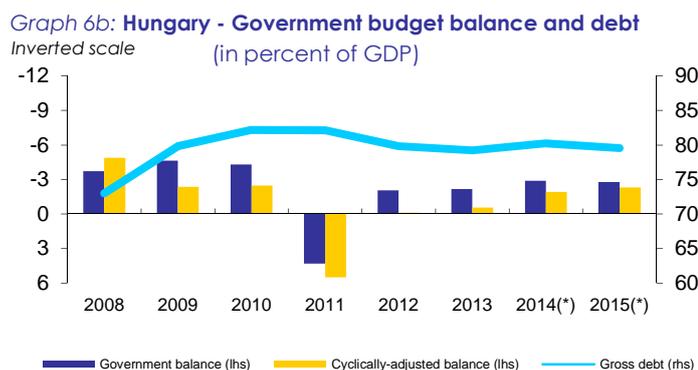
Inflation is projected to increase to 1.0% in 2014 and to 2.8% in 2015 according to the Commission services' 2014 Spring Forecast, mainly due to the fading-away of utility price cuts, less favourable commodity price developments and the gradual closing of the output gap. The relatively low price level in Hungary (about 59% of the euro-area average in 2012) suggests potential for further price level convergence in the long term.

Graph 6a: Hungary - Inflation criterion since 2008
(percent, 12-month moving average)



Note: The dots in December 2014 show the projected reference value and 12-month average inflation in the country.
Sources: Eurostat, Commission services' Spring 2014 Forecast.

Hungary fulfils the criterion on public finances. Hungary is not the subject of a Council Decision on the existence of an excessive deficit. The general government balance, after recording a surplus of 4.3% of GDP in 2011 due to a significant one-off operation, turned into a deficit of 2.1% of GDP in 2012. The deficit-to-GDP ratio reached 2.2% in 2013 and according to the Commission services' 2014 Spring Forecast, it will amount to 2.9% in 2014 and to 2.8% in 2015 under a no-policy-change assumption. General government debt is projected to increase marginally from 79.2% of GDP in 2013 to 79.5% of GDP in 2015.



(*) Commission services' Spring 2014 Forecast.

Source: Eurostat, Commission services.

Hungary does not fulfil the exchange rate criterion. The Hungarian forint is not participating in ERM II. Hungary operates a floating exchange rate regime, allowing for foreign exchange market interventions by the central bank. The forint exchange rate against the euro has been volatile in recent years. The forint was broadly stable against the euro in the second half of 2012, but depreciated by about 6% in early 2013. Supported by increased investor interest in EU financial assets and improvements in the macroeconomic situation, the forint strengthened in May and remained in the range of 290-300 HUF/EUR for the rest of 2013, except for a few days ahead of the Fed's September meeting and in late December. The forint has remained at levels over 300 HUF/EUR in the first months of 2014, with temporary pressures linked mainly to expectations about US monetary policy, the continuation of the domestic monetary easing, as well as the political crisis in Ukraine.

Hungary fulfils the criterion on the convergence of long-term interest rates. The average long-term interest rate in the year to April 2014 was 5.8%, below the reference value of 6.2%. It was above the reference value at the time of the last convergence assessment of Hungary in 2012. The monthly average long-term interest rate declined from its peak of 9.5% in early 2012 to close to 5% by May 2013. Long-term interest rates rose during the summer of 2013 and in early 2014, but have fluctuated generally in a close range to their annual average. Long-term spreads vis-à-vis the German benchmark bond stood at some 410 basis points in April 2014.

Additional factors have also been examined, including balance of payments developments and integration of labour, product and financial markets. Hungary's external surplus has gradually increased each year since 2009. Since 2011, the improvement has mainly reflected higher goods trade surpluses and better absorption of EU funds. Net FDI inflows remain relatively small. The balance-of-payments assistance granted to Hungary by the EU and the IMF in autumn 2008 expired in late 2010. Although Hungary asked for precautionary balance of payments assistance in November 2011, as the country's financial market situation had stabilised, this request was withdrawn in January 2014. The Hungarian economy is highly integrated to the euro area through trade and investment linkages. On the basis of selected indicators relating to the business environment, Hungary performs worse than most euro-area Member States. Hungary's financial sector is well integrated into the EU financial system. In the context of the Macroeconomic Imbalance Procedure, Hungary was subject to an in-depth review, which found that Hungary continues to

experience macroeconomic imbalances, which require monitoring and decisive policy action.

7. POLAND

In the light of its assessment on legal compatibility and on the fulfilment of the convergence criteria, and taking into account the additional relevant factors, the Commission considers that Poland does not fulfil the conditions for the adoption of the euro.

Legislation in Poland - in particular the Act on the Narodowy Bank Polski (NBP) and the Constitution of the Republic of Poland - **is not fully compatible** with the compliance duty under Article 131 of the TFEU. Incompatibilities concern the independence of the central bank, the prohibition of monetary financing and central bank integration into the ESCB at the time of euro adoption. In addition, the Act on the NBP also contains some imperfections relating to central bank independence and the NBP integration into the ESCB at the time of euro adoption.

Poland fulfils the criterion on price stability. In Poland, 12-month average inflation was above the reference value at the time of the last convergence assessment in 2012. The average inflation rate in Poland during the 12 months to April 2014 was 0.6%, well below the reference value of 1.7%. It is expected to remain below the reference value in the months ahead.

Annual HICP inflation declined rapidly from above 4% in the first half of 2012 to below 1% in the second quarter of 2013, due to favourable commodity price developments as well as an abrupt decrease in the prices of telecommunication services. It remained below 1% during the second half of 2013 and in early 2014, to a large extent reflecting low inflationary pressures in global markets and a relatively stable exchange rate.

Inflation is expected to increase only gradually to 1.1% in 2014 and 1.9% in 2015 according to the Commission services' 2014 Spring Forecast, as the output gap is estimated to remain negative. The relatively low price level in Poland (close to 56% of the euro-area average in 2012) suggests potential for further price level convergence in the long term.

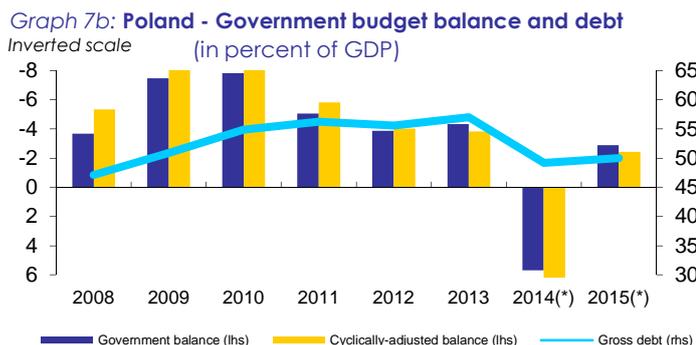
Graph 7a: Poland - Inflation criterion since 2008
(percent, 12-month moving average)



Note: The dots in December 2014 show the projected reference value and 12-month average inflation in the country.
Sources: Eurostat, Commission services' Spring 2014 Forecast.

Poland does not fulfil the criterion on public finances. Poland is at present the subject of a Council Decision on the existence of an excessive deficit (Council Decision of 7 July 2009)¹⁶. The Council recommended Poland to correct the excessive deficit by 2012. On 21 June 2013, the Council concluded that Poland had taken effective action but adverse economic events with major implications on public finances had occurred, and issued revised recommendation under Article 126(7) TFEU, in which it recommended that Poland should put an end to the excessive deficit situation by 2014. The Council established the deadline of 1 October 2013 for Poland to take effective action. On 10 December 2013, the Council established in accordance with Article 126(8) TFEU that Poland had not taken effective action. It adopted a new recommendation under Art.126 (7) TFEU, according to which Poland should bring an end to the excessive deficit situation by 2015 in a credible and sustainable manner.

According to the Commission services' 2014 Spring Forecast the general government budget balance is projected to increase from a deficit of 4.3% of GDP in 2013 to a surplus of 5.7% of GDP in 2014, largely due to a large, one-off asset transfer from the second pension pillar. In 2015, the general government budget balance is expected to turn negative again, posting a deficit of 2.9% of GDP under ESA95. The general government debt-to-GDP ratio is forecast to fall from 57% in 2013 to 49.2% in 2014, mainly as a result of the transfer of pension fund assets, before increasing to 50% in 2015.



(*) Commission services' Spring 2014 Forecast.
Source: Eurostat, Commission services.

Poland does not fulfil the exchange rate criterion. The Polish zloty is not participating in ERM II. Poland operates a floating exchange rates regime, allowing for foreign exchange market interventions by the central bank. Following a sharp depreciation in the second half of 2011 – which induced foreign exchange market interventions by the NBP – the zloty's exchange rate against the euro partially recovered in early 2012. The zloty thereafter broadly stabilised and predominantly traded in the range of 4.1-4.3 PLN/EUR until early 2014. Compared to April 2012, the exchange rate of the zloty against the euro was thus basically unchanged in April 2014.

Poland fulfils the criterion on the convergence of long-term interest rates. The Polish 12-month average long-term interest rate was exactly at the reference value at the time of the last convergence assessment in 2012. The average long-term interest

¹⁶ Decision 2009/589/EC (OJ L 202, 4.8.2009, p. 46).

rate in the year to April 2014 was 4.2%, well below the reference value of 6.2%. Long-term interest rates declined from above 6% in early 2011 to below 4% by end-2012, reflecting improved investor sentiment towards the country as well as a substantial fall in domestic inflation. Long-term interest rates increased again during the second half of 2013 as risk appetite in global financial markets dwindled. As a result, long-term interest rate spreads vis-à-vis the German benchmark bond hovered around 270 basis points in early 2014.

Additional factors have also been examined, including balance of payments developments and integration of labour, product and financial markets. Poland's external balance improved considerably in recent years, turning into a surplus of 1% of GDP in 2013, driven by a strengthening trade balance. The Polish economy is well integrated into the euro area through both trade and investment linkages. On the basis of selected indicators relating to the business environment, Poland performs worse than most euro-area Member States. Poland's financial sector is well integrated into the EU financial system as confirmed by the substantial share of foreign-owned banks. In the context of the Macroeconomic Imbalance Procedure, Poland has not been subject to an in-depth review.

8. ROMANIA

In the light of its assessment on legal compatibility and on the fulfilment of the convergence criteria, and taking into account the additional relevant factors, the Commission considers that Romania does not fulfil the conditions for the adoption of the euro.

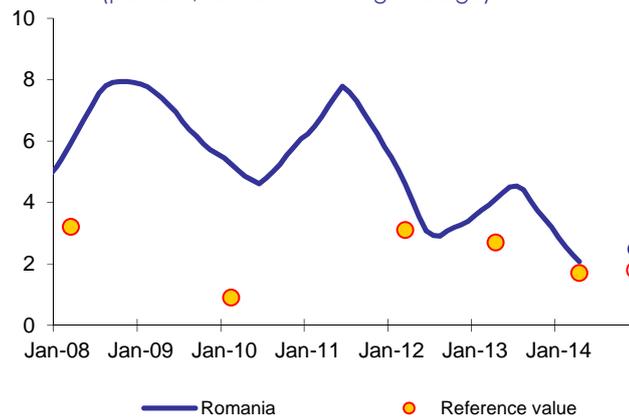
Legislation in Romania – in particular Law No. 312 on the Statute of the Bank of Romania (the BNR Law) – **is not fully compatible** with the compliance duty under Article 131 of the TFEU. Incompatibilities concern the independence of the central bank, the prohibition of monetary financing and central bank integration into the ESCB at the time of euro adoption. In addition, the BNR Law contains imperfections relating to central bank independence and to central bank integration in the ESCB at the time of euro adoption with regard to the BNR's objectives and the ESCB tasks laid down in Article 127(2) of the TFEU and Article 3 of the ESCB/ECB.

Romania does not fulfil the criterion on price stability. In Romania, 12-month average inflation was above the reference value at the last convergence assessment in 2012. The average inflation rate in Romania during the 12 months to April 2014 was 2.1%, above the reference value of 1.7%. It is projected to remain above the reference value in the months ahead.

Romania has recorded volatile and elevated inflation rates in recent years. Annual inflation peaked at 8.5% in May 2011 following an increase in the standard VAT rate in mid-2010 and a rise in food prices. It fell significantly during the second half of 2011 and in early 2012, supported by a good harvest and lower energy commodity prices but picked up again in the second half of 2012 and beginning of 2013 due to rising food and energy prices. Annual average inflation moderated to just above 3% in 2012 and 2013.

Inflation is expected to be lower in 2014, supported by lower food prices and to pick up in 2015 as domestic demand is set to recover. The Commission services' 2014 Spring Forecast projects annual HICP inflation to average 2.5% in 2014 and 3.3% in 2015. The relatively low price level in Romania (around 54% of the euro-area average in 2012) suggests significant potential for further price level convergence in the long term.

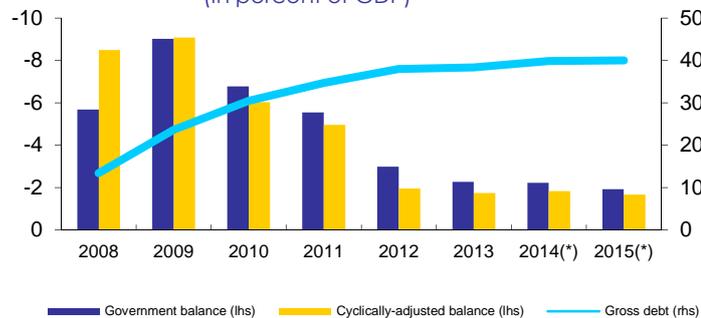
Graph 8a: Romania - Inflation criterion since 2008
(percent, 12-month moving average)



Note: The dots in December 2014 show the projected reference value and 12-month average inflation in the country.
Sources: Eurostat, Commission services' Spring 2014 Forecast.

Romania fulfils the criterion on public finances. Romania is not the subject of a Council Decision on the existence of an excessive deficit. The general government deficit declined from 5.5% of GDP in 2011 to 3.0% in 2012, mainly due to expenditure restraint but also involving revenue measures. The deficit-to-GDP ratio turned out at 2.3% in 2013 and according to the Commission services' 2014 Spring Forecast, it is projected to decrease further to 2.2% of GDP in 2014 and to 1.9% in 2015, under a no-policy-change assumption. The general government debt is expected to increase from 38.4% of GDP in 2013 to 40.1% of GDP in 2015.

Graph 8b: Romania - Government budget balance and debt
Inverted scale (in percent of GDP)



(*) Commission services' Spring 2014 Forecast.

Source: Eurostat, Commission services.

Romania does not fulfil the exchange rate criterion. The Romanian leu is not participating in ERM II. Romania operates a floating exchange rate regime, allowing for foreign exchange market interventions by the central bank. After a strong depreciation during the global financial crisis in late 2008 and early 2009, the leu broadly stabilised from 2009 until late 2011, supported by the EU-IMF financial assistance programme. The leu's exchange rate against the euro came under depreciation pressures during temporary bouts of global risk aversion, especially in mid-2012. It firmed somewhat in late 2012 and in early 2013, as foreign interest in RON-denominated assets increased. The leu's exchange rate against the euro temporarily depreciated in mid-2013 and early 2014, reflecting heightened global risk aversion which induced operations by the BNR in the interbank as well as in the

foreign exchange market. During the two years before this assessment, the leu depreciated against the euro by 1.9%.

Romania fulfils the criterion on the convergence of long-term interest rates.

Average long-term interest rates in Romania were above the reference value at the last convergence assessment in 2012. The average long-term interest rate in Romania in the year to April 2014 was 5.3%, below the reference value of 6.2%. Long-term interest rates in Romania remained at just above 7% for most of the period 2010-2011, before falling in 2012. They declined to around 5.5% by the end of 2012 and floated around 5.3% for most of 2013, reflecting improved investor sentiment towards the country. As a result, long-term interest rate spreads vis-à-vis the German benchmark bond declined from above 500 basis points in late 2012 to about 380 basis points in April 2014.

Additional factors have also been examined, including balance of payments developments and the integration of labour, product and financial markets. Romania's external balance (i.e. the combined current and capital account) improved markedly during the global crisis. Romania's external deficit narrowed to 3% of GDP in 2012 and the external balance shifted into surplus in 2013. The narrowing of the external shortfall reflected, in particular, a lower merchandise trade deficit. Romania has been a recipient of international financial assistance since 2009. The first two-year joint EU-IMF financial assistance programme was followed by a further two joint EU-IMF programmes, granted in 2011 and 2013. Unlike the first programme, both subsequent programmes have been treated as precautionary, and no funding has been requested so far. External financing pressures eased further in 2012-2013 amid an improvement in the external balance and recovery in global risk appetite. The Romanian economy is well integrated into the euro area through both trade and investment linkages. On the basis of selected indicators relating to the business environment, Romania performs worse than most euro-area Member States. Romania's financial sector is well integrated into the EU financial system as confirmed by the substantial share of foreign-owned banks. In the context of the Macroeconomic Imbalance Procedure, Romania has not been subject to an in-depth review.

9. SWEDEN

In the light of its assessment on legal compatibility and on the fulfilment of the convergence criteria, and taking into account the additional relevant factors, the Commission considers that Sweden does not fulfil the conditions for the adoption of the euro.

Legislation in Sweden - in particular the Sveriges Riksbank Act, the Instrument of Government and the Law on the Exchange Rate Policy - **is not fully compatible** with the compliance duty under Article 131 of the TFEU. Incompatibilities and imperfections exist in the fields of independence of the central bank, prohibition of monetary financing and central bank integration into the ESCB at the time of euro adoption.

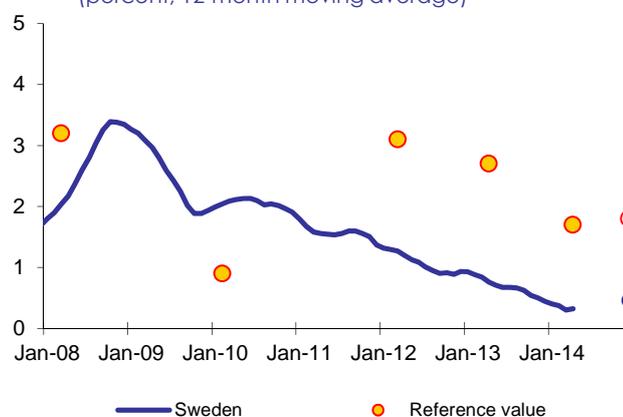
Sweden fulfils the criterion on price stability. In Sweden, 12-month average inflation was below the reference value at the time of the last convergence assessment in 2012. The average inflation rate in Sweden during the 12 months to

April 2014 was 0.3%, well below the reference value of 1.7%. It is projected to remain well below the reference value in the months ahead.

In recent years, HICP inflation in Sweden fell from an average of 1.4% in 2011 to 0.9% in 2012, before declining further to 0.4% in 2013. The decline over the last two years was driven by the strengthening of the krona and sluggish internal and external demand, and was broad-based across various goods and services. In April 2014, annual HICP inflation stood at 0.3%.

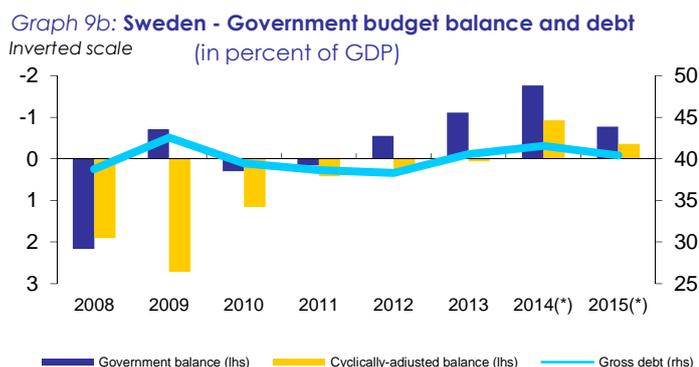
On the back of a gradual pick-up in growth, inflation is likely to increase only moderately in the course of 2014. No particular upward pressure is foreseen from any HICP component and wage developments are projected to remain moderate. The Commission services' 2014 Spring Forecast projects annual average inflation at 0.5% in 2014 and 1.5% in 2015. The level of consumer prices in Sweden relative to the euro area gradually increased since Sweden joined the EU in 1995, to 126% in 2012.

Graph 9a: Sweden - Inflation criterion since 2008
(percent, 12-month moving average)



Note: The dots in December 2014 show the projected reference value and 12-month average inflation in the country.
Sources: Eurostat, Commission services' Spring 2014 Forecast.

Sweden fulfils the criterion on public finances. Sweden is not the subject of a Council Decision on the existence of an excessive deficit. The general government balance turned into a deficit of 0.6% of GDP in 2012 which widened to 1.1% in 2013. This mainly reflected lacklustre growth and a number of government measures to support the economy. According to the Commission services' 2014 Spring Forecast, the government deficit is projected to reach 1.8% of GDP in 2014, before declining to 0.8% in 2015 under a no-policy-change assumption. The gross public debt ratio stood at 40.6% of GDP in 2013 and is projected to increase further in 2014, reaching 41.6% of GDP, before falling back to 40.4% in 2015.



(*) Commission services' Spring 2014 Forecast.

Source: Eurostat, Commission services.

Sweden does not fulfil the exchange rate criterion. The Swedish krona is not participating in ERM II. Sweden operates a floating exchange rate regime, allowing for foreign exchange market interventions by the central bank. Following the strong depreciation of the krona against the euro at the onset of the financial crisis in 2008, the krona appreciated by some 35% between March 2009 and August 2012, reaching a twelve-year high in August 2012. While this appreciation was also a correction of the krona's previous weakening, safe-haven flows in the context of the euro-area sovereign debt crisis significantly contributed to it. During the two years before this assessment, the krona depreciated against the euro by some 2%.

Sweden fulfils the criterion on the convergence of long-term interest rates. The average long-term interest rate in Sweden in the year to April 2014 was 2.2%, well below the reference value of 6.2%. The Swedish 12-month average interest rate had also been markedly below the reference value at the last convergence assessment in 2012. Having declined from above 4% in 2008, it bottomed out at some 1.6% between October 2012 and May 2013 and has been increasing since then. Yield spreads vis-à-vis German long-term government bonds widened between end-2012 and autumn 2013, as Swedish bond yields increased owing to a partial reversal of safe-haven flows from the euro area. The spread against the German benchmark bond stood at some 60 basis points in April 2014.

Additional factors have also been examined, including balance of payments developments and integration of labour, product and financial markets. The surplus on Sweden's external balance has been on a declining trend since 2007, falling from above 9% of GDP in 2007 to 6.6% in 2013, which is partly explained by a structural decrease in Sweden's merchandise trade surplus. Sweden's economy is highly integrated into the euro area through trade and investment linkages. On the basis of selected indicators relating to the business environment, Sweden performs better than most euro-area Member States. Sweden's financial sector is well integrated into the EU financial sector, especially through inter-linkages in the Nordic-Baltic financial cluster. In the context of the Macroeconomic Imbalance Procedure, Sweden was subject to an in-depth review in 2014, which found that Sweden continues to experience macroeconomic imbalances, which require monitoring and policy action.